This volume is one of a series of reports prepared by the Committee on Branch, Group, and Chain Banking for the information of the Federal Reserve Board and the Federal Reserve System. These reports were not approved or adopted by the Federal Reserve Board as an expression of its views. All citations of these reports should reflect this limitation.

# 225 BANK SUSPENSIONS
# CASE HISTORIES FROM EXAMINERS' REPORTS

---

Material prepared for the information of the
Federal Reserve System by the
Federal Reserve Committee on
Branch, Group, and Chain Banking

U.S. Federal Reserve
Branch, Chain + Group Banking Committee.

## Members of the Committee

E. A. Goldenweiser, Director, Division of Research and Statistics, Federal Reserve Board, Chairman
Ira Clerk, Deputy Governor, Federal Reserve Bank of San Francisco
M. J. Fleming, Deputy Governor, Federal Reserve Bank of Cleveland
L. R. Rounds, Deputy Governor, Federal Reserve Bank of New York
E. L. Smead, Chief, Division of Bank Operations, Federal Reserve Board

---

J. H. Riddle, Executive Secretary and Director of Research

---

The Committee was appointed February 26, 1930, by the Federal Reserve Board

> ". . . to assemble and digest information on branch banking as practiced in the United States, group and chain banking systems as developed in the United States and elsewhere, the unit banking system of the country, and the effect of ownership of bank stocks by investment trusts and holding corporations."

## LETTER OF TRANSMITTAL

To the Federal Reserve Board:

The Committee on Branch, Group, and Chain Banking transmits herewith a study of 225 banks which suspended during the years 1921-1931. The material is largely derived from a review of examiners' reports, which cover in some cases a considerable period of years prior to the respective suspension.

Respectfully,

E. A. Goldenweiser
Chairman

CONTENTS

CONTENTS (Cont'd)

CONTENTS (Cont'd)

# CHAPTER I

## PURPOSE, MATERIALS, AND METHODS

An analysis of the examination reports of 120 member banks which suspended in the years 1921-1930 and 105 member banks which suspended in 1931 has been undertaken in order to secure a definite picture of the operations, problems, and policies of these institutions prior to closing. The general purpose of the study is to throw more light on the causes of bank suspensions. There have been many previous discussions of bank failures and their causes, but nearly all of them treat the subject from the standpoint of the outside observer. In the present study, the materials used relate to the internal operations of banks and to the criticisms by examiners as these banks progressed towards insolvency. In this way, more of the personal element in banking and a more intimate view of the detailed operations are shown.

The original study covered 120 banks suspending during 1921-1930, but later a list of 105 member banks suspending in 1931 was selected by the Committee for further study in order to determine whether the factors of banking weakness had changed either in emphasis or scope in that year. General business conditions had changed in 1931 and securities had depreciated heavily. Many bank failures occurred in that year in the five Federal reserve districts which were not represented in the first study. Furthermore, it was observed that the proportion of large banks among the 1931 suspensions was greater than among those failing in previous years.

## Selection of Sample Banks for the 1921-1930 Study

The basic materials for the 1921-1930 study were case histories of 120 suspended member banks (119 national and 1 State member) and comparative histories of 33 active member banks in towns that had had bank failures. The failed banks were selected from 7 Federal reserve districts, and the active banks from 5 Federal reserve districts. The distribution of these banks, by districts, was as follows:

Table 1 - Distribution by Federal Reserve Districts of Banks Selected for the 1921-1930 Study

| District | Number of suspended banks | Number of active banks |
|---|---|---|
| No. 6 - Atlanta | 20 | 5 |
| No. 7 - Chicago | 20 | 0 |
| No. 8 - St. Louis | 20 | 6 |
| No. 9 - Minneapolis | 11 | 12 |
| No. 10 - Kansas City | 20 | 5 |
| No. 11 - Dallas | 20 | 5 |
| No. 12 - San Francisco | 9 | 0 |
| Total | 120 | 33 |

The method of choosing the suspended banks for the study was designed to make the sample thoroughly representative. In 4 Federal reserve districts, the Federal Reserve Committee on Branch, Group, and Chain Banking arbitrarily chose the banks for the study. These districts were Atlanta, St. Louis, Kansas City, and Dallas. Lists were prepared of the failed member banks in these districts, arranged in chronological order according to date of failure. This chronological list was then divided into 20 parts, and 1 bank chosen from each part. For example, if there were 80 failed member banks in the district, every fourth bank was chosen. In a few cases, it was found that the resulting sample list of failed banks gave one State in the district an overrepresentation and some other State an inadequate representation. Where this was the case, some of the failures in the States having too many banks in the sample list were replaced by banks drawn at random from the States which were poorly represented. It was later found that in a few cases historical records had been destroyed, and it was necessary to substitute other banks whose records were available.

In the Chicago, Minneapolis, and San Francisco districts, the Federal reserve bank officials chose respectively 9, 11, and 9 failed member banks as typical examples, and the histories of these banks were added to those selected by the Committee. In the Chicago district the Committee selected an additional 11 banks, bringing the total number of failed banks in the sample list for that district up to 20.

Active banks, or banks still in operation when the data were compiled, were chosen by the Federal reserve bank officials in 5 of the above 7 districts. In the choice they used their own discretion. The only rules laid down for the choice of these banks were that they should be banks located in communities where bank failures had occurred, that they should embrace banks of various sizes, and that they should be in good condition.

These lists include banks from large cities, suburbs, and small towns. The failed banks include institutions from mixed farming, wheat raising, live stock, cotton, tobacco, and rice growing communities. Some of them were from communities which had been visited by floods, drought, and storms. Some were from oil boom towns, and others from mining communities. Several banks are included which were adversely affected by the Florida land boom. The list of banks is well distributed according to the year of failure as well as according to the size of community. The list of active banks also includes institutions from a variety of economic areas, largely rural, and to be sure that these surviving banks were not favored by less strenuous circumstances, they were all chosen from towns which had had bank failures.

The towns or communities from which the active banks were selected averaged slightly larger than the communities from which the failed banks were selected. The median failed bank was in a community with a population range from 1,000 to 2,500 people, whereas the median active bank was in the next larger population group with a range from 2,500 to 5,000 people.

Table 2 - Classification of Selected Active Banks
and Banks Suspending during 1921-1930
by Size of Community

| 1920 population | Suspended banks | Active banks |
|---|---|---|
| Under 500 | 8 | 2 |
| 500 - 1,000 | 25 | 3 |
| 1,000 - 2,500 | 39 | 8 |
| 2,500 - 5,000 | 21 | 5 |
| 5,000 - 10,000 | 13 | 6 |
| 10,000 - 50,000 | 10 | 6 |
| 50,000 - 100,000 | 3 | 2 |
| 100,000 and over | 1 | 1 |
| Total | 120 | 33 |

The banks selected were also well distributed according to size, as measured by deposits in 1920, or the earliest date thereafter for which figures were available. The selected active banks were slightly larger than the selected failed banks. The median failed bank was in the deposit group $250,000-$500,000, and the median active bank was in the next higher group with deposits from $500,000 to $750,000.

Table 3 - Classification of Selected Active Banks and Banks Suspending during 1921-1930 by Size of Deposits

| Deposits | Suspended banks | Active banks |
|---|---|---|
| $10,000 - 50,000 | 2 | 0 |
| 50,000 - 100,000 | 4 | 1 |
| 100,000 - 150,000 | 7 | 0 |
| 150,000 - 250,000 | 18 | 4 |
| 250,000 - 500,000 | 36 | 6 |
| 500,000 - 750,000 | 17 | 6 |
| 750,000 - 1,000,000 | 11 | 3 |
| 1,000,000 - 2,000,000 | 18 | 7 |
| 2,000,000 - 5,000,000 | 3 | 5 |
| 5,000,000 - 10,000,000 | 1 | 0 |
| 10,000,000 - 50,000,000 | 3 | 1 |
| 50,000,000 and over | 0 | 0 |
| Total | 120 | 33 |

## Selection of Sample Banks for the 1931 Study

The 105 banks selected for the 1931 study included 101 national banks and 4 State banks, members of the Federal reserve system. All failed national banks with deposits of five million dollars or more were included. The remainder of the banks were apportioned among the twelve Federal reserve districts to give proper representation to each district and were selected in much the same manner as those in the 1921-1930 group. As a result of this method of selection, the distribution of the banks used in the sample list was as follows:

Table 4 - Distribution of Selected Banks Suspending in 1931 by Federal Reserve Districts

| District | Number of suspended banks |
|---|---|
| No. 1 - Boston | 5 |
| No. 2 - New York | 7 |
| No. 3 - Philadelphia | 6 |
| No. 4 - Cleveland | 13 |
| No. 5 - Richmond | 10 |
| No. 6 - Atlanta | 6 |
| No. 7 - Chicago | 19 |
| No. 8 - St. Louis | 10 |
| No. 9 - Minneapolis | 9 |
| No. 10 - Kansas City | 8 |
| No. 11 - Dallas | 6 |
| No. 12 - San Francisco | 6 |
| Total | 105 |

The sample group of 1931 bank suspensions includes institutions from all types of communities. Using as a basis the descriptive material provided in the case of each bank, the following classification of the banks according to type of community was prepared to indicate the representative character of the cases. The chief reason for subdividing the farming region into northeastern and other sections was to determine whether or not the causes of bank failure in the five northeastern districts, which were not included in the earlier study, were radically different from the causes of failure in the seven districts represented in the earlier study.

Table 5 - Classification of Selected Banks Suspending in 1931 by Type of Community

| Type of community | Number of banks |
|---|---|
| Failed banks in cities of over 100,000 population | 16 |
| Failed banks in other industrial and suburban cities | 16 |
| Failed banks in mining communities | 8 |
| Failed banks in northeastern farming region(1) | 10 |
| Failed banks in other farming regions | 55 |
| Total | 105 |

(1) Federal reserve districts 1 to 5 inclusive.

The failed banks used in the 1931 study are distributed according to the size of community in Table 6.

Table 6 - Classification of Selected Banks Suspending in 1931 by Size of Community

| 1930 population | Cities of over 100,000 population | Other industrial and suburban cities | Mining communities | Northeastern farming region | Other farming regions | Total |
|---|---|---|---|---|---|---|
| Under 500 | 0 | 0 | 2 | 1 | 5 | 8 |
| 500 - 1,000 | 0 | 0 | 1 | 3 | 13 | 17 |
| 1,000 - 2,500 | 0 | 2 | 2 | 3 | 13 | 20 |
| 2,500 - 5,000 | 0 | 3 | 2 | 0 | 8 | 13 |
| 5,000 - 10,000 | 0 | 3 | 0 | 2 | 10 | 15 |
| 10,000 - 50,000 | 0 | 8 | 1 | 1 | 6 | 16 |
| 50,000 - 100,000 | 0 | 0 | 0 | 0 | 0 | 0 |
| 100,000 and over | 16 | 0 | 0 | 0 | 0 | 16 |
| Total | 16 | 16 | 8 | 10 | 55 | 105 |

These banks were also well distributed according to the size of bank, as measured by deposits in the last half of 1930. This is shown in Table 7.

Table 7 - Classification of Selected Banks Suspending in 1931 by Size of Deposits

| Deposits | Cities of over 100,000 population | Other industrial and suburban cities | Mining communities | Northeastern farming region | Other farming regions | Total |
|---|---|---|---|---|---|---|
| Under $50,000 | 0 | 0 | 0 | 0 | 0 | 0 |
| 50,000 - 100,000 | 0 | 0 | 0 | 0 | 5 | 5 |
| 100,000 - 150,000 | 0 | 0 | 1 | 0 | 7 | 8 |
| 150,000 - 250,000 | 0 | 0 | 0 | 0 | 10 | 10 |
| 250,000 - 500,000 | 0 | 4 | 3 | 3 | 10 | 20 |
| 500,000 - 750,000 | 0 | 1 | 1 | 6 | 9 | 17 |
| 750,000 - 1,000,000 | 0 | 1 | 2 | 0 | 4 | 7 |
| 1,000,000 - 2,000,000 | 0 | 1 | 0 | 1 | 7 | 9 |
| 2,000,000 - 5,000,000 | 5 | 7 | 0 | 0 | 3 | 15 |
| 5,000,000 - 10,000,000 | 3 | 2 | 1 | 0 | 0 | 6 |
| 10,000,000 - 50,000,000 | 7 | 0 | 0 | 0 | 0 | 7 |
| 50,000,000 and over | 1 | 0 | 0 | 0 | 0 | 1 |
| Total | 16 | 16 | 8 | 10 | 55 | 105 |

No new data on active banks were compiled for 1931, but the records of active banks used in the earlier study and covering the years from 1921 to 1930, inclusive, are also used for comparisons with the 1931 suspensions. It must be recalled, however, that these active banks were selected from only five Federal reserve districts and represent largely rural sections.

Comparisons are also made between the failed banks and all operating member banks outside of central reserve cities. The central reserve city banks were excluded in order that the figures might not be unduly weighted by a few large city institutions which differ widely in the character of their business from the failed institutions.

The figures for the operating banks outside of central reserve cities were taken from the abstracts of member bank condition reports as of December 31 each year from 1919 to 1931, inclusive. Here again, the comparisons must be made with qualifications. In the first place, the ratios between balance sheet items of the operating banks are based on aggregates which are influenced heavily by the larger banks, whereas most of the ratios of the failed banks are medians, in the construction of which large and small banks have equal weights. Furthermore, the consolidated balance sheet of operating banks contains the figures of many banks which later failed.

## Nature of Data Compiled

Three types of information regarding these selected banks were compiled. The first consisted of excerpts from examiners' criticisms over a period of years prior to suspension. This was collected for the suspended banks only. The second type of information consisted of statistical material taken from balance sheets, examiners' reports, and earning and dividend reports.

These data were compiled for both suspended and active banks. The third type of data was collected only for the 105 banks suspending in 1931. This was a list of bonds and securities of each failed bank for three dates: at the time of the last examination, one year before the last examination, and two years before the last examination.

In the appendix will be found the first six case histories, inserted to show the nature of the data collected from examiners' comments. These case histories give certain descriptive data about each bank and its community, certain balance sheet items, examiners' classifications of criticized assets, and the above-mentioned excerpts from confidential comments by examiners. This statistical and critical material was taken from each examination report from 1920 to the time of closing, except in a few cases where the compilation begins as of a somewhat later date.

The examiners' criticisms and other data have been disguised to prevent the recognition of the identity of the various banks in the sample list, since the identification would be of no advantage in this study. In the process of disguising the material, the populations of the various towns and cities have been rounded off to even hundreds or thousands, and the names of States, towns, banks, corporations, examiners, and other persons have been either deleted or changed to key letters where it was desirable to indicate the repeated reference to the same party.

In spite of the effort to make the sample list of banks representative, certain deficiencies in the material used must be recognized. The collected excerpts from examiners' comments were perhaps too condensed in some cases. In other cases, comments would have been more illuminating if they had been extended further back. The comments in the case histories are necessarily in the language of the examiners and much illustrative material is inadequate because of the absence of elaboration by the examiner. There is also evidence that certain special types of criticism have been more fully developed in some districts than in others. Examples of this were the citations of poor farming methods in one Federal reserve district and the frequent mention in some districts of the lack of credit data in the subject banks, whereas this was rarely mentioned in other districts.

## Methods of Analysis

Two general types of analysis were used in the study. The first was a statistical approach to the subject by means of balance sheet ratios. Using the detailed statistical information collected, the history of each bank that failed and the history of each active bank were shown in the form of several ratios for each examination. It was necessary to resolve the figures for the large number of individual banks into series showing the typical condition of active and suspended banks. To do this, the several ratios of each class of bank for given periods were assembled and median ratios were found. Tables showing these median ratios appear in appropriate places in the text, and a number of illustrative charts are presented comparing the course of these median ratios for suspended banks and active banks.

The second method of analysis was to tabulate the frequency of the various criticisms made by examiners. If a bank was criticized for slack collection methods several times on different examinations, this criticism was tabulated only once. On the other hand, criticisms by examiners were tabulated even if they were of minor importance and played only an unimportant part in the failure of the bank. In a summary of this sort, it must be recognized that there is some chance of difference of interpretation of an examiner's comments. An effort has been made to avoid personal bias, but the fact must be conceded that no two persons would read these case histories and arrive at exactly the same number of frequencies for the various tabulated criticisms.

The examiners' comments and other data provide a wealth of illustrative material. Here again the choice of examples has been largely a matter of judgment. An effort was made to use only typical cases as illustrations, but it was frequently necessary to make a choice on the basis of the thoroughness with which the examiner expressed his ideas.

For the 105 banks suspending in 1931 an analysis is also made of their bond holdings.

## References to Case Histories

In the following chapters frequent quotations are made from examiners' comments to illustrate various points. The quotations are accompanied by reference to the case histories by number. The suspended banks of the 1921-1930 group are numbered from 1 to 120. (The first six of these cases are given entirely in the appendix.) The active banks are numbered from 121 to 153. The suspended banks of the 1931 group are numbered from 154 to 258.

The word suspended is used throughout this volume to designate the banks selected for the study which closed during 1921-1931, although the data presented relate to their condition prior to suspension. The word active is used to designate the 33 selected banks which were still in operation at the time the data were compiled.

## CHAPTER II

## ASSETS AND LIABILITIES OF SUSPENDED AND ACTIVE BANKS

Success or failure of a bank depends in large measure on the quality of its assets. In fact quality is a much more important factor than either the form or distribution of assets. Bad assets lead to failure either through impairment of capital as a result of losses, or through a shortage of cash as a result of a frozen condition. Every bank must be prepared to go through periods of declining deposits. Withdrawals may be the result of reduced business activity generally, the flow of funds away from a region or community for economic reasons, or the loss of confidence on the part of depositors. When deposits begin to decline, a bank may be forced to dispose of some of its assets or use them as a basis for borrowing. So long as the assets are high-grade and liquid these withdrawals can be met. If the process continues until the bank has left only an inferior grade of assets, however, and cannot realize on them as rapidly as deposits are withdrawn, then it must close its doors.

The quality of a bank's assets in turn reflects the quality of its management. Many of the defects in management leading to failure are revealed in the studies of balance sheet items and trends in this chapter.

### Quality of Assets

The quality of assets of a bank may be judged by comparing its fixed and criticized assets with its capital and surplus. In this way, the fixed and criticized assets are measured against the stockholders' equity in the bank. In making this comparison the method worked out by the Federal Reserve Bank of Minneapolis has been adopted. For the sake of brevity in expression the percentage ratio between a bank's fixed and questionable assets and its capital and surplus is referred to in this discussion as the "ratio of non-liquidity."

The items included in the total fixed and questionable assets are the following:

1. Losses.
2. Doubtful assets.
3. Slow loans.
4. Slow assets in the investment account, including foreclosures, claims, judgments, defaulted bonds, and depreciation on bonds.
5. "Other real estate" reported as "slow."
6. Expenses in excess of earnings.
7. Banking house and furniture and fixtures.

From this gross total of criticized and fixed assets are deducted the following items, which are construed as offsets to questionable assets:

1. Undivided profits.
2. Reserves for losses and depreciation.
3. Estimated true value of "other real estate" in excess of its book value and prior liens.
4. Other concealed assets, including appreciation on bonds.

The total of fixed and criticized assets includes everything which a bank examiner classifies as losses, doubtful, slow, or otherwise undesirable. It also includes the banking house and furniture and fixtures, since these assets are permanent and usually cannot be disposed of until the bank goes into liquidation. Furthermore, an occasional bank has too large an investment in its banking house and weakens its earning power and liquidity as a result. From the total of fixed and criticized assets all reserves for losses and depreciation and all concealed assets, such as appreciation on bonds, are deducted. The undivided profits account is also deducted from the total of fixed and criticized assets, since undivided profits are in the nature of unsegregated reserves.

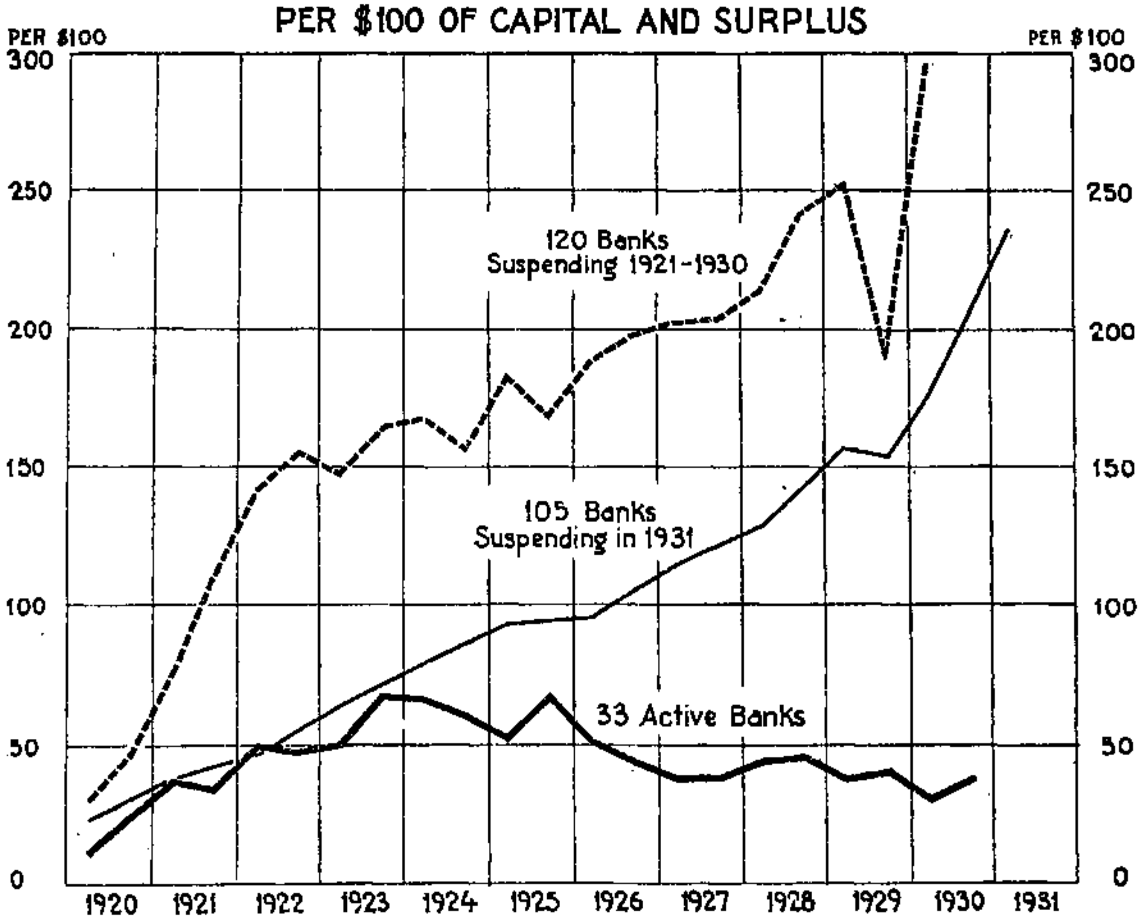
The inclusion of "slow" assets in the total of fixed and criticized assets requires some explanation. If all slow assets were fully collectible within a reasonable length of time there would be little justification for considering them fixed or frozen, but slow assets are nearly always a composite of collectible assets, partly-collectible assets, and assets of doubtful value which the examiner hesitates to criticize more severely on account of lack of information. A line that has been carried continuously for an extended period in its entirety is considered a slow loan by many examiners, unless the borrower can sell the security and liquidate the entire line without stopping or hampering his operations. Some years ago the Comptroller of the Currency made the statement that "any loan is slow upon which it will subsequently be necessary to take real estate in order to prevent loss." However, the comptroller commented that he would not make a hard and fast rule as to what assets should be considered slow or doubtful.

The net total of criticized and fixed assets minus undivided profits, reserves, and concealed assets is divided by the capital and surplus of the bank to compute the percentage known as the ratio of non-liquidity. This ratio furnishes a quick way of summarizing the condition of the bank and makes direct comparison possible between the condition of banks of various sizes.

Chart 1 and Table 8 show the comparative histories of the active banke and suspended banks used in this study, as measured in terms of ratios of non-liquidity. As in other charts and tables used in this study, the typical or median experiences of the two classes of banks are shown.

CHART 1

FIXED AND QUESTIONABLE ASSETS
PER $100 OF CAPITAL AND SURPLUS




**Fixed and questionable assets per $100 of capital and surplus for the typical or median bank in (1) the 120 selected member banks suspending during 1921-1930, (2) the 105 selected member banks suspending in 1931, and (3) the 33 active banks selected from towns where failures had occurred.**

The typical active bank never allowed its fixed and questionable assets to rise above 68 per cent of capital and surplus, and during good years, such as 1920 and 1929, the active banks' ratios were less than 50 per cent. To state the policy of active banks in another way, they always kept their total of criticized and fixed assets well below their stockholders' investment in the bank.

Banks which later suspended followed a very different course. In 1920 their ratios of non-liquidity were not materially worse than the ratios of the active banks. This was partly due to the favorable agricultural situation. From 1920 on, however, the amount of fixed and questionable assets of suspended banks rose steadily until the typical banks showed ratios much above 100 per cent. This means that the banks which later failed had criticized and fixed assets much larger than their capital and surplus for an extended period before they closed. In some cases the undesirable assets amounted to ten times capital and surplus.

Table 8 - Fixed and Questionable Assets per $100 of Capital and Surplus

| Date | Suspended banks: 120 banks suspending in 1921-1930 (median) | Suspended banks: 105 banks suspending in 1931 (median) | 33 selected active banks(1) (median) |
|---|---|---|---|
| 1920-1st half | $ 30 | $ 23 | $ 11 |
| 1920-2nd half | 46 | | 23 |
| 1921-1st half | 78 | 38 | 37 |
| 1921-2nd half | 110 | | 34 |
| 1922-1st half | 141 | 47 | 50 |
| 1922-2nd half | 155 | | 48 |
| 1923-1st half | 148 | 61 | 50 |
| 1923-2nd half | 164 | | 68 |
| 1924-1st half | 168 | 79 | 66 |
| 1924-2nd half | 156 | | 60 |
| 1925-1st half | 183 | 92 | 52 |
| 1925-2nd half | 169 | | 68 |
| 1926-1st half | 189 | 95 | 51 |
| 1926-2nd half | 198 | | 43 |
| 1927-1st half | 202 | 114 | 38 |
| 1927-2nd half | 203 | | 38 |
| 1928-1st half | 213 | 129 | 44 |
| 1928-2nd half | 242 | | 45 |
| 1929-1st half | 252 | 157 | 37 |
| 1929-2nd half | 191 | 153 | 40 |
| 1930-1st half | 296 | 176 | 30 |
| 1930-2nd half | | 208 | 38 |
| 1931-1st half | | 236 | |

(1) Banks still in operation when these data were compiled. They were selected from communities which had had failures.

An analysis of the ratios of non-liquidity of suspended banks divided into groups according to the year of failure shows that a similar development occurred among banks failing in every year from 1921 to 1930, inclusive. The ratios of typical banks in all groups were small in 1920, but deteriorated rapidly as the banks approached failure. Banks which closed in 1927 had the worst ratios according to median experience.

Table 9 - Fixed and Questionable Assets per $100 of Capital and Surplus

| Date | Banks suspending in | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1921 | 1922 | 1923 | 1924 | 1925 | 1926 | 1927 | 1928 | 1929 | 1930 | 1931 |
| 1920-1st half | $ 10 | $ 42 | $ 51 | $ 28 | $ 12 | $ 51 | $ 23 | $ 51 | $ 9 | $ 17 | $ 23 |
| 1920-2nd half | 6 | 74 | 58 | 50 | 28 | 86 | 38 | 77 | 12 | 16 | |
| 1921-1st half | 180 | 149 | 62 | 94 | 61 | 99 | 155 | 86 | 40 | 66 | 38 |
| 1921-2nd half | 164 | 218 | 106 | 137 | 108 | 139 | 227 | 96 | 59 | 71 | |
| 1922-1st half | | 273 | 154 | 156 | 130 | 266 | 107 | 162 | 139 | 65 | 47 |
| 1922-2nd half | | 292 | 200 | 145 | 176 | 303 | 125 | 155 | 172 | 107 | |
| 1923-1st half | | | 252 | 177 | 155 | 141 | 141 | 189 | 114 | 142 | 61 |
| 1923-2nd half | | | 280 | 230 | 196 | 151 | 229 | 163 | 112 | 108 | |
| 1924-1st half | | | | 297 | 204 | 189 | 322 | 141 | 85 | 110 | 79 |
| 1924-2nd half | | | | | 207 | 225 | 238 | 146 | 85 | 133 | |
| 1925-1st half | | | | | 352 | 230 | 331 | 153 | 113 | 125 | 92 |
| 1925-2nd half | | | | | | 206 | 271 | 150 | 107 | 132 | |
| 1926-1st half | | | | | | 218 | 321 | 209 | 121 | 120 | 95 |
| 1926-2nd half | | | | | | | 430 | 224 | 129 | 154 | |
| 1927-1st half | | | | | | | 447 | 240 | 151 | 174 | 114 |
| 1927-2nd half | | | | | | | | 292 | 211 | 167 | |
| 1928-1st half | | | | | | | | 299 | 248 | 176 | 129 |
| 1928-2nd half | | | | | | | | 343 | 260 | 223 | |
| 1929-1st half | | | | | | | | | 257 | 243 | 157 |
| 1929-2nd half | | | | | | | | | | 199 | 153 |
| 1930-1st half | | | | | | | | | | 296 | 176 |
| 1930-2nd half | | | | | | | | | | | 208 |
| 1931-1st half | | | | | | | | | | | 236 |

An analysis of the ratios of non-liquidity of the banks which failed in 1931 by economic areas shows that banks in the large cities and in the mining communities made a more favorable showing than banks in the other groups. A part of this better comparative showing was no doubt caused by the fact that a larger portion of their weak assets was in the form of bonds. The examiners in setting up criticized assets merely include the depreciation on bonds and recently have omitted entirely the depreciation on the higher grades of bonds, whereas they include the total book value of other weak assets in the criticizable total. This explains in some measure why the fixed and questionable assets of banks in the two farming groups, where bond investments were small, reached higher levels. Banks in suburban and smaller industrial cities which were adversely affected by the collapse of the city real estate boom, found their ratios of non-liquidity rising materially as city real estate loans began to be added to the criticized assets beginning in 1926.

Table 10 - Fixed and Questionable Assets per $100 of Capital and Surplus in Selected Banks Suspending in 1931

| Date | Median or typical bank in | | | | |
|---|---|---|---|---|---|
| | Cities of over 100,000 population (16 banks) | Other industrial and suburban cities (16 banks) | Mining communities (8 banks) | Northeastern farming region (10 banks) | Other farming regions (55 banks) |
| 1920 | $ 11 | $ 35 | $ 42 | $ 9 | $ 22 |
| 1921 | 39 | 11 | 26 | 41 | 67 |
| 1922 | 28 | 26 | 22 | 24 | 73 |
| 1923 | 28 | 45 | 39 | 21 | 107 |
| 1924 | 36 | 36 | 43 | 80 | 114 |
| 1925 | 68 | 74 | 57 | 91 | 144 |
| 1926 | 46 | 62 | 41 | 106 | 159 |
| 1927 | 54 | 94 | 60 | 157 | 155 |
| 1928 | 55 | 90 | 58 | 172 | 183 |
| 1929-1st half | 60 | 108 | 81 | 224 | 181 |
| 1929-2nd half | 107 | 165 | 97 | 199 | 188 |
| 1930-1st half | 123 | 181 | 122 | 200 | 187 |
| 1930-2nd half | 168 | 211 | 153 | 196 | 220 |
| 1931-1st half | 175 | 270 | 177 | 233 | 260 |

Loans to Officers, Directors, Relatives, and Their Interests

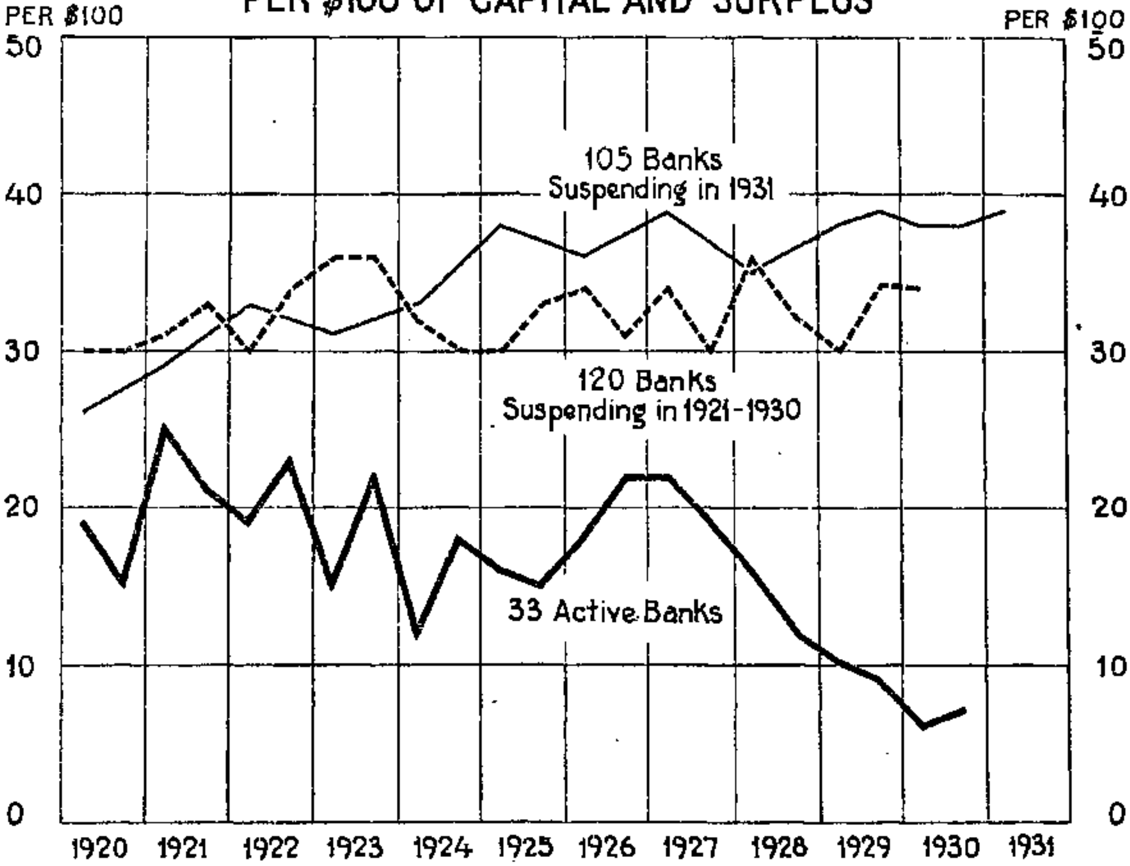
A study of the histories of representative active banks and banks which closed shows a wide difference in the amounts loaned to officers, directors, and related interests. This is illustrated in Chart 2 which gives for both active banks and suspended banks the loans to officers, directors, and their interests per $100 of capital and surplus. The figures are given in Table 11.

Table 11 - Loans to Officers, Directors, and Their Interests per $100 of Capital and Surplus

| Date | Suspended banks: 120 banks suspending in 1921-1930 (median) | Suspended banks: 105 banks suspending in 1931 (median) | 33 selected active banks (median) |
|---|---|---|---|
| 1920-1st half | $ 30 | $ 26 | $ 19 |
| 1920-2nd half | 30 | | 15 |
| 1921-1st half | 31 | 29 | 25 |
| 1921-2nd half | 33 | | 21 |
| 1922-1st half | 30 | 33 | 19 |
| 1922-2nd half | 34 | | 23 |
| 1923-1st half | 36 | 31 | 15 |
| 1923-2nd half | 36 | | 22 |
| 1924-1st half | 32 | 33 | 12 |
| 1924-2nd half | 30 | | 18 |
| 1925-1st half | 30 | 38 | 16 |
| 1925-2nd half | 33 | | 15 |
| 1926-1st half | 34 | 36 | 18 |
| 1926-2nd half | 31 | | 22 |
| 1927-1st half | 34 | 39 | 22 |
| 1927-2nd half | 30 | | 19 |
| 1928-1st half | 36 | 35 | 16 |
| 1928-2nd half | 32 | | 12 |
| 1929-1st half | 30 | 38 | 10 |
| 1929-2nd half | 34 | 39 | 9 |
| 1930-1st half | 33 | 38 | 6 |
| 1930-2nd half | | 38 | 7 |
| 1931-1st half | | 39 | |

CHART 2

LOANS TO OFFICERS DIRECTORS AND THEIR INTERESTS PER $100 OF CAPITAL AND SURPLUS




Loans to officers, directors, and their interests per $100 of capital and surplus for the typical or median bank in (1) the 120 selected member banks suspending during 1921-1930, (2) the 105 selected member banks suspending in 1931, and (3) the 33 active banks selected from towns where failures had occurred.

For active banks the general trend of these loans was downward, especially after 1927. For the banks suspending in 1931, however, the trend was upward, and just prior to failure the loans to officers, directors, etc., amounted to nearly 40 per cent of capital and surplus.

It is evident that the typical active bank reduced loans to the management when circumstances were favorable, whereas in many of the banks which later suspended the management increased their borrowings as the years passed, in spite of the fact that the condition of these banks was growing worse.

The median histories of the suspended banks grouped according to the year of failure were very similar to the composite for all the suspended banks as shown in the above table. Loans to officers, directors, and their interests were larger relative to capital and surplus than in the active banks, and these loans were not reduced as a rule during the years covered by the study.

A closer analysis of the 1931 bank failures shows that suspended banks in each of the economic regions habitually loaned larger amounts to their officers, directors, and related interests than the typical active bank. The heaviest lenders to these interests were the banks in large cities and in other industrial and suburban cities.

Table 12 - Loans to Officers, Directors, and Their Interests per $100 of Capital and Surplus in Selected Banks Suspending in 1931

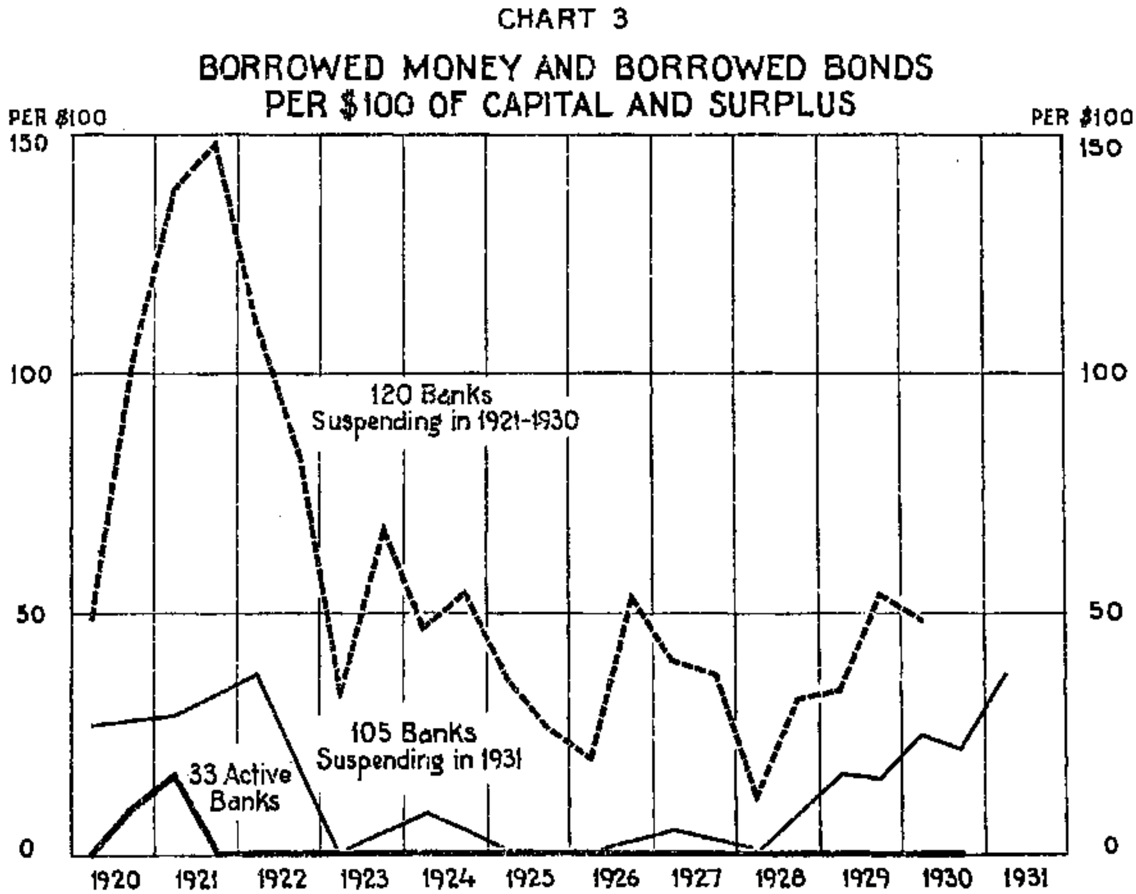
| Date | Median or typical bank in: Cities of over 100,000 population (16 banks) | Other industrial and suburban cities (16 banks) | Mining communities (8 banks) | North-eastern farming region (10 banks) | Other farming regions (55 banks) |
|---|---|---|---|---|---|
| 1920 | $46 | $37 | $27 | $24 | $20 |
| 1921 | 52 | 53 | 33 | 36 | 21 |
| 1922 | 49 | 54 | 38 | 33 | 20 |
| 1923 | 51 | 60 | 29 | 42 | 21 |
| 1924 | 52 | 58 | 36 | 35 | 20 |
| 1925 | 50 | 65 | 45 | 40 | 26 |
| 1926 | 49 | 58 | 40 | 36 | 25 |
| 1927 | 60 | 49 | 46 | 35 | 27 |
| 1928 | 59 | 56 | 50 | 36 | 25 |
| 1929-1st half | 60 | 56 | 53 | 39 | 29 |
| 1929-2nd half | 59 | 54 | 45 | 37 | 28 |
| 1930-1st half | 53 | 66 | 46 | 34 | 29 |
| 1930-2nd half | 58 | 62 | 38 | 33 | 32 |
| 1931-1st half | 60 | 53 | 32 | 34 | 32 |

## Borrowings

Striking differences appear in the history of borrowings by suspended and active banks. The ratio used to measure this factor was the amount of borrowed money and borrowed bonds per $100 of capital and surplus. The median bank of the 33 active banks borrowed nothing at the beginning of 1920, but did borrow small amounts in the latter part of 1920 and in the first half of 1921. After that year, a few of these active banks borrowed from time to time, but the typical or median bank was out of debt continuously from 1922 to 1930.

In contrast, the typical suspended bank of the 1921-1930 group was never out of debt according to median experience during the whole period from 1920 to the date of failure. Borrowings by the typical suspended bank reached a high level of 149 per cent of capital and surplus in the second half of 1921.

Borrowings by the median suspended bank of the 1931 group reached a peak of 38 per cent of capital and surplus in 1922. In the succeeding six years the median bank was out of debt almost continuously. Beginning in 1929, however, these banks borrowed heavily, the ratio for the median bank rising to 36 per cent of capital and surplus in the first half of 1931. Chart 3 and Table 13 show the borrowings of the typical bank in each of the three groups.




Borrowed money and borrowed bonds per $100 of capital and surplus for the typical or median bank in (1) the 120 selected member banks suspending during 1921-1930, (2) the 105 selected member banks suspending in 1931, and (3) the 33 active banks selected from towns where failures had occurred.

Table 13 - Borrowed Money and Borrowed Bonds per $100 of Capital and Surplus

| Date | Suspended banks: 120 banks suspending in 1921-1930 (median) | Suspended banks: 105 banks suspending in 1931 (median) | 33 selected active banks (median) |
|---|---|---|---|
| 1920-1st half | $ 49 | $26 | 0 |
| 1920-2nd half | 103 | | $10 |
| 1921-1st half | 139 | 29 | 17 |
| 1921-2nd half | 149 | | |
| 1922-1st half | 110 | 38 | 0 |
| 1922-2nd half | 83 | | |
| 1923-1st half | 33 | 0 | 0 |
| 1923-2nd half | 67 | | |
| 1924-1st half | 47 | 8 | 0 |
| 1924-2nd half | 54 | | |
| 1925-1st half | 36 | 0 | 0 |
| 1925-2nd half | 26 | | |
| 1926-1st half | 20 | 0 | 0 |
| 1926-2nd half | 53 | | |
| 1927-1st half | 40 | 4 | 0 |
| 1927-2nd half | 38 | | |
| 1928-1st half | 11 | 0 | 0 |
| 1928-2nd half | 31 | | |
| 1929-1st half | 34 | 16 | 0 |
| 1929-2nd half | 53 | 15 | |
| 1930-1st half | 49 | 24 | 0 |
| 1930-2nd half | | 21 | |
| 1931-1st half | | 36 | |

A study of median ratios of the suspended banks grouped by year of failure shows that the typical banks which failed from 1921 to 1927, inclusive, were never out of debt from 1920 to the date of failure. Banks which failed in 1928, 1929, and 1930 were out of debt only occasionally, and banks which failed in 1931 were out of debt about one-half of the time. Banks which failed in the earlier years borrowed more heavily than banks which failed in the later years.

Table 14 - Borrowed Money and Borrowed Bonds per $100 of Capital and Surplus

| Date | Banks suspending in | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1921 | 1922 | 1923 | 1924 | 1925 | 1926 | 1927 | 1928 | 1929 | 1930 | 1931 |
| 1920-1st half | $ 81 | $102 | $ 46 | $ 63 | $ 74 | $ 95 | $154 | $ 59 | 0 | $20 | $26 |
| 1920-2nd half | 121 | 219 | 45 | 134 | 129 | 254 | 146 | 62 | $ 15 | 73 | |
| 1921-1st half | 181 | 195 | 140 | 154 | 159 | 151 | 156 | 163 | 55 | 70 | 29 |
| 1921-2nd half | 154 | 280 | 200 | 164 | 171 | 188 | 205 | 74 | 118 | 81 | |
| 1922-1st half | | 289 | 207 | 185 | 148 | 214 | 136 | 94 | 111 | 35 | 38 |
| 1922-2nd half | | | 78 | 182 | 99 | 187 | 132 | 50 | 77 | 19 | |
| 1923-1st half | | | 172 | 160 | 80 | 93 | 88 | 28 | 0 | 0 | 0 |
| 1923-2nd half | | | | 147 | 53 | 116 | 144 | 32 | 9 | 8 | |
| 1924-1st half | | | | 112 | 98 | 62 | 140 | 52 | 16 | 0 | 8 |
| 1924-2nd half | | | | | 94 | 67 | 106 | 45 | 37 | 12 | |
| 1925-1st half | | | | | 110 | 66 | 149 | 18 | 20 | 13 | 0 |
| 1925-2nd half | | | | | | 87 | 106 | 9 | 0 | 0 | |
| 1926-1st half | | | | | | 82 | 122 | 60 | 0 | 0 | 0 |
| 1926-2nd half | | | | | | | 129 | 69 | 38 | 20 | |
| 1927-1st half | | | | | | | 120 | 38 | 27 | 16 | 4 |
| 1927-2nd half | | | | | | | | 48 | 59 | 0 | |
| 1928-1st half | | | | | | | | 0 | 18 | 27 | 0 |
| 1928-2nd half | | | | | | | | 23 | 44 | 8 | |
| 1929-1st half | | | | | | | | | 34 | 38 | 16 |
| 1929-2nd half | | | | | | | | | | 46 | 15 |
| 1930-1st half | | | | | | | | | | 49 | 24 |
| 1930-2nd half | | | | | | | | | | 81 | 21 |
| 1931-1st half | | | | | | | | | | | 36 |

A closer analysis of the borrowing record of the banks which failed in 1931 shows that banks in mining communities borrowed less in proportion to capital and surplus than any other group of banks. Banks in all of the other groups borrowed much more freely, and in many cases continuously.

Table 15 - Borrowed Money and Borrowed Bonds per $100 of Capital and Surplus in Selected Banks Suspending in 1931

| Date | Median or typical bank in | | | | |
|---|---|---|---|---|---|
| | Cities of over 100,000 population (16 banks) | Other industrial and suburban cities (16 banks) | Mining communities (8 banks) | North eastern farming region (10 banks) | Other farming regions (55 banks) |
| 1920 | $43 | $31 | 0 | $10 | $40 |
| 1921 | 10 | 7 | 0 | 14 | 91 |
| 1922 | 8 | 38 | 0 | 23 | 65 |
| 1923 | 24 | 0 | 0 | 10 | 0 |
| 1924 | 0 | 27 | 0 | 0 | 16 |
| 1925 | 38 | 12 | 0 | 9 | 0 |
| 1926 | 17 | 5 | 0 | 0 | 0 |
| 1927 | 33 | 0 | 0 | 16 | 3 |
| 1928 | 0 | 0 | $16 | 0 | 0 |
| 1929-1st half | 49 | 20 | 17 | 15 | 6 |
| 1929-2nd half | 27 | 35 | 8 | 50 | 0 |
| 1930-1st half | 8 | 32 | 0 | 22 | 28 |
| 1930-2nd half | 8 | 28 | 12 | 28 | 23 |
| 1931-1st half | 0 | 38 | 46 | 43 | 38 |

## <u>Further Comparisons of Suspended and Active Banks</u>

<u>Comparison of Banks Suspending in 1930 with the 33 Active Banks</u>. - On account of the special interest in recent failures, a more detailed comparison was made between the histories of the 25 representative banks which failed in 1930 and the 33 active banks used in this study. This affords a comparison over a period of nearly eleven years.

The comparisons are made as of five different dates, the first half of 1920, 1925, 1928, 1929, and 1930. The balance sheet items taken from each examination report for each bank were reduced to percentages of total loans and investments for that bank on the date of the examination. Median ratios were computed for each balance sheet item on each date, providing a single ratio for each item for the suspended banks and another for the active banks in each of the five years used in the study. Table 16 shows the ratios for the typical suspended bank and the typical active bank.

Table 16 - Balance Sheet Items per $100 of Loans and Investments of 25 Representative Member Banks Which Failed in 1930, and of 33 Active Member Banks(1)

| Item | 25 banks which failed in 1930 (median) | | | | | 33 selected active banks (median) | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1920 | 1925 | 1928 | 1929 | 1930 | 1920 | 1925 | 1928 | 1929 | 1930 |
| Loans | $75.8 | $88.3 | $88.2 | $84.2 | $85.1 | $78.7 | $67.1 | $61.4 | $59.7 | $56.5 |
| Bonds and securities | 24.2 | 11.7 | 11.8 | 15.8 | 14.9 | 21.3 | 32.9 | 38.6 | 40.3 | 43.5 |
| Loans and investments | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Banking house and furniture and fixtures | 2.1 | 4.0 | 3.7 | 3.3 | 4.3 | 2.0 | 2.2 | 2.3 | 2.0 | 2.3 |
| Other real estate | 0.0 | 1.2 | 3.0 | 3.1 | 3.7 | 0.0 | 0.3 | 0.1 | 0.0 | 0.0 |
| Cash and due from banks | 17.7 | 16.8 | 17.3 | 18.6 | 18.4 | 25.6 | 31.4 | 24.8 | 19.2 | 22.0 |
| Capital funds | 15.1 | 17.8 | 17.9 | 18.0 | 17.0 | 16.2 | 15.1 | 14.8 | 13.3 | 15.7 |
| Time deposits | 20.9 | 42.1 | 40.8 | 38.6 | 47.6 | 31.3 | 41.1 | 38.5 | 37.3 | 40.7 |
| Total deposits | 94.3 | 105.2 | 102.1 | 97.4 | 95.3 | 103.9 | 115.6 | 109.8 | 106.3 | 101.2 |
| Borrowed money | 1.6 | 0.0 | 3.7 | 4.9 | 7.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

(1) Data from examination reports in first half of each year.

This comparison again shows that the suspended banks had larger loans and investments relative to deposits than the active banks, and also a larger proportion of loans relative to loans and investments than the active banks. This latter difference developed after 1920, however, and suggests that the condition of the two groups of banks in 1920 did not vary greatly.

Certain other differences in the assets of the two groups may also be noted. Banking house and furniture and fixtures were consistently lager in all five years in the suspended banks than in the active banks. Other real estate was larger relative to loans and investments in the suspended banks than in the active banks. Furthermore, the ratio of other real estate to loans and investments increased steadily in the suspended banks, whereas it was reduced to zero in 1929 and 1930 in the median active banks. This indicates either that the suspended banks did not follow as aggressive a policy in disposing of or charging off other real estate as did the active banks, or that they acquired larger amounts of other real estate in order to reduce losses on bad loans.

Cash and balances due from banks were smaller relative to loans and investments in every year in the suspended banks than in the active banks.

Deposits of the suspended banks were less than total loans and investments in 1920, 1929, and 1930, indicating that in those years the suspended banks were using funds other than deposits for the purpose of acquiring or maintaining earning assets. Borrowed money was being utilized by the suspended banks in 1920, 1928, 1929, and 1930 according to median experience, whereas the median active bank was entirely out of debt during all of the five years.

<u>Composition of Loans and Investments of Banks Suspending in 1931 and of Member Banks Outside of Central Reserve Cities</u>. - Changes made in 1928 in the condition reports of member banks make it possible to compare in detail the loans and investments of the 105 banks which failed in 1931 with those of all operating banks outside of central reserve cities. Table 17 gives a classification of the loans and investments of the two groups as of December 31, 1928. This is on an average about two and one-half years prior to the date of failure of the 105 banks. This table throws light on the hitherto unknown amount of open-market loans in the portfolios of active and suspended banks and the amount of miscellaneous assets among their securities.

Table 17 - Loans and Investments on December 31, 1928, of 105 Member Banks Failing in 1931 and of All Member Banks Outside of Central Reserve Cities

| Classification of loans and investments | 105 banks failing in 1931 | | All member banks outside of central reserve cities | |
|---|---|---|---|---|
| | Amount (000 omitted) | Per cent of total | Amount (000 omitted) | Per cent of total |
| Loans to Customers | | | | |
| To banks | $ 1,928 | 0.6 | $ 209,743 | 0.8 |
| On securities | 67,556 | 21.0 | 4,117,045 | 16.0 |
| On farm land | 3,683 | 1.1 | 408,451 | 1.6 |
| On other real estate | 21,490 | 6.7 | 2,540,791 | 9.8 |
| All other | 116,030 | 36.1 | 8,450,275 | 32.7 |
| | 210,687 | 65.5 | 15,726,305 | 60.9 |
| Open-market Loans | | | | |
| Acceptances | 149 | 0.1 | 87,552 | 0.3 |
| Commercial paper | 4,006 | 1.2 | 346,811 | 1.4 |
| Brokers' loans (in New York and outside) | 15,037 | 4.7 | 1,457,173 | 5.6 |
| | 19,192 | 6.0 | 1,891,536 | 7.3 |
| Investments | | | | |
| U. S. securities (including circulation bonds) | 30,222 | 9.4 | 3,043,954 | 11.8 |
| Other securities | 60,155 | 18.7 | 5,088,312 | 19.7 |
| | 90,377 | 28.1 | 8,132,266 | 31.5 |
| Miscellaneous items included in securities account | 1,265 | 0.4 | 72,838 | 0.3 |
| Total | $321,521 | 100.0 | $25,822,945 | 100.0 |

Loans to customers comprised a slightly larger percentage of total loans and investments in the suspended banks than in all member banks outside central reserve cities, but the increase was in loans on securities which theoretically might have been very liquid. Open-market loans were smaller, relative to total loans and investments, in the suspended banks than in the more comprehensive group. Likewise investments were smaller in the suspended banks, composing 28.1 per cent of total loans and investments, as compared with 31.5 per cent in the case of the operating member banks. Combining the totals of security investments and open-market loans to arrive at a grand total of investments as contrasted with loans to customers, it is found that on December 31, 1928, these items composed 34.1 per cent of loans and investments of the suspended banks as compared with 38.8 per cent in the case of all member banks outside of central reserve cities. The similarity of these proportions reflects the fact that the 1931 failures, in addition to one class of banks with small bond accounts which closed on account of loan and other difficulties, included also another class of banks with large bond accounts where bond depreciation was an important element in the failure.

<u>Consolidated Balance Sheets of Banks Suspending in 1931 and of Operating Banks</u>. - Consolidated balance sheets of the 105 failed banks have been made from their condition reports of December 31, 1928, and December 31, 1930, for comparison with the abstracts of condition reports of all member banks outside of central reserve cities on the same dates. In this comparison loans to customers and open-market loans are shown separately. The various balance sheet items have been reduced to percentages of loans and investments and are presented in Table 18.

Table 18 - Balance Sheet Items per $100 of Loans and Investments of 105 Member Banks Failing in 1931 and All Member Banks Outside of Central Reserve Cities(1)

| Item | 105 banks failing in 1931 | | All member banks outside of central reserve cities | |
|---|---|---|---|---|
| | December 31, 1928 | December 31, 1930 | December 31, 1928 | December 31, 1930 |
| Loans to customers | $ 65.5 | $ 69.5 | $ 60.9 | $ 63.1 |
| Open-market loans | 6.0 | 1.4 | 7.3 | 4.0 |
| Investments(2) | 28.5 | 29.1 | 31.8 | 32.9 |
| Cash and due from banks | 20.3 | 18.7 | 20.1 | 20.7 |
| Capital funds | 15.0 | 16.2 | 16.0 | 17.6 |
| Due to banks | 10.1 | 10.8 | 10.2 | 10.7 |
| Demand deposits | 48.3 | 43.3 | 47.1 | 44.3 |
| Time deposits | 44.2 | 47.6 | 45.0 | 48.1 |
| United States deposits | 0.9 | 1.0 | 0.8 | 0.8 |
| Total deposits | 103.5 | 102.7 | 103.1 | 103.9 |
| Borrowed money | 4.5 | 4.6 | 2.9 | 1.4 |

(1) Total loans and investments declined 5.3 per cent in the 105 suspended banks during the two years, and 5.4 per cent in the member banks outside of the central reserve cities.

(2) Including miscellaneous assets reported in the investment account.

Deposit Trends of Suspended and Active Banks

The deposit trends of active and suspended banks have been compiled in order to determine whether withdrawals from suspended banks over a period of years prior to failure were heavier than from active banks. For each bank the deposits shown in the first examination report each year were reduced to a percentage of deposits in 1920, or the earliest succeeding date for which data were available. The median percentage was then selected for each year for each of three groups of banks; namely, (1) 33 active banks, (2) 25 banks suspending in 1930, and (3) 105 banks suspending in 1931. Table 19 gives the figures for the median or typical bank in each group.

Table 19 - Deposit Trends of Representative Suspended and Active Banks

(index numbers: median experience)

| Year | 25 banks closed in 1930 | 105 banks closed in 1931 | 33 active banks |
|---|---|---|---|
| 1920 | 100 | 100 | 100 |
| 1921 | 87 | 92 | 77 |
| 1922 | 73 | 87 | 76 |
| 1923 | 100 | 102 | 89 |
| 1924 | 99 | 104 | 90 |
| 1925 | 98 | 107 | 112 |
| 1926 | 100 | 114 | 113 |
| 1927 | 90 | 115 | 114 |
| 1928 | 106 | 127 | 131 |
| 1929 | 93 | 127 | 133 |
| 1930 | 81 | 119 | 125 |
| 1931 | | 100 | |

The use of medians tends to hide the extreme fluctuations either on the rise or on the fall of deposits of individual banks. Since only one date for each year was taken for each of the banks, it is probable that neither the highest nor the lowest deposit figure for any bank is included in the series. The figures, therefore, show only the general trends of deposits. Furthermore, in the case of closed banks the deposits on the date of closing were not used, and consequently the figures do not reflect the shrinkage of deposits during the final few days of the bank's existence.

In both the active and suspended bank lists there were a number of banks which enjoyed remarkable increases in deposits during the period covered by the survey. One active bank had deposits in 1929 more than nine times as large as in 1920. One of the banks which closed in 1930 had deposits in 1926 and 1929 more than three and one-half times as large as in 1920, and one bank which closed in 1931 had deposits in 1930 eighteen times as large as in 1920.

Even among the banks which suffered extreme losses of deposits, it was generally found that this could not be classed as the principal cause of the failure, although it may have been the more immediate cause. The banks which suffered heavy withdrawals and then failed were uniformly banks whose assets were undesirable and frozen and which could not, therefore, be converted into cash to meet deposit withdrawals. Generally, this frozen condition was of long standing, and loss of confidence led to the final heavy withdrawals.

The 1930 bank failure with the greatest deposit decline suffered a loss of more than one-half of its deposits during the years 1920-1926. In 1928 its deposits reached a low level of 36 per cent of 1920, but in 1929 they increased to 45 per cent of the 1920 figure. At the time of failure, however, they had declined again to 33 per cent of the 1920 amount. This bank's loss of deposits was caused partly by crop failures and low commodity prices, but undoubtedly lack of confidence in the bank on the part of the community was also responsible for part of the shrinkage. The bank was overextended in 1920, with borrowings nearly twice as large as its capital and surplus. The management had made excessive loans based on speculative farm deals and was in such poor condition in 1920, that it had been placed on the comptroller's list for special frequent examinations. Looking back on the 1920 situation, the examiner wrote in 1923: "If this bank should ever again give the amount of trouble as to excessive loans that it has in the past, the charter should be revoked." In succeeding years, there were several instances where the president of the bank endeavored to avoid the results of his mismanagement by such means as charging illegal loans against profit and loss, paying illegal dividends, and selling bonds to the bank at prices above the market quotations. This man died in 1925, and thereafter the management of the bank passed through several hands. In 1928 and 1929 good crops and the establishment of a new industrial plant in the community caused an increase in the deposits of the institution, but the weight of the frozen assets of the bank was so great that the shrinkage in deposits of 1930 and 1931 could not be met.

The bank failure of 1931 with the greatest deposit shrinkage lost half of its deposits in 1921 and another portion in 1922, so that its deposits in the latter year were only 28 per cent of the 1920 level. From that time on, the deposits of this bank remained at about the 1922 level until shortly before the time of failure, when they decreased to 14 per cent of the 1920 level. This bank was in an oil-boom town. The management which was in charge in 1920 consisted of a group of unscrupulous directors who misused the bank in a variety of ways. The most important misuse of the bank was in the matter of loans to oil-field operators. The examiner had the following to say about these loans in 1920:

> 4-22-20 ". . . The town of ____ is in the midst of a big development and it is the opinion of your examiner that this bank is too liberal in the making of loans to operators who at present may be all right, but may meet with such reverses as to affect their financial standing at any time."

In June, 1920, the management was acquired by another group of unscrupulous promoters, who immediately began using the bank's funds for their own private interests. The bank was resold in November, 1920, at which time as assessment of 150 per cent was voted and a reorganization of the bank occurred. The purchaser of the controlling interest in the bank was a capitalist, who knew nothing about the banking business. In 1922 the examiner had the following to say about this man and the condition of the bank:

> 1-27-22 "Mr. _____, the dominating figure in the bank, makes a statement worth 3/4 million but is one of these characters if he regards a man's credit good, matters of law are not considered very essential. He is safe and conservative but this trait should be curbed. Just now in view of the fact that the restoration of the bank from the exploiting of former management, depends on keeping him connected, diplomacy is suggested in presenting his idiosyncrasies to him. From sources thought reliable, it is learned he made the statement 'if it took $100,000 to put the bank on its feet, he would spend that much.' No liquidation in farm paper, largely Creek negro freedmen, is expected before fall. The interest is, as it has always been in small fields, problematical; it is contingent on excitement, i.e., development. All lines, except those shown, are apparently margined or satisfactory financial statements on hand. This is just a 'nursing case' and it will take time, patience and diplomacy to work it out. By comparison with last report, it would indicate progress has been made."

For several years the owner of the bank contributed heavily and out of proportion to his stock ownership to keep the bank open and to take out losses which developed in assets which were in the bank when he purchased it. However, the lack of experience of the bank management soon began to be reflected in new loans of an undesirable character and in certain illegal transactions, the latter probably unwittingly committed. In 1924 the examiner described the situation as follows:

> 7-15-24 "The entire capital stock of this bank is now owned by the board of directors, and 215 shares are owned by _____. Correspondence on file in your office will give all of

> the details of the situation here. It is, essentially, that President ____ has voluntarily taken on the responsibility of keeping this bank open. It has already cost him an enormous sum and the bank lacks a lot of being clear now. His determination and resources are such that it is believed he will accomplish his purpose if given reasonable time in which to do it. He has voluntarily saved the Department the loss of a bank and it is believed he will comply with his promise to remove $7,000.00 of the losses within the next ninety days. The other directors are of little financial worth. The directors have had persistent heavy overdrafts which Mr. ____ promised to have discontinued. Mr. ____, Vice President, is active manager of the bank. It appears that he has practically exhausted his resources in keeping it open. While giving all due credit to him for his efforts in the collection of the old paper, the condition of their tenant paper is not such as to warrant one in believing he is a good chattel mortgage banker."

Examiners' comments showed that the president made further contributions in 1925, 1926, 1927, and 1928, but at the same time he continued to make improvident loans. In January, 1928, the examiner commented as follows:

> 1-12-28 ". . . The total of doubtful assets, at this examination, shows a decrease since the previous examination; which is, however, very largely accounted for by the amounts classed as worthless. President ____, the bank's managing officer, has seemingly no conception of the principles of credit extension. His new loans consist largely of advances to former bankrupts and negro tenant farmers, in every instance inadequately secured. He is himself a gross, unprepossessing figure, and the only reason for tolerating his presence around a bank is the fact that he will, when urged, continue his contributions to remove losses. Unless his policies can be changed, his contributions will continue to be semi-annual affairs."

In the last half of 1929 the bank was placed on the special examination list, and apparently this action had a very salutary effect. The loans of the bank were reduced to less than one-half of the deposits, the criticized paper was reduced to one-half of capital, surplus, and undivided profits, and in December, 1929, there were no violations of law. At that time it can be said that the bank was in good condition as to its assets, were it not for the weak management.

In the summer of 1930 the management of the bank again went beyond the bounds of good business. Loans practically doubled, a large amount of borrowings appeared in the report and the total of criticized assets increased. The examiner's comments at that time follow:

> 6-9-30 "President ____ and his family have again gone on a regular 'rampage' by the excess credit route. The line of credit used by Mr. ____ and his family amounting to over $30,000.00. The son who operates the ____ is wholly irresponsible. Has no assets, ability, or anything else. Admitted that he had lost money gambling. He, through the approval of his mother, has been giving purported bills of exchange for everything that he might take a notion to purchase in the operation of his business. He only has about a $4,000.00 stock on hand at this time, consisting almost entirely of flour and stock feed. If it were not for his father, who will have to liquidate this account, it would represent a large loss. President ____ claims he is worth $425,000.00. I think that is at least $275,000.00 high. I told President ____ that if he was worth one-half of what he claimed he was worth I could see no reason for his flagrant violation of Section 5200. That he could have easily borrowed from one of his correspondents. He spoke as though it would take him sixty days to get his account out. He claims his account is largely represented by paying up back income taxes that the government has dug up . . ."

Thereafter the condition of the bank became rapidly worse. The condition of the president's personal affairs and the general condition of the bank is shown by the following quotation from the last examination of the bank made in April, 1931:

> 4-15-31 ". . . President ____'s current obligations are being classed doubtful this examination, with a thorough understanding that unless liquidated, a more adverse classification may be anticipated at next examination. It is believed President ____ can still liquidate his obligations to subject bank, but it will be necessary to apply the pressure to bring the necessary results. Classification of ____'s obligations arrived at after due consideration and the experience of three examinations. Mrs. ____ was invited to

attend the directors' meeting, incidentally, took the meeting by storm, gave a complete history of the bank for years, stated the sacrifices her husband had made, and the pitch of her voice was convincing enough that it was not necessary for her to place a pistol on the desk to hold attention or attendance, which it is said she has resorted to in past. Recommend notice of impairment be issued for $15,950.26, and the bank retained on the special list. . ."

The bank closed in July, 1931, after suffering a withdrawal of $14,000 of deposits since the April examination.

A study of these cases leads to the conclusion that the deposit trends of active and suspended banks have been very similar, aside from the final runs. This applies to the usual experience and not neccesarily to extreme cases.

## CHAPTER III

## LOAN AND COLLECTION POLICIES

Loans or lending policies were criticized by examiners in 210 of the 225 suspended banks, or 93 per cent of the cases. These criticisms, which are listed in Table 20, ranged from general statements regarding weak or injudicious loans to specific illustrations of special kinds of mistakes.

Table 20 - Criticisms of Loan and Collection Policies

| Type of criticism | 1921-1930 suspensions (120) | 1931 suspensions (105) | Total (225) |
|---|---|---|---|
| Lax lending methods | 64 | 88 | 152 |
| Slack collection methods | 66 | 67 | 133 |
| Unwise loans to directors and officers | 56 | 54 | 110 |
| Lack of credit data | 26 | 57 | 83 |
| Capital loans | 26 | 20 | 46 |
| "Placed paper" | 18 | 9 | 27 |
| Excessive loans to tenants | 19 | 8 | 27 |
| Loans subject to prior liens | 13 | 10 | 23 |
| Loans to accommodate other banks | 13 | 9 | 22 |
| Loans based on inflated land values | 15 | 6 | 21 |
| Excessive loans on city real estate | 1 | 14 | 15 |
| Evasion of loan limit by splitting lines with other banks | 11 | 4 | 15 |
| Unwise loans to relatives and friends | 3 | 11 | 14 |
| Attempts to capture business by loans | 7 | 6 | 13 |
| Emphasis on profits over safety | 9 | 3 | 12 |
| Non-resident loans | 5 | 5 | 10 |
| Loans collateralled by bank's own stock | 0 | 8 | 8 |
| Automobile paper | 2 | 4 | 6 |
| Belief in "service to community by loans" | 2 | 2 | 4 |
| Loans for security speculation | 0 | 3 | 3 |
| Concentration of credit on "one crop" or industry | 0 | 3 | 3 |
| Loans to "straw men" to permit speculation by officers | 0 | 2 | 2 |

Note: Other criticisms occurring only once were: bonuses received for loans; loans to purchase stock in subject bank; loans made up to 100 per cent of appraised value; lack of eligible paper; concentration of demand collateral loans; demand paper carried too long; loans to non-customers; loans collateralled by local manufacturer's non-liquid stock; financing pure bred live stock; unwarranted liability on cattle and cotton deals; loans to "get-rich-quick" promoter; and loans secured by life insurance.

The commonest criticism was "lax lending methods," which refers to lending methods generally rather than to one or two specific types of loans. Slack collection methods ranked second. Unwise loans to directors and officers and their interests ranked third, lack of credit data fourth, and capital loans fifth. In many cases, of course, two or more of the criticisms listed applied to the same bank.

A variety of criticisms of speculative loans on securities appeared in the 1931 study, including such items as loans to "straw men" to permit speculation by bank officers, loans collateralled by the bank's own stock, and various other loans for security speculation. These criticisms occurred almost entirely in the city banks. In both studies banks in rural areas made loans of a speculative nature on farm real estate.

Lax Lending Methods

One hundred and fifty-two of the suspended banks were subject to thie general criticism. This large total is important because general laxity was recorded only where the examiner made a general criticism of the lending methods of the bank. A bank was not recorded as having lax lending methods if the examiner criticized only some specific kind of loan.

Frequently these comments occurred only in 1920, or in the first year of a bank's troubles. Later examination reports described only the struggle of those banks to survive. Probably this is the reason why poor lending policies are so often overlooked as a cause of failure.

A common type of criticism is illustrated in case 104 where the examiner wrote in 1927:

"President A appears to lend money in most any amount and under most any conditions to most anyone who applies, without due consideration to the time when payment can be expected or the source from which funds for liquidation are to come."

Sometimes the criticism inferred that wilful negligence had been a factor, as well as merely inexperienced or lax lending methods. An illustration is found in case 70 where the examiner wrote in 1920:

"All violations are promptly adjusted each time during the examination and then bank apparently feels free to operate as it desires until an examiner comes six months later. Bank has been repeatedly criticised for excess loans, reserve shortage, etc. Advised officers and directors that adjustment of criticised items during examination did not satisfy requirements of the law. The President pleaded ignorance on many points, but when excess loans have been repeatedly granted and reserve continually short it is hard to believe that the matters are due entirely to ignorance."

Correspondence in the Federal reserve bank files shows that this bank was a heavy borrower in 1918 and 1919, and during those years had a large amount of statutory bad debts and a chronic deficiency in reserves. As early as 1915, the bank showed loans in excess of deposits and borrowings up to 60 per cent of capital. The bank borrowed heavily from 1915 until it closed in 1922.

In case 101 the examiner wrote in 1925:

"The outstanding undesirable feature of bank's assets is the accumulation of slow and undesirable agricultural paper, largely due to the former policy of permitting borrowers to carry over all or a portion of the lines from one year to the next when complete liquidation should have been insisted upon. Many of these lines became so heavy in time that liens on real estate were resorted to for additional protection, and some of these are now largely dependent on this real estate for final liquidation. This condition is all the more singular as this section of the country has as a rule enjoyed good crop harvests nearly every year until the present one."

This bank should have collected its loans during the good crop years. The effect of failing to do so became clearly evident during the succeeding years when crops were poor. In 1926 the same examiner had the following to say:

> "Condition of this bank at present is rather unsatisfactory, though not considered alarming. Criticised assets are somewhat larger than at last examination. This condition is largely due to the very liberal credit policy while operating under a State charter during which time they accumulated a large volume of slow and non-liquid paper. In addition to this, the bank has not heretofore insisted upon seasonal liquidation of farm credits, even during good crop seasons, but permitted borrowers to carry over a large portion of their lines from year to year. A great many of these lines in time assumed unwarranted proportions and became more or less frozen. The crop disaster of the past season which caused a 75 per cent shortage in the normal value of the crops has brought this condition out more clearly than possibly it could have been done by any other means, and directors should now be awake to the importance of immediately adopting a vigorous collection policy."

By 1927 the weakness of this bank's policies had become still more evident, and the examiner wrote:

> "Extension of credit in the cotton-growing section of the Plains has been abused beyond all measure and nowhere more flagrantly than here. The banks are not alone in this abuse, but must share their full responsibility. Where a merchant by investing a few hundred dollars in fixtures and a month or two rent on a location may establish a line of credit of several thousand dollars with a wholesale house, besides obtaining a credit line at his local bank on the plea of working capital--it is time to call a halt. Farm credits are in the main based on equities equally absurd. A high percentage of failures naturally results, which is bad for any community. The community will not suffer in the least by thus curtailing credit. On the contrary, it will eventually be far better off. It has been suffering the past two years from <u>too much credit</u>."

In case 66 economic conditions and poor loans were jointly responsible for the troubles into which this bank was plunged. The hard winter of 1919-1920 caused difficulties for ranchmen throughout the northern half of the United States and forced banks to extend their lines of credit more than they would ordinarily have done. However, correspondence in the Federal reserve bank files indicates that this particular bank was a continuous borrower since 1914, and had been in a weak condition since 1918. In January, 1920, the examiner wrote:

> "This bank, although on the special list for a long time, still continues to violate the law and appears careless in matter of extending credit. I would recommend the most drastic measures possible to compel them to comply with the law. Crop failures in this locality make it necessary to carry over considerable paper, some of which has narrow margin of security."

In April, 1920, the same examiner wrote:

> "Because of a long hard winter and the high price of feed, it has been necessary to strain credits in order to assist some of their customers to carry live stock through the winter in order to avoid serious losses, and some of the excess loans may have been excusable on these grounds, but this is not true in all cases, and the violations are due largely to the carelessness of the officers and their weakness in not being able to decline the loans."

This bank struggled along for two more years before the drop in prices of agricultural products and crop failures in the dry land farming area, coupled with the "free and lenient policy" which had been followed in making loans during earlier years, forced the suspension of payments shortly before the close of 1922.

In some cases it is difficult to determine whether the examiners' comments were intended as criticisms of lending policies or whether the troubles were attributed to economic forces. There was much more justification for a banker's making loans against inflated values in the farming country in 1919 and 1920 than there was for similar mistakes in such localized booms as that in Florida or those in the various oil fields. An illustration of a banker's unreasonable attitude towards an oil boom was given in case 79 where the examiner wrote in 1923:

"It must be remembered that this condition dates back some three years when a probable oil boom was apparent, but failed to materialize. The officers failed to foresee the future, and went ahead and made large loans to farmers, business men, and parties here to invest in 'XX' real estate and loans of a speculative nature. It will be noted that the paper classified as worthless in this report is in the majority loans to bankrupt concerns, oil operators, and to parties who invested in lots of the 'XX' townsite addition. These lots are practically worthless as town property, and the only value would be in acreage land."

## Slack Collection Methods

Weak or negligent methods in handling collections of loans constituted one of the most serious criticisms found in the study of suspended banks. Examiners criticized 133 of the 225 banks for this defect in management.

In case 69 the bad effect of allowing customers to run the bank's collection policy was discussed in a memorandum appearing in the Federal reserve bank's files and dated in early 1921. The statement in reference to this matter was as follows:

"With reference to the paper of this institution, will say that I do not believe that the care has been exercised that should have been. There are too many tenant farmers owing the bank, and credit has been too liberally extended to this class. Several tenant farmers have notes in the institution running from $2,000 to $3,000, where the limit should not have been to exceed over $800 to $1,000. The reason for this can be attributed to the fact that the cashier has lived in this section all of his life, and does not seem to have had the nerve necessary to stand up under the demands of his customers. The result is that in place of reducing their indebtedness, it has been constantly increased from year to year, and the statutory limitation has prevented their getting more money than they actually owe at the present time. There is no question in my mind but what there has been a loss of confidence in the management of the institution. There has also been a tendency to pay off other indebtedness they owed in preference to paying the obligations which they owed the bank. The farmers have been kind of watching one another and have discussed amongst themselves that the indebtedness which they owe the bank could wait, as it seemed to be a very easy matter to obtain such extensions as they might desire. I even believe that this has been advocated by the directors of the bank, and, although I have no positive proof, I believe the directors themselves have not taken the paying of their notes seriously and being in that position could not very well ask other note makers to do any better than what they themselves do."

In case 120 borrowers had been allowed to form the habit of not even paying the interest on their notes at the time of renewal. In 1922 the examiner wrote:

"Management has been far from aggressive, the borrowers have been educated to add interest to their loans whenever renewed if unable or not convenient to pay the interest, and it will be difficult for the officers to reverse such a practice or policy."

Case 111 illustrates the disastrous effects of not pushing collections when conditions are opportune. Crops were good in 1928, but collections were allowed to lag and the crop failure of 1929 caused serious troubles for the bank. The examiner wrote:

"He (the cashier) is regarded as being a very weak credit man and unless a more rigid collecting policy is pursued during the marketing season the aggregate losses will be rather heavy. Better than an average cotton crop was marketed here last season, and if proper efforts had been put forth many lines could have been liquidated in full, a portion of which were carried over and with this year's crop being cut short approximately 50%, it leaves the bank with an accumulation of slow and doubtful paper, and in few instances are the borrowers in a position to strengthen bank's position."

In case 46 so little emphasis was placed on the proper collection policy that the bank allowed insufficient clerical help for this purpose. This was first criticized by the examiner in 1922 as follows:

"It is evident that a great deal of delinquency in attention to maturing paper can be attributed to insufficient help. At present the bank is short one employee, since the resignation of Mr. B, active vice president, and the work has accumulated in the past two months."

Two years later slack collections were still in evidence, as seen from the following comments of the examiner:

"Bank is apparently in standard condition with the exception of overdue paper, which is a continuing result of a long established habit, and the local borrowers more or less suit their own convenience in arranging for their maturing paper."

Later in 1924 the faulty organization of the bank for handling collections was further described as follows:

"No improvement is shown in condition of overdue paper. It is largely left to President D to attend to maturing paper. He is a practicing lawyer, and is usually busy in his law office, hence the bank's business is neglected."

Many specific cases could be cited to illustrate the character of slackness in collection policies. Case 52 furnishes a well written discussion of this matter. In 1929 the examiner criticized the directors for not paying their own debts to the bank in the following words:

"If the directors really wish to get this bank in sound condition, they cannot show their desire in any better way than arranging to pay back what they owe the bank. And if each officer and each director pays the bank what he owes it, examiner believes that the officers and directors will see that other debtors pay their obligations to the bank."

Later in 1929 the same examiner criticized in detail the failure to collect a number of the loans. His description of the bank's weak policy follows:

"T, the Chancery Clerk, is a very popular man and owes bank $11,408. and endorses quite a number of notes, of which notes aggregating $13,408. are listed as subject to criticism. The greater portion of these loans have been in the bank a great many years and apparently no effort is being made to collect same. His statement is not especially attractive and bank has no data as to the extent of his indirect liability. No reason is apparent why he should not be required to pay or adequately secure his indebtedness, nor why notes which he has endorsed should not also receive diligent attention. But apparently nothing is done. He is popular, a county official, and a friend of the bank and thus the matter drifts on, and really management does not know whether or not the loans can be collected, as no effort has been made to collect same. Other instances: In 1924, O. had loans that were regarded as hazardous, and bank got as security a mortgage on five small dwelling houses in this town. Five years have past and loan still remains in the bank. None of the houses have been sold and debt reduced. Can these houses be sold, if so, they should be and debt reduced. If they cannot be sold, bank should be charging off the loan. Messrs. D have had full loans in the bank for many years. One of the Messrs. D has been associated in business with Pres. C for many years. Examiners have repeatedly criticised these lines, but they remain in the bank and apparently no effort is being made to collect same, and if any effort is being made, it is meeting with very little success.

"At last examination, P owed this bank direct loans of $11,000., loan made by Q for his accommodation $980.00; he also had an overdraft of $855., making an excess line. These various items still remain in the bank and the line is still in excess. Mr. R is a lawyer who has a good practice, was formerly a director in the bank, and was a law partner of Judge A, who prior to his death was a director and a valuable man on the board. Mr. R is said to be a man of some property interests, lives well, rather extravagantly for a man heavily in debt. But bank has made no effort to collect or secure loan nor even collect the overdraft. Mr. R is said to have recently sold some brick company stock for a substantial sum. Examiner asked officers why Mr. R had not used some of the money in paying his indebtedness to bank. The reply was that Mr. R's wife was going to keep that money to send the children to college, and bank apparently is standing by doing nothing. However, a few days prior to examination, a committee was appointed to see Mr. R and try to get him to pay something, but court has been in session and Mr. R was busy and has not yet been seen. These instances are thus mentioned so that it may be seen why this bank has gotten into this condition and why it has been retained on list for special examination for so many years."

In many cases collections were made difficult by adverse farming conditions, but even under these circumstances, it was frequently stated by examiners that the banks under criticism had not made as strong an effort to collect as they might have done. In some cases adverse comparison was made with the collection records of other banks in the same locality. For example, in case 102 the examiner wrote in 1921:

"The condition of the bank's note case is very unsatisfactory. Its condition is serious when it is considered that the normal liquidation for the year is completed, except for the sale of a few straggling bales of cotton and some small cattle sales that will be made in spite of the stagnation. The farmers generally have their feed. However, a fair grain crop has been produced, and the crop of 1922 will be even cheaper than that of 1921. Notwithstanding all these facts, pro and con, the fact remains that the bank is in a seriously extended condition, and also the fact cannot be denied that a better condition could have been produced by a more conservative policy. Other banks in the same section are in a much better condition. For instance, the state bank at this place has retired all borrowed money and has 40% reserve."

A year later the same condition was shown to have continued and the examiner wrote:

"No improvement is shown in this bank since last examination. In fact, when it is remembered that the liquidating period of the year has come and gone the bank is thought to be in worse condition than at last examination. It is to be admitted that this section is in trouble and has been for a number of years. Three crop failures followed successively and last spring the A River, in the bottom land of which stream a considerable portion of the adjacent farm lands lie, overflowed its low banks twice, so that these waters and the excessive rains made it necessary to plant three crops. The crop was therefore late and poor. Other localities, however, in practically the same condition have succeeded in making better progress, and the state bank in this place has collected well, so that they now have 50% cash reserve."

In some banks a new management assumed control and later took an inordinately long time to collect the poor loans inherited from the preceding management. Their attitude might be characterized somewhat as follows: "Don't blame us for the slow improvement; we are not responsible for the mistakes of the previous management." Case 4 is a typical example. In 1921 the examiner wrote:

"The condition of this bank is very unsatisfactory. Former President A seems to have unloaded considerable amount of slow and doubtful paper before leaving. The paper does not bear his endorsement and in nearly every instance is that of tenant farmers secured by live stock and future crops, the former inadequate and the latter undeterminable. The directors of this bank are to blame for allowing this paper to come into the bank. All paper classed in this report as doubtful and remaining in the bank after this year's crop is harvested, should be promptly charged off."

Three years later the criticized paper still remained in the bank and many of the lines had increased under the new management. The examiner stated the condition as follows:

"Note the tremendous amount of slow and doubtful paper. There is some apprehension on my part as to whether the directors and officers have the force or the will to rise to the occasion necessary to save the bank. I am in doubt as to whether or not they really appreciate the fact that the bank is in an almost serious position. For it appears they have become accustomed to its condition, and justify their personal position, each one of them, by the often repeated statement. 'You know we are not responsible - the fault is with our predecessors.' Apparently no positive efforts have been made - certainly not in a forceful and intelligent manner, to reconstruct the bank, in a handling of the many slow and doubtful items of assets. Reference back three, four or five years ago, to certain lines now standing, shows that such lines are now carried at an increase of from 200 to 500%."

By the winter of 1925 some of these notes had been brought to suit in an effort to collect, but even then the directors of the bank were apparently half-hearted in their attention to these matters. Developments in this bank continued to be adverse, and in 1926 the examiner wrote the following description of the situation:

"The condition of the bank is not at all satisfactory. Many of the loans are tied up with court litigation and have been in this same condition for a long time. The bank continues to make additional advances to tenant farmers who appear to be hopelessly involved. Aggressive action of the directors would in many cases help to clear out some frozen paper, but the directors are of the easy going type and appear willing to wait and hope that loans will be paid voluntarily. Directors state that the bank was in very bad shape when they took charge and are prone to compliment themselves on the good work they have done in clearing up the situation. Most of this clearing up was done by charging off rather than by collection. If the loans classed doubtful are not paid or properly secured this fall, they should be eliminated from the assets of the bank."

Finally, in 1927, the examiner began to list some of these stale loans as losses, and even then the directors protested because the loans were inherited from a former management. The examiner described the situation as follows:

"Loans listed as lossed in this report have been carried for a number of years, without any progress in the way of reductions. In most cases they are loans to tenant farmers who have not been able to make any money except to pay advances for crops. Directors claim that these loans are old workout propositions handed down by a former management, and therefore feel that they should have time to work them out."

<u>Loans to Officers, Directors, Relatives, and Their Interests</u>

The chief abuses of loans to officers, directors, and their interests were unwarranted capital loans to weak credit risks and failure to enforce collections against these favored parties. Faulty lending policies in this regard were very general among the suspended banks. Among the 225 cases studied there were unwise loans to directors, officers, and their interests in 110 cases, and unwise loans to relatives of bank officials in 14 cases, making a total of 124 cases where this fault occurred in a sufficiently pronounced form to be mentioned by the examiners.

Three cases will illustrate these lending practices. In case 109 a national bank examiner and a Federal reserve bank examiner made a joint examination in 1922. The Federal reserve bank examiner made the following comment:

> "If there was ever an institution organized by 'the stockholders, for the stockholders,' this is the ONE. This condition largely is responsible for their present deplorable strait. The officers of this bank have wilfully indulged themselves in this practice, and have about reached a point where they cannot liquidate in the 'pinch' to save this institution from going on the rocks."

The national bank examiner wrote:

> "The officers and directors are borrowing 34% of the bank's capital and surplus and the first thing I demanded after classifying the loans was that they eliminate their lines, or materially reduce them, at once. This they claimed they could not do without a little time, and even then they did not think they could raise an amount that would be called a material reduction. There is a condition existing in this bank that is found in very few. In making up the schedule of liabilities for borrowed money, I suspected the shareholders were riding the bank and called for their stock register. I found that fourteen of their shareholders were borrowing $217,630.00, direct, and their affiliated interests $19,189.00, making a total of $236,819.00.........Based on these figures the fourteen shareholders referred to above are using the entire working capital, and approximately all local deposits. They have been using the bank for a select few and have not served the public as a bank should."

In 1923 the hopelessly frozen condition of these favored loans became evident and the examiner wrote:

"In regard to the B, Cashier D, and Mrs. C lines your examiner is beginning to get somewhat uneasy, as practically no reduction has been effected in each case since I have been visiting the bank, over a period of about two years. As shown in this report, the directors are still borrowing unduly, considering the bank's over-extended condition. I again suggested to them that they borrow funds elsewhere and liquidate their indebtedness here, but all, with the exception of H, claimed they had tried to do this but had failed."

Case 27 affords a more complete illustration of the evils of unwise credit extensions to officers, directors, and their interests. In 1922 there was evidence of too generous treatment of the directors and their interests and the examiner wrote:

"Directors and their interests borrowed 125 per cent of their capital and surplus. Considering the over-loaned condition of the bank these lines are subject to criticism."

In 1923 the examiner wrote:

"The directors are interested in the majority of local industrial plants in an official capacity and as a result these companies have extended lines."

By the summer of 1926 many of these loans had increased and the examiner wrote as follows:

"Bank is carrying an excessive amount of bad assets on which no interest is being paid and many accommodation loans to cover up excess loans to local industrial concerns in which the officers and directors have a financial interest. The president's loans have been renewed without the payment of interest."

A year later a full realization of the bad effects of this abuse of credit was reached and the examiner stated that:

"The board is weak in ability and does not direct. Management rests largely with the president whose ability is seriously questioned. Under his management this institution has become water-logged with undesirable frozen assets. Almost one-third of the loans are to directors and their interests and comparative reports will show this amount to be increasing. These loans have been in the bank for years with no reduction until they have become of a very frozen and, in a substantial part, doubtful nature. Very few losses are admitted and comparatively small charge-offs are being made while earnings are only nominal. Apparently in an attempt to deceive and evade the excess feature, numerous accommodation loans are being carried, including directors - largely for the accommodation of corporations in which directors are interested. Many of these are being renewed without any payment of interest. Borrowings are steady. Reserves are small or deficient. The result of the policy which permits the board and its interests to borrow 195 per cent of the capital and surplus, a very large percentage of which is frozen or doubtful. Officers and members of board have no conception of a capital loan, nor is there any one of them apparently qualified to pass on an application for a line of credit."

In case 71 among a great variety of malpractices appeared the matter of unwarranted loans to relatives of the bank cashier. In 1926 the examiner wrote:

"It appears that the bank in the past was used to a large extent in financing the 'X family' in their various banking operations. Said banking operations proved unsuccessful, and now this bank is endeavoring to collect on the various lines obtained through aforesaid operations."

These loans remained in the bank with some increases until they equaled the entire capital and surplus of the bank, and in 1929 the examiner summarized the situation as follows:

"Loans to officers, directors, relatives, and affiliated concerns

| | Recapitulation |
|---|---|
| Slow | $ 7,431.00 |
| Doubtful | 13,200.00 |
| Loss | 25,575.00 |
| Total | $46,206.00 |

"The above loans are those made to the various officers, directors, their relatives and affiliated concerns of the chain of which this bank is a unit. The purpose of this compilation is to reveal how grossly the officers of this chain have violated their public trust by misusing depositors' monies and the extent to which this bank has been exploited for the furtherance of their personal interests. The classification of each loan is indicated thereafter to reveal the sub-standard quality of same, and the recapitulation reveals that the entire capital and unimpaired surplus has been withdrawn by these individuals in the form of loans, thereby forcing the customers to capitalize this bank with their deposits. If these loans are good and collectible, as represented, the payment of same will eliminate capital impairment and is a duty and obligation, both moral and legal, that these individuals owe to the shareholders and depositors of this bank."

## Capital Loans, Loans on Inflated Real Estate Values, and Excessive Loans to Tenants

Errors in policy regarding loans on real estate and loans to farmers were common in the group of closed banks used in this survey. Frequently loans were made without specific security which proved to be undesirably large, and in an effort to secure the loans junior mortgages were taken. This habit was not the subject of general comment by the examiners, but in studying the histories of banks that closed, it was found that the practice was present in exaggerated form in a large number of cases. Many faulty loans on real estate bore evidence that they were made to give a special benefit or profit to officers, directors, or interests close to the management and thus were merely a phase of exploitation of banks by their management.

Capital Loans. - Banks frequently make loans which cannot be repaid at maturity in the ordinary course of business transactions, and sometimes several renewals are necessary. It is not the intention here to make a general condemnation of such loans. However, the examiners' comments show that in the group of suspended banks studied capital loans were excessive.

In case 62 the examiner made pertinent comments as to the shortcomings of capital loans. In January, 1920, he wrote:

"It is hard in the final analysis to criticize individual loans, but the cumulative character of the large lines and their seeming fixity of amount and continuity of the accommodations do produce a situation of non-liquidity which is not satisfactory to your examiner.....Examiner lists large lines and classified interests in order to emphasize the tendency to make what approach, if they are not in fact, capital or partial capital loans, which are necessarily of a non-liquid or, at least, of a not easily liquidating character. Individually considered the various lines possess merit and may be rated good, but taken collectively produce a condition of non-liquidity. This situation is not regarded as satisfactory and is considered to be one which is likely to cause trouble to both borrowers and bank in the event of a recession of deposits requiring liquidation of loans."

These comments were further elaborated in August, 1920, as follows:

"The habit of loaning to corporations all that they should borrow, and then to the individual for company's benefit is as unsafe as it is unlawful. It will be noted that practically all excess loans are otherwise criticised."

In case 68 the examiner described typical capital loans. In 1922 he wrote:

"Acting as manager for the ______ Stock and Farming Company in the sale and management of large land holdings, he has taken into the bank many top-heavy lines to contract holders, whose equities in their respective lands are consistently small."

In 1923 the succeeding examiner described the capital loans of this bank as follows:

"A large proportion of the bank's loans are to tenant farmers, and to individuals who are buying their farms on contracts. Generally, the terms of these contracts are favorable to the holder, but the conditions of recent years have not permitted them to improve their position to any degree, and when consideration is given to the fact that in some cases credits are extended using the equities in these contracts as a basis, the situation cannot be said to be satisfactory."

In case 63 the bad effect of capital loans on a bank was well described by an examiner in 1922:

"They have extended unwarranted credit to so great a degree that only through the success of the farmers for several seasons can they hope to bring this battered ship of distorted finance to a harbor of safety. In my opinion, the damage has not been done this year, but in the past, and they now find themselves confronted with the day of reckoning - loaded up with paper which no one can adjust without serious loss. They must, therefore, face the issue by charging out the difference between what their actual securities are worth and the face of the loan. The customers realize their position, and many are quitting with frequent cases of bankruptcy. The serious question here is whether continual nursing of their unwarranted loans will serve any purpose. They have already reached a limit where the farmer cannot pay his interest, let alone make a payment on principal."

In case 33 capital loans were made to finance land speculation outside of the community for non-resident borrowers. The serious effects of this unwise policy were described in 1922 as follows:

"The bank's paper is not of the best sort, a large part of it being trading paper growing out of land deals and smaller transactions. Many of these loans have been made to aid land speculation. The bank has been finding it difficult or impossible to effect reduction of its paper, and it will likely be some months before any material reduction can be brought about."

The seriousnees of the situation had become more evident in 1923, and the examiner wrote:

"A real menace lies in the large amount of loans that are dependent on the security of lands that are either non-productive or are subject to heavy prior liens. This has come about by a policy formerly pursued of loaning money too freely to outsiders and in furtherance of land speculations. This tendency has been corrected."

By 1925 the examiner found the bank in an alarming condition and commented as follows:

"The directors are leaving the management to the president who fails to comprehend the bank's perilous situation. The loans generally are of a poor class, many were made to aid land speculations and in place of improving are growing constantly worse as the land equities in which they are invested are being wiped out. In examiner's opinion, resources classified as doubtful are likely soon to develop entirely bad."

Loans on Inflated Farm Land. - Loans based on farm land values, made at the height of the farm real estate boom during the war by bankers who did not recognize the temporary nature of high land prices, frequently caused serious trouble. In case 25 the examiner wrote in 1921:

"It appears that practically all paper of this bank classed as doubtful and loss, grew out of land speculation, cattle feeding, and the general slump in all farm products."

By January, 1924, the hopelessly frozen character of these real estate loans, based on inflated prices, had become evident, and the examiner wrote:

"The aggregate of slow and questionable assets of this bank is unreasonably high, a large per cent of which is dependent on real estate security, and of this a considerable amount can be liquidated only from the sale of the security which is largely farm lands and for which there is practically no market. During the boom period, land in this locality, in some instances, sold as high as $500 per acre and at the present time it would not sell for one half that amount."

In August, 1924, the nature of the frozen real estate loans was further described in the following words:

"Under the management of the president, loans were made in this bank during the high tide of prosperity without regard for the financial standing of the tenant farmers, and those with heavy encumbrances on their land. As a natural result, the bank is now loaded with a large amount of slow and doubtful assets that are dependent, in a large measure, on the successful sale of real estate."

In case 21 unsound real estate loans were augmented by loans to finance the raising of pure bred live stock. In 1923 the examiner wrote:

"This section ran rampant on the subject of high-grade cattle and hogs which, coupled with high land speculation, aided and abetted by the present officers of the bank who had no conception of what the future might hold, and instead of calling in loans as they matured chose the policy of borrowing from an outside source, which is an incident thereto, loaded the bank with a most unwieldy mass of frozen assets."

Loans on Inflated City Real Estate. - City bankers made just as glaring errors in loans on urban property as country bankers made in their loans on farms during the various real estate booms. Comment has already been made on the generally slack lending policy which created a mass of undesirable loans in an oil boom town. Two other examples are given here of faulty loans on city real estate. In case 120 the president was interested in city real estate and undoubtedly his judgment was colored by his personal interests. The effects of his policies began to appear in 1921 when the examiner wrote as follows:

"Primary cause of present non-liquid condition was loaning by President to investors in local city real estate and the placing of large loans, which could not be handled by this bank, of sheep and cattlemen with city correspondents."

In 1922 the following comment was made:

"This bank is carrying an enormous amount of paper which is dependent upon the sale of real estate for liquidation, largely city property. This condition reflects the management of President who has personally invested heavily in city real estate."

By January, 1923, the situation had become worse, as indicated by the following sentence:

"Many of the bank's loans are so frozen and so dependent on sale of real estate that the bank can almost be classed as a real estate holding company."

The ultimate effect of this policy was described in 1926 as follows:

"It might be able to pay its depositors in full over a long period of time, but with the large amount of other real estate now owned, unsalable at almost any price, immovable for the past three to five years, and with but little prospects of moving any material part of it within a reasonable future period, if the present management continues to grant credit as freely and liberally as they have the past five years, the bank is inevitably headed for the rocks."

In case 9 a bank in an entirely different part of the country with a satisfactory record of growth and sound banking lost its sense of values in the Florida boom and was plunged into serious difficulties. Between July, 1925, and January, 1926, the deposits of this bank increased more than one million dollars from $1,936,000 to $2,966,000. Its loans also increased from $1,148,000 to $1,931,000. The increase in deposits and loans and the causes were described by the examiner as follows:

"Deposits since the last examination show healthy increase, but it might be proper to say that a substantial portion should be attributed to an augmented loan account. B. is supported by a rich truck farming section, also some citrus fruit growing. For a long time, the expansion and development of the little city could be justly stated to be the result of a natural growth. However, here recently, like most other places considerable real estate activities have taken place, with resultant greatly enhanced property values. The President considers himself a very conservative banker. However, in this your examiner does not fully agree. I believe he wants to be conservative and, no doubt, is more so than the other local state bankers. The examiner feels, has made criticism, also told President and Cashier that they are too liberal in credit extensions, and once a loan develops weak and slow they are not disposed to push it for collection with the proper vigor they should."

With the collapse of the Florida boom, land values declined sharply and the bank found itself possessed of a large volume of frozen loans to real estate operators, as well as a large loan to a tourist hotel, which is discussed later under real estate bonds.

A number of the banks used in the 1931 study were plunged into difficulties either by being operated by real estate promoters or by being carried away by the enthusiasm of city real estate booms in their communities. When these booms collapsed, the banks found that they had made undesirable loans based on inflated land values. Many of these loans were thoroughly frozen; some of them were converted into real estate, which, in turn, was frozen; and in a few cases, the real estate loan mistakes were directly responsible for the suspension of the bank.

The worst case of unsound real estate loans among the 1931 suspensions was bank 171. This bank was operated by real estate promoters who placed the greater part of their loanable funds in loans to real estate dealers, home purchasers, churches, hotels, building contractors, and building and loan associations. To avoid excessive loans to certain parties, this bank even followed the unethical practice of making loans to "straw men," or, in other words, loans to men of no financial worth who were merely acting as agents for other interests so that the names of these interests would not appear on the bank's books.

Bank 171 was a suburban bank converted from a State bank to a national bank in September, 1924. At the time of its first examination after conversion it was reported to be a heavy lender on real estate security. Many of these loans violated the National Bank Act. The examiner's comments follow:

> "Like all suburban communities, the real estate field is an active factor in the business life. This feature is reflected to a substantial degree in the loans to building and loan associations, mortgage loans, and loans to real estate dealers, builders, and the building trade. Two of the directors are active in this line. This class of loans is for legitimate purposes and the security is on a conservative basis. As a State bank, the management was in the habit of taking real estate mortgages as 'side collateral' or 'additional security,' without regard to the requirements of the law. The directors were instructed that mortgage loans must comply with the law, and it was put squarely up to them whether they intended to meet the requirements of the law in this respect. They disclaimed any intention to deliberately

violate the law, but at the same time, cited instances where they felt the necessity of taking such additional security in order to accommodate the business of the community."

Late in 1925 the examiner made further comments on the character of the real estate loans and criticized the concentration of loans in the real estate field. His statement follows:

". . . As will be noted from the report, a large part of the bank's loans are tied up in some manner with real estate. A number of the bank's directors are active in this line. The credit files of the bank are very complete, and there is every indication that care is used in granting lines of credit. The President was informed, however, that the loans of the bank should be more diversified, as the percentage of loans allied with real estate transactions was too large. Bank has a number of loans to building and loan associations and these were gone over with the President and he stated, as far as the officers could determine, they were doing a safe business in assisting home-buyers, and that to their knowledge, no funds were being loaned to real estate enterprises on a large scale. The President and some of the directors are interested in the ________ Corp. and the ______ Corp. These companies furnish regular statements and show progress. The loans to these companies appear safely secured. His attention was directed to the number of loans secured by stock of these companies, and as some of the loans are of long standing, he was advised that regular and material reductions should be obtained from all borrowers where loans are renewed and all demand notes should be changed to time. The bank has a number of loans secured by real estate liens. The bank's equity appears to be adequate, and the President advises that a number of these loans are only temporary. Bank also has a number of small loans secured by entered judgments, and the majority of the loans are $500.00 or under. It is possible that some of these don't conform to Section 24, Federal Reserve Act, but in case of very small borrowers who borrow for personal rather than business reasons, payments in full or reductions are more easily obtainable, as long as a judgment is on record. The officers were advised, however, that adequate information should be on file. The bank is rapidly reducing the unlawful real estate loans, and only two small ones remain, which are having attention."

In February, 1926, the examiner stated that 62½ per cent of the bank's loans were real estate loans, some of them to building and loan associations which were violating the law. The comment follows:

"Approximately 62½% of the bank's loans are tied up with real estate (secured and unsecured) $487,000 to Building and Loan Associations, which associations the President assures are carefully managed, although his attention was called to the fact that some of them had been borrowing in excess of the state limit (25% of withdrawal value of shares). The loans to real estate dealers and builders are to parties known to the directors, and where unsecured are supported by financial statements."

In October, 1926, the bank was still heavily involved in real estate loans, as shown by the following quotation:

". . . Over one-half of the bank's loans are tied up with real estate. These lines are to building and loan associations, real estate dealers, builders, and loans secured by real estate mortgages. The President again assured the associations borrowing were doing a safe building and loan business, and that the builders and real estate borrowers were all people known to the Directors and considered capable in their line."

In May, 1927, the subsidence of the real estate boom had begun to affect the real estate loans adversely, as shown by the following statement of the examiner:

"This is a neighborhood bank located in (the examiner names a suburban section of a large city). They also conduct an office over a mile away. Mr. A, the President, is an attorney, and interested in a number of concerns, many of which deal in, or finance real estate. He, therefore, thinks, to a large extent, in terms of real estate values, although it is believed he is conservative and capable, and does not let the bank take unwise risks. As at previous examinations, a large percentage of the loans are tied up with real estate. Real estate business is very quiet, and has been for some time. The statement files of the bank are very complete, which indicates a proper investigation of all lines. Most loans allied with real estate are more or less slow, and the management was urged to insist on reductions and obtain security on loans that appeared to be slow in liquidation."

In November, 1927, the bank found that its concentration in loans with real estate security was a detriment since it curtailed the amount of paper eligible for rediscount at the Federal reserve bank. In this examination the matter of taking notes from "straw men" was also mentioned.

"Approximately 60% of the loans are connected with real estate (B/L Associations, realtors, builders and loans secured by mortgages). Concentration of loans in this type of business has existed for some time. The matter was discussed with the President and Cashier, and they agreed it would be necessary to diversify its business more. This was brought to their attention when they found it necessary to rediscount, as the amount of eligible paper was comparatively small. The necessity of reducing the slow and doubtful items was brought to the attention of the management. The other real estate owned and carried in Suspense Account shows an increase. They were urged to make every effort to get these unprofitable items out of the bank. It might be added that the real estate business is, and has been very dull. ..... The matter of taking 'straw makers' on notes in connection with real estate loans was also discussed. This is an old practice with real estate borrowers. The management has promised in the future to obtain detailed information in connection with all mortgage loans (particularly those submitted by real estate dealers and builders) and 'straw' makers will be refused."

In May, 1928, the examiner's comment contains further details of the loans to "straw men." The quotation follows:

"Concentration in loans allied with real estate continues. There are a number of loans to building and loan associations, but officers state they are doing a safe business. A large percentage of loans are secured by mortgages. There are still some real estate loans in this bank on which the makers are only 'straw men.' The President is looking into them, will furnish the name of the real borrower, and they will be eliminated if found to be unlawful; as an example of this practice there are two mortgage loans to Z totaling $22,500. This man is a watchman in the bank. The officers were again advised that a detailed record of all real estate loans should be in the bank, and if 'straw men' were used, the name of the actual borrower should always be known. The amount of slow and doubtful loans and the Suspense items continue to increase in total, (exceeding the Surplus and Profits of the bank). Many of the loans are very slow and will require time to work down. The Suspense account represents real estate acquired through sales to protect old debts. There are enough real estate people associated with this bank to make a market so that the bank can dispose of these properties."

In November, 1928, the examiner commented at some length on the evil effects of concentrating in loans on real estate. Such loans were criticized as being slow and frequently leading to the acquisition of other real estate, in which case the bank incurs expenses for taxation and other items. The quotation follows:

". . . There are a number of men on the Board of Directors who are in the real estate business and the bank has always handled a number of loans dealing with real estate transactions. As a result the bank has continually been criticised for concentration in loans allied with real estate. A large amount is loaned to various building and loan associations, but the management assure they are well known to them and that they are engaged in a safe and legitimate building and loan business. There are other loans to persons engaged in the real estate business and builders. Over one million dollars of the loans are secured by mortgages or judgments, mostly the former. A number of these loans have been to builders, and while the equity is there to secure the bank, it is believed it would be a rather slow job liquidating some of them, if payment were required and demanded. The amount of slow and doubtful loans and the Other Real Estate account continue to materially increase. (Slow and Doubtful loans: Suspense a/c; Total of these two accounts classed as Slow, Doubtful and Loss is about 70% of the capital, surplus and profits of the bank). A number of the loans so listed are believed to be very slow and will require time to completely liquidate. The losses estimated will be charged off. Regarding the 'Other Real Estate Account,' this has been increased over 100% since the last examination, and represents real estate acquired through sales and which the bank has purchased to protect themselves from possible loss on old debts. Their judgment is questioned in acquiring some of the items in this list and it is believed they would have been as well, if not better off, to have taken the small initial loss, instead of acquiring a large amount of real estate, some of which is not paying any income, and then take a long time to sell it, in the meantime, having to pay taxes and other expenses. The large line is also one for consideration and action. While the M Corporation has no liability to the bank on these mortgages, nevertheless, the original parties giving the mortgages now have no responsibility and the M Corp. has taken over the properties to protect their liens, and of course have to pay interest on mortgages to the bank. It is their intention to take these mortgages out of the bank. This entire situation was discussed with the President and Cashier, and their attention directed to the large amount of slow assets the bank had and which required some action on the part of the management. The bank has been borrowing since the last examination and will continue to do so unless the real estate concentration is reduced. There are some real estate dealers in the bank who borrow constantly and by calling some of their loans and reducing the number of loans to building and loan associations, the bank should be able to go out of debt. They were also requested to see in the future that all information in connection with real estate loans including the committee report in detail shall be placed in the files so that an examiner can readily obtain the details of each loan, as many of them are very much involved, due to the practice among real estate people of using 'Straw men.'"

In May, 1929, the examiner described an unsuccessful effort by the directors to dispose of other real estate.

> ". . . Since last examination a Real Estate Committee composed of Directors has been named, but no progress has been made toward selling any properties. Exchange of properties was arranged in one case, but only time will tell whether this action was wise. The management was requested in the future to discourage exchanges and only make sales, of their real estate. The Board has a number of members in the real estate business, and the fact that they have been unable to do anything with the properties owned by the bank confirms the report that real estate in E at this time is not moving at all. In fact it is very difficult to sell any real estate in the outlying sections. There have been a number of foreclosures in the City and a number of Building and Loan Associations have had to take over their properties. This bank loans to a number of Associations and some of their statements show that they have taken over real estate. The management, however, say that they are acquainted with these Associations and feel they are capably managed and in safe condition. This is a neighborhood bank in the (examiner names suburban section of a large city). There is very little demand for commercial loans and a very large percentage of the loans are allied with real estate, including loans on mortgages. Some of their mortgage loans do not conform to law and they have been requested to collect them. There are also a number of loans secured by assigned mortgages. The management was requested to look these over as some of them should be collected."

In the same examination the examiner described the general condition of the bank in the following words:

> ". . . The Cashier was requested to see that full reports in connection with all real estate loans be compiled and put in the bank along with the mortgages. Many of the real estate transactions are so involved that it is difficult to find out just who the party is that is being accommodated. The following facts stand out at this examination: Deposits have declined; bank has been regular borrower; large amount of slow and doubtful items, including real estate owned and bond depreciation; unlawful real estate loans and concentration in loans connected with the financing of real estate."

In November, 1929, the progressive deterioration in the real estate situation and in the assets of the subject bank was described by the examiner as follows:

"This is a neighborhood bank located in (examiner names suburban section of a large city). While the bank has loans to a number of customers in that section, the larger part of their business has been to real estate developers, loans on real estate security, borrowers financing mortgages and building and loan associations. The real estate situation in E is not good and it is hard to sell any real estate and only then at a much lower figure than cost. The building and loan situation is even worse. Many properties have been taken over; stockholders have been withdrawing their funds and it is a very difficult matter to tell which are good associations and which are not. A sort of mortgage moratorium has been declared and it is my understanding that a number of trust companies and others holding mortgages have agreed not to call any that are due at this time but will carry them along if interest is paid. With this background and the fact that this bank has a large amount of real estate on hand; loans to building associations; mortgage loans and other loans allied with real estate; it is easier to appreciate the problem they have. This bank has a number of real estate men connected with the Board and they do think and always have thought in terms of real estate. The concentration has been repeatedly criticised, and it is only of late that the active management has agreed with the examiner that some plan for breaking up this concentration will have to be adopted and followed. There is a large amount of slow and doubtful assets in the bank, showing an increase over the last examination. Most of them will require time to work out. The estimated losses should be charged off and the value of the doubtful items obtained. In connection with other real estate owned, these propertiss should be re-appraised and it is believed it will be found the bank value is high. The management was advised that the excess loan must be brought within the lawful limit and they were further advised of the liability of the directors."

In May, 1930, the undesirable concentration of real estate loans was described by the examiner in the following terms:

"The real estate situation in E has been very bad and shows very little improvement. Real estate is worth what it will bring, which is considerably less than prices obtainable a few years ago and present day appraisements are at best an expert guess. This bank has over 62% of its loans tied up with real estate financing ($1,126M secured by mortgages; $410M to building and loan associations; $164M to real estate dealers and $212M to builders, churches, hotels and loans secured by judgmente and mortgage finance company stock). Regarding the mortgage loans, it is believed the bank is protected by suffi¢ient equities, but these loans are not readily collectible and in order to get them out of this bank, practically all of them will have to be refinanced elsewhere. The bank is after the building and loan associations and requiring reductions. Since last examination over $100M has been collected from the various associations borrowing. Loans to real estate dealers and builders are all more or less slow."

At the time of this examination, the bank had real estate loans of $1,912,000, out of total loans of $3,055,000.

The last examination of this bank was made in December, 1930, at which time the examiner placed the responsibility for the bank's deplorable condition squarely on the shoulders of the directors. His comment follows:

". . . At this writing, no bank or trust company can be found that is willing to attempt to liquidate the bank. The directors of this bank are responsible for its condition and many of the loans are either to themselves; concerns in which they have an interest; loans to acquaintances and financing of real estate which they have recommended."

In case 169 the judgment of the bank officials was warped by speculative optimism regarding the future of real estate values following the opening of a new bridge. The boom collapsed and left the bank with a large volume of frozen loans. In July, 1929, the examiner described this situation and expressed the view that the bank would be able to work out of its difficulties.

". . . This bank, like others in the outlying ____________ districts, is suffering from the slump that followed the real estate boom of 1925. There was then widespread optimism as to the results to come from the building of the __________ Bridge, and land development operations, and extended building held full sway. There was a somewhat general participation in these movements which were further encouraged by the program of roadbuilding and boulevarding hereabouts. With the collapse of the boom and its high prices, and the entanglement of so many individuals therein, the re-action left little market for real estate, even at normal or sub-normal prices. Foreclosures have now had their run, and, for the first time since the boom, there seems to be an awakening in real estate. Rental property is filling up instead of standing idle. As a result of the combination of ________ Company and ________, and the increased manufacturing activities which will have ________ for their center, the population of the city, itself, should increase, forthwith, about 15,000. The ________ Manufacturing Company will employ about 600 in its factory about a mile and a half from this bank. In the liquidation of its loans with various real estate features, the bank does not depend upon 'boom' prices, but rather upon a return to normal activity. There has been nothing to do, but wait until the stagnation passed. Had the bank pressed for payment, it would have been acquiring real estate, instead of simply allowing its customers to keep up their interest meanwhile. The new President has decided trading ability, and is adroit in the handling of situations, so that with a betterment which is evidently at hand along real estate lines, should be able, before long, to work out of bank, a number of loans which it has carried during the dull period."

By August, 1930, these hopes had largely vanished, as shown by the following quotation:

"Condition much the same as prevailed at last examination. A large portion of the loans are dependent upon real estate and the officers and directors, individually or through companies formed for the purpose, are speculating with the bank's funds. While some of them have made a pretense of depositing collateral, it is little more than a sham because they deposit shares of stock of the companies in whose name title is taken to the real estate. The whole trouble arises from a visionary boom in real estate values anticipated when the ________ River Bridge was built and everybody who could muster up sufficient credit bought real estate with the expectation of reselling at a handsome profit. Failure to realize their hopes left the bank with a lot of slow loans and questionable security."

In case 219 the bank was in the habit of making loans on real estate up to 100 per cent of the appraised value of the property, as shown by the examiner's comment in November, 1928.

"Policy of loaning up to one hundred per cent of appraised value of real estate subject to criticism."

In case 154 the bank made mistakes in granting loans for construction. In May, 1930, the examiner criticized "illegal loans upon real estate, principally construction loans, at greater than 50 per cent of the market value of the properties." In April, 1924, an excessive loan for the construction of a large reservoir was described as follows:

> ". . . Many estimated losses remain together with a large amount of doubtful paper in which losses will probably develop. By far, the most important matter is the _______ excess loan, whose outcome is dependent on the completion of a large reservoir construction contract for the _____ of _____. While this loan is enormously excessive and varies up and down as the advances to the contractors are made and repaid, there seems to be nothing to do but carry the loan to completion of the contract. This loan was in the bank when converted to the __________ System. No one can tell whether loss or profit will result. The bank is in the contracting business to the extent of this loan."

In May, 1925, the reservoir loan was believed to contain a large loss, as shown by the following comment:

> ". . . First: The ______ contract. No one knows how this will come out. This bank has ceased to make advances and the contract is to be financed to completion by _______. I believe that a heavy loss will be sustained. The estimate of $300,000 is wholly arbitrary."

<u>Excessive Loans to Tenants</u>. - Among the suspended banks there were many cases where bankers failed to realize that a tenant's ability to repay a loan depends almost entirely on his earning power. Loans were made based on the tenant's chattels, and when it was found that these loans could not be repaid at maturity they were renewed, frequently for larger amounts, until they became thoroughly frozen and developed into losses. A few illustrations will indicate the nature of the mistakes made. In case 86 the examiner wrote in 1921:

"Paper reflects poor judgment in the granting of credit. Loans are largely slow and non-liquid with some losses probable on insufficiently secured tenant farmer loans."

This case continued to become more aggravated during succeeding years, and in February, 1926, the examiner wrote:

"Lacks executive ability and forcefulness. Lacks officers who know how to run a bank and keep it solvent. Lacks men of vision and moral courage. The bank's assets are negligently and recklessly handled. Funds are loaned to 'honest fellows' who happen to apply, apparently without reference to security."

The next examiner wrote in July, 1926:

"Evidently unsecured credit was formerly advanced without inquiry as to borrower's financial responsibility, with the result that the bank now finds itself burdened with a mass of slow and doubtful assets."

The bank by this time had been placed in a vulnerable position, and in succeeding years crop failures occurred which caused the bank's final suspension in 1927.

In March, 1926, further complications in connection with the reservoir loan developed, as shown by the following quotation:

". . . First: The _____ contract. No one knows how this will come out. This bank has ceased to make advances and the contract is to be financed to completion by _____. It has not yet been determined whether the _______ dam has slipped during the past winter. If it has not slipped the contract will probably be completed leaving a claim of approximately $1,400,000 against the City of ________. No one knows when or how this claim will be settled and in my judgment a loss of at least $300,000 should be estimated on the unsecured portion of the debt held. In view of the prospective litigation such figures have not been set up in the report."

At various times in the later history of this bank its claim against the city on account of this reservoir was mentioned but the quotations were too indefinite to be of value in this study.

In December, 1923, a further misuse of loanable funds by this bank in credit extensions for the construction of apartment houses was described in the following terms:

> ". . . The '_____ ___ Line' so called is an outgrowth of unwise financing of construction mortgage loans for _____ and his interests. In addition to direct loans to ________ and his company, the ________ Company other loans were made collateraled by mortgages understood to have been legal for a national bank. Proceeds were used to finance the construction of apartment houses and loans were to be temporary only, until savings bank mortgages could be obtained. ________ was the operator who arranged the financing. Difficulty has been encountered in placing mortgages and this bank has been forced to continue its advances in order that properties might be completed and placed in a position where sales may be possible, or mortgages placed so that such advances may be liquidated. Loans clearly above the value limit for real estate loans have resulted and in addition, in my opinion, loans in excess of the legal limit to one borrower have also been made. Total advances on these mortgage loans have been very large, but participations out have reduced the totals to figures which would be legal if such participations are bona fide. In some instances, the money advanced for participations has come from outside this bank and there is no criticism on the basis of excessive loans. In two instances, however, loans have been made by the bank for the purpose of allowing the borrowers to participate in the real estate loans and in exactly the same amount as their borrowings and on the same date. This was done to avoid having excessive loans to the mortgage loan signers and the participants are considered to be accommodation signers only. As shown in the schedule of excessive loans, I do not consider that the illegal feature has been avoided. President ______ disagress with this classification and argues that the loans are entirely within the law in this report."

In case 105 the examiner gave the bank some good advice which, if followed, might have forestalled later troubles. In 1923 he advised:

"A discontinuance of the policy of lending money in material amounts to tenant farmers and others financially irresponsible, on the probability that they will make a cotton crop or in some other manner produce a basis of credit by the maturity of the paper."

Case 118 was a bank located in the rice growing section, which was not sufficiently conservative in its loans to tenants growing rice. The examiner described the lending policy of this bank in February, 1921, as follows:

"Serious condition of bank is result of incompetent management and excessive rains and floods coming just at the time when rice crop was ready to harvest, ruining a large part of the crop, and preventing threshing. This happened last November and the rice has been in the fields until this writing, threshing having just commenced. Former management made loans in large amounts to tenant farmers, depending, in most cases, on rice for payment. This has been a profitable crop for past three years, and last season the growers thought they would make a tremendous profit, and put in all the land they could get under lease, borrowing all the bank would let them have to do so. Rice is expensive to put in, and bank loaned to limit on nothing but prospects."

In case 104 the examiner in 1928 looked backward over the history of the bank and commented on the errors in loans to tenants and their effects. His description of the failure to use sound judgment in tenant loans was as follows:

"It was found that a large number of lines under $500 were apparently worthless. Many were begun in 1922 and 1923 with an original loan of, say, $25 to a tenant farmer on an unsecured basis, and being unpaid was increased by interest and a new loan granted from time to time. In this way, paper has accumulated which is certainly worthless under the management of the officers who have directed the affairs of the bank, and presumably will not be collected by the receiver."

## Placed Paper, Non-resident Loans, Loans to Accommodate Other Banks, and Split Loans

The types of loans enumerated in the title of this section are all somewhat similar and shade into each other in such a way that separate treatment of each class is difficult. There is nothing specifically wrong with any of the types of loans mentioned above when they are handled properly and the same principles are followed as in making other good loans. The banking troubles centering around these classes of loans arise from the making of such loans either without sufficient credit information or to further the selfish purposes of the bank management. Errors in these loans were frequent. Among the 225 failed banks used in this study, errors from placed paper were mentioned in 27 cases, loans to accommodate other banks were criticized in 22 cases, split loans between banks were criticized in 15 cases, and non-resident loans were criticized in 10 cases.

Placed Paper. - Placed paper consists of bills receivable of one bank which are purchased by another bank. In its best form placed paper consists of high-grade notes which one bank sells to another bank as a liquid investment for the second bank. As will be seen from the following illustrations, this purpose in placed paper is frequently distorted into the sale of undesirable notes from one bank to affiliated banks to evade the criticism of examiners. (In some parts of the country the bank selling its paper to another bank classes such paper as "sold out" paper.)

Case 44 is an excellent illustration of a bank, well run as to its local business, but mulcted by the management of the chain of banks to which it belonged through the sale to this bank of undesirable notes. A letter accompanying this case history and written by the Federal reserve agent of its district outlines the development of this case very clearly, as follows:

"In my opinion, Bank 44 is one case in which a bank with good management failed. It is my understanding that all the losses occurred in loans placed in the bank by A. Company. These loans were accepted by the active management because of the implicit confidence which the management had in the integrity, ability, and financial strength of A. The X. Company of Y was the central bank of the A. Company's chain of banks. The Y bank and A. Company placed enough paper in Bank 44 to render it insolvent. I am advised that the loans and other assets that were taken on the judgment of the local management were of an unusually liquid type. The question naturally arises 'Can the management of a bank be good that would permit such a large volume of loans to be acquired from one source without making an independent investigation?' The files of the office of the Comptroller of the Currency will show copies of the letters from the Comptroller's office to the bank in which the Comptroller instructed reduction of the A. Company line, and in which he finally advised the directors that they would be personally responsible for loss if the line was not reduced to a reasonable amount. In making loans to other than A. Company, the bank made close credit investigations and used its independent judgment in accepting the loans. The management was bad to the extent that it failed to use these same safeguards in loans made to or through A. Company and the X. Company of Y."

Case 71 is another illustration of a bank which was a member of a chain banking system and where the owners of the chain placed undesirable notes of one bank in another bank, at times approaching criminal violation of law in so doing. In this bank the purchase of notes from other banks in the chain was habitually practiced from the beginning of the case history in 1920. In the first examination of the history the examiner wrote:

"LARGE LINES: Some improvement in large lines, as a guarantee has been obtained from the ____ Farm Mortgage Company, and credit statements are on file supporting paper taken from the ____ Bank of ____, ____. The lines are still carried in too large amounts and in poor shape."

This paper was known to be undesirable but it remained in the bank, and in December, 1921, the examiner made the following comment:

"The bank allowed a large amount of paper to be taken in from closely affiliated banks, and now is having great difficulty in removing any of it. Therein lies the worst feature of the bank's present condition."

At the close of 1923 paper of this type was still being held. The examiner did not specifically criticize this paper as slow, doubtful or loss but merely questioned the advisability of carrying paper of this sort as a secondary reserve. His comments follow:

> "LARGE LINES: The bank line listed and discussed at some length has been criticised as it is practically all paper taken from other banks which directors of this bank are interested in. Presumably, the paper is at least fair, but statements do not accompany all unsecured loans, and the security on the collateralled loans is frequently held by the sending bank so that an accurate check is impossible. Your examiner questions the advisability of taking such a large proportion of this paper which emanates from the surrounding territory and is no more liquid than its own paper. As long as the bank has surplus funds, it should be carrying a fair proportion of liquid assets in the form of prime commercial paper, Treasury Certificates or Liberty Bonds, and the management was so advised."

Examiners continued to criticize this misuse of the practice of buying placed paper during subsequent years, but they began to experience difficulties in identifying such paper because the managers of the chain apparently disguised such notes by having them made out on the note form of the purchasing bank. In 1928 the examiner wrote:

> "There is believed to exist in many of the banks operated by the Y and Z system exchanged notes of various banks and, while there may be some existing here, they cannot be identified, as the loans carried are all on this bank's form of note."

By the summer of 1929 the condition of this bank had become very precarious with estimated losses larger than the combined capital and surplus of the bank, and large amounts of slow and doubtful assets. At that time the examiner wrote:

> "PLACED PAPER: Other banks of this chain are carrying paper of very inferior quality for this bank, which reciprocates by carrying the same class of paper for them. This highly objectionable and unsound practice, together with the preceding criticism (loans to relatives), is primarily the cause of the deplorable condition of this bank."

Finally, a short while before the bank closed, the examiner summarized the wrecking of this profitable bank by the bank management in the following words:

> "Exploitation by officers and directors for their own interests and that of their relatives and affiliated interests is the chief reason for the deplorable condition of this bank. This bank, organized under a state charter with a $10,000.00 capital, has increased its capital to $25,000.00 and surplus to $25,000.00 from earnings; has paid its shareholders $60,500.00 in cash dividends; has capitalized the ____ Investment Company, a shareholders' concern, with a $45,000.00 capital, and, in addition to that wonderful record, it has charged out over $95,000.00 of losses that have been placed in this bank by the dominant interests of their affiliated concerns and their own borrowings, and $20,000.00 of losses on this type of paper still remain in the bank. This record borders on the criminal, and yet Mr. Y. feels no sense of guilt, but is trying desperately to saddle this hopelessly insolvent bank on to local farmers by reselling his stock to them through Cashier X."

Examples also occurred among the cases studied showing the dangers of placing paper from the standpoint of the bank selling the notes. In case 65 some of these pitfalls were described in 1921 as follows:

> "In addition, Mr. Z., president, secured by mortgage $20,000.00 of placed paper, held by the ______ Cattle Loan Company and the ______ Bank of _________, without recourse on the bank. This paper was causing serious embarrassment, the holders threatening immediate action if the same was not fully protected. ..... The bank has outstanding still, in addition to the paper held by the _______ Bank of ________, above mentioned, about $60,000.00 of other placed paper. Approximately $50,000.00 of this paper is held by the X banks in ________, and Mr. X., father of the cashier, assured me that he would see that this paper was taken care of in such a way as not to embarrass the bank."

A second example of the hazards of placed paper, or "sold out" paper, as it is called in this instance, was found in case 90. In 1923 the examiner wrote:

> "This is an exchange of paper between the subject bank and its correspondent bank at ____. At the time of this examination, its correspondent bank is carrying approximately

$67,300 of the so-called 'sold out' paper, and this bank, in turn, is carrying approximately $43,000 of paper for its correspondent bank. Should the correspondent bank undertake to hold this bank liable on the ____ ranch company line (amount $33,000 'sold out' and $2,500 carried in subject bank) the line may present a serious problem to this bank, as the line is not fully covered by security."

The following footnote inserted by the Federal reserve bank described later developments in the "sold out" paper of this bank.

"Later correspondence on file in the office of the Chief National Bank Examiner disclosed the fact that the bank carrying the 'sold out' paper charged matured notes in the amount of $28,000 and did not credit renewals, and returned one draft of the subject bank, claiming that the subject bank's account was overdrawn, which, of course, caused the subject bank considerable embarrassment. One of the contributing, if not the principal, factors resulting in the suspension of the subject bank was its 'sold out' paper."

Non-resident Loans. - In some localities the demand for loans was apparently insufficient to use the lending capacity of banks up to the desired amount, and these banks went outside of their community to secure loans. Where these loans were made without proper regard for conservative loan limits or on the recommendation of brokers interested only in selling the loan, difficulties arose. In case 32 this type of loan was criticized by the examiner in 1922, as follows:

"The officers are capable men but were too optimistic through the period of inflation and the bank is loaded with paper of a very slow nature. Some improvement in the way of reducing and securing has been made, but the general condition of loans is unsatisfactory, and there is much work to do which, if neglected, will result in heavy losses. Apparently, they sought outside paper of a capital and promotion nature. One reason for the bank having to borrow is the large amount of non-resident and non-customer paper on hand. This paper is menacing to an extent, and will apparently be slow in liquidating."

Loans to Accommodate Other Banks. - In this class of loan also it is only the abuse of such loans that is held up for criticism. It is sound banking practice for correspondent banks to make loans with adequate security to other banks having relations with them, but it is quite another thing for one bank to make loans to an affiliated bank to prevent it from closing, and without adequate security. It is this class of loan with which the following illustrations are concerned. In case 29 the growth of the practice of supporting a weak affiliated bank by accommodation loans was described as follows:

> "The president for the past several years had devoted the larger part of his time to the affairs of the bank, and has gradually increased deposits. However, together with this increase in business of the bank he has also increased his outside holdings to where his operations have become extensive and his indebtedness heavy. It is believed that a large amount of the paper listed as slow in this report found its way into the bank through these operations. Particular attention is called to approximately $100,000 in loans taken for the accommodation of a neighboring bank in which the president of this bank is interested and which bank is believed to be in financial difficulties. This bank has been instructed that accommodation loans of this character should be curtailed materially and that in examiner's opinion this particular item of criticism should be watched carefully and followed up."

A year later this practice was described as follows:

> "The president is borrowing heavily through his affiliated concerns and a large part of the slow paper undoubtedly came through the neighboring state bank in which he is heavily interested. The president is making efforts to reduce this indebtedness."

In 1927 the examiner stated that the directors of the bank were fully aware of the president's practice in this matter:

> "For the past several examinations, criticism has been directed toward the line of credit, direct and indirect, extended to a state bank in a neighboring town in which the president is heavily interested. This state bank is known to be in a very bad condition and it is the president's intention to work out this bad condition by placing a large amount of that bank's paper in this bank. The directors of this bank are fully aware of the reason that this accommodation line is being

> extended. It is the opinion of the examiner that it would be the best policy for the bank to build up a good secondary reserve in bonds, instead of taking a chance on a proposition of this kind."

Another similar case was 67. In 1921 this bank even violated the law to extend assistance to two affiliated banks. The examiner apparently opposed this practice for he made the following statement:

> "EXCESSIVE LOANS: As shown on Page 5, unusual methods have been resorted to in order to loan bank's funds to two State institutions controlled by Directors. Apparently, both banks have been in seriously extended condition since the early part of January of this year, and probably longer. Judging by information obtained from Directors, your Examiner is convinced that it was clearly understood that the law was being violated, Directors' defense being that it was merely a matter of keeping the banks from closing."

The next examiner visiting the bank later in 1921 condoned this practice in the following statement:

> "EXCESS LOANS: To affiliated banks for purpose of temporary accommodation to forestall possible closing. On account of closing of several state banks in this vicinity, these banks were in an extended condition and help was necessary to keep them going. If they had closed, the effect on other banks in county would perhaps have worked a great hardship. Therefore, accommodations appear warranted, but should be reduced at once."

Whatever the merits of supporting the weak affiliated institutions, it appears that it was dangerous to allow these weak banks to loan on the stronger institutions. This matter was discussed by the next examiner in 1922 as follows:

> "As shown by this report, the bank is in an exceedingly unsatisfactory condition, the cause of which is in a great measure due to the financing of banks and other interests controlled by the X-Y combination, who control and dominate this bank. EXCESS LOANS: The excess loans to banks were brought about by advancing money to their banks that were struggling under financial difficulties, and it was claimed that this procedure was taken to avoid their closing. The funds were advanced with the understanding that it was to

be only temporarily, but it has now become more or less permanent with no immediate prospects for reduction to the legal limit. It is claimed that these banks have loans with the War Finance Corporation which have been approved and as soon as the returns are received these loans will be reduced, but not sufficient funds will be available for a reduction to within the limitations of Sec. 5200. X and Y hold the control of the State Banks that are excessive borrowers, and it is shown beyond a doubt that they have abused their control by accepting the loans, which, in your examiner's opinion, have greatly endangered this bank. It would appear from their financial statements that they are men with sufficient financial responsibility to finance their enterprises from other sources than this bank."

Split Loans. - Two or more country banks sometimes split a loan to a borrower, and split loans frequently mean loans beyond sound limits. In case 98 the examiner wrote in 1922:

"The former management took on entirely too many large cattlemen and floated the loans in Y and Z, and left this bank, in some cases, with the unsecured end."

In 1923 the examiner described this split loan policy as follows:

"Wherever a bank has maintained a policy of lending their limit loan to a borrower and then lending him as much as he wanted through a loan company attached to the bank, or lending him money for some eastern bank, the lending bank has always had a difficult proposition and probable losses to face. That is the situation here."

In case 89 the bank management apparently made split loans with other banks as an outlet for unused lending power. The character and purposes of the split loans were described as follows in 1922:

"The President dictates the policies of the bank and, as heretofore stated, is interested in two other country banks and is apparently using the funds of this bank to further his interests in the other two institutions. The loans the subject bank is carrying for the two banks are not first class, since it is evident that frequently the borrowers also owe one, and, in some instances, both of the other banks the legal loan limit; those banks, in many instances, holding the first mortgages on such borrowers' property and this bank having no security at all, or security that is very unsatisfactory. The unsecured lines of credit under discussion are based on property statements, the net worth of which, it would seem, is represented by highly inflated real estate values placed on the holdings of the borrowers. Then, too, in the instances where this bank holds second mortgages as security the equity could only be protected by advances which would be prohibitive. The officers' and directors' attention was called to the fact that in many instances heavy lines of credit had been extended to families, the credit extended being so heavy that it required the legal loan limit of the two affiliated banks and the subject bank to carry the borrower at a time when the subject bank was overextended and compelled to rediscount in order to carry such borrowers."

## Loans to Officers for Speculation in Securities

At several banks the examiner criticized the practice of making large loans to the officers and directors of the bank to permit them to speculate in securities. In case 154 the bank management was criticized very severely for this practice. The examiner's comment in 1930 regarding the poor quality of the management and their unsound practices follows:

> "With respect to the safety of the management, it is evident that a radical change in policy at least is required. I believe the violations of law in most instances to be willful and persistent, and the danger in the heavy loans in this and affiliated banks to the managing officers and certain of the directors for stock speculation, and the use of accommodation notes are obvious. The moral effect alone on the entire personnel is bad. As before stated, the management's position with respect to the excessive loans appears to be that the law has been successfully evaded. Director ____ is generally reputed to be a plunger, and while he does not in my judgment dominate, I believe his influence is bad. If these unlawful and unsound practices continue, the results to this bank and the other banks in the group may be grave, indeed. President ____ and Director ____ have shown a disposition so far to support these banks with their personal resources, but there is, of course, a limit to their ability in this respect, and I believe they are now greatly extended. The other directors, with the possible exception of Directors ____ and ____ are men of limited means."

A particular phase of the overextension of credit to the management of bank 154 was its practice of making loans to "straw men." "Straw men" are persons of no financial responsibility who are allowed to sign notes and borrow funds from the bank, the proceeds of such loans going to bank officers or directors, or other favored interests. The reason for this indirect method of extending credit is either to allow the individual to receive more credit than he is legally or financially entitled to, or to make it unnecessary for his name to appear on the bank's record as a borrower. A description of this practice is given in the following comment written in 1930:

> "The use of accommodation notes or straw names for the purpose of dealing in stocks still continues. A loan of $189,250. went through the books March 29, 1930 in the name of ____ (brother of President ____ employed in the real estate loan department of the bank) secured by 2500 shares of Paramount. This loan was reduced by sundry payments in April, and the balance paid May 2nd. A similar loan of $221,915. in the name of ____ (a bank employee) went through the books also on March 29th, secured by 500 Col. Gas, 500 Con. Gas, 500 Nat'l Pr. & Lt., 1600 Amarada, and 500 Paramount. The balance of this loan was paid May 3rd. There was held in cash as a credit at the date of the examination $137,546.50 arising from the sale of Westinghouse stock on sundry loans shown in detail on Page 11. This cash was not credited to the loans, but was held, no doubt, for the purpose of buying other stocks when the opportunity was considered favorable. The ____ note shown in the slow and doubtful schedules is an instance of stock speculation in an endeavor to recover a loss. ____ has been bankrupt for months. His note is still carried in the assets, and there are frequent changes in the collateral securing the loan."

In bank 156 the examiner's comment in 1930 shows that this bank also was following the practice of lending money to "straw men" for undesirable purposes. The quotation follows:

> "The excessive loan and large line to ____ Bros. (Director ____) is particularly subject to criticism. There is no financial statement on file. ____ is in the leather business, real estate, theatres, controls the ____ Trust Co. and is interested in various other enterprises. He is a plunger and is known to be a heavy borrower. How much he is worth cannot be

ascertained. Directors were advised that the excessive loan to ____ Bros., should be reduced to the legal limit immediately and that the straw notes and accommodation loans should be eliminated from the bank at once. They were further advised that credit information regarding ____ should be obtained or the line placed on a secured basis or liquidated."

## Criticized Demand Loans

Bank 172 was in the habit of carrying demand loans as a large part of its earning assets. These demand loans were collateralled by stocks and bonds but were ineligible for rediscount at the Federal reserve bank and in spite of their demand classification, they proved difficult to collect. As early as 1923 this practice was criticized by the examiner as follows:

"It was suggested that large amount of demand paper could be changed to time notes. At present time, bank has very little paper eligible for rediscount."

Two years later the same practice continued as shown by the following quotation:

"The bank continues to carry a large proportion of demand paper, 61% of total loans being in this form. The apparently large amount of past due paper is caused by the failure to collect interest on demand loans, which are billed quarterly."

In 1928 it began to be apparent that the demand loans were frozen, as shown by the following comment:

"The general character of the loans is slow and of capital nature. Past due paper is excessive both as to amount and number. The greater proportion of bank's loans are demand, a number of which have been carried without reduction over an extended period. It was recommended that a plan of amortization be arranged for these loans in order to prevent their developing into frozen assets. There is no doubt but that this bank has an unusually large amount of slow paper and action should be taken to curtail accumulating any additional."

In the spring of 1929 a further description of these demand loans was given, as follows:

"Loans consist mostly of advances to local merchants, real estate dealers and oil and gas operators. In many instances the borrowers worth is chiefly in real estate, and the loans are of a capital nature, having been carried a long time with little or no reductions. Credit information is wholly inadequate, and several important loans were not supported by financial statements. Attention is directed to the large amount of demand loans carried, 78% of the total loans being in this form."

At the last examination of the bank made in April, 1931, the examiner's comments showed that the demand loans were still in the bank's assets, although other circumstances were directly responsible for the closing of the bank.

"The institution is in an extremely non-liquid condition. A large portion of the unsecured loans are based upon real estate equities, and the collateral loans include a number of purely speculative loans to individuals with little financial responsibility. Many of the latter loans are under-collateraled at present market prices. Due to a combination of circumstances, which included sudden death of a director, a defalcation, and friction among the board members, the bank experienced a slow run, and during the period from March 1, to date of closing the examination, deposit liabilities declined $490,000.00 in spite of efforts of the management to regain the confidence of its customers. Immediately after closing the examination, efforts were made to sell the assets to two other local banks. Having been unsuccessful in closing a deal, the bank was closed on May 4 by the State Banking Department, and a temporary receiver was appointed."

## Loans Collateralled by Bank's Own Stock or Stock of Affiliates

Several cases were found where banks either had made illegal loans secured by their own stock, or had made loans to individuals and others to assist in the purchase of the stock of affiliated banks or companies. These practices were subjected to severe criticism.

In case 155 loans were made to borrowers who purchased stock of the bank at the same time. Although there is no evidence in the examiner's comments that the stock was actually pledged to secure the loans, the practice was criticized in 1930 as follows:

> ". . . In further reference to loans originally made to borrowers who purchased stock of the bank at the same time, it should be stated that at the present time the total loan to these borrowers is $550,324.65 which is $76,027.21 greater than on May 31, 1930, and $29,687.65 greater than when originally reported in February, 1930. These loans were apparently all introduced by one ____. Checkings with reputable ____ credit men regarding this man are not favorable, although no actual dishonesty charges were made. He has been instrumental in introducing other borrowers since the preceding examination and some of their loans are criticized herein. Many of these have come from the Tr. Co. recently consolidated with the ____ Bank."

In case 166 the bank had been endeavoring to sell 600 shares of its stock to responsible outside parties who were believed to be able to bring enough business to the bank to place it on a satisfactory earning basis. Apparently this deal was not completed, and in 1930 it was found that the bank had sold some of its stock to a penniless corporation which borrowed the money from the bank with which to make the purchase and pledged the bank's stock as collateral. The transaction was described as follows:

> ". . . The bank has a loan to ____ Inc., secured by 139 shares of this bank's stock. This corporation has no paid in capital and this stock is the only asset. This loan should never have been granted, and taking the bank's stock as collateral was known to all of them to be unlawful."

In case 219 the bank was criticized in 1925 and again in 1928 and 1930 for having loans collateralled by stocks of affiliated banks. In 1928 loans of this nature were made with 670 shares of stock of affiliated banks as collateral, and by the spring of 1930 the number of shares of affiliated bank stock held as collateral had been increased to 2,185. In 1931 the parent bank located in the downtown section of the city was taken over by another bank, but as no provision was made for the absorption of affiliated banks, the subject bank suspended business. There is no record of what happened to the loans secured by stocks of affiliated banks.

In case 154 the bank at two different times used its own funds to support the price of its stock. In May, 1930, this practice was described as follows:

> ". . . The settlement sheets in the bond department show numerous transactions in the bank's own stock. Most of these items are cleared the same day. It is admitted by President that support has been given to the market for the bank's stock, but he denied that there has been any speculation by officers or directors in the stock. He claims that there has been a considerable bona fide distribution of stock, which is still going on, that none of those on the inside have disposed of any of their personal holdings or profited by stock dealings."

This same bank, case 154, purchased the bonds of an affiliated corporation to provide funds for that corporation to buy a group of banks. This practice was described in May, 1930, as follows:

> ". . . The illegality of the bank's investment in the securities of the ____ Trust has been repeatedly criticized by the Examiners and by your office. There has been some reduction in the amount of bonds originally purchased, but on account of lack of marketability, the bonds have moved slowly, and no definite plan or promise for their elimination from the bank's assets has been submitted. The funds supplied to the Trust by the bank's purchase of the bonds have been used for the most part in purchasing the controlling interest in the group of banks above named. These banks were taken over before the market crash last fall, and at prices above book values and including large allowances for good will. The price paid for the ____ Bank stock was especially high, and the condition of the bank requires a further investment or contribution for its support. A detailed statement of the Trust, as submitted by the management, is shown in the bond and stocks account. The item shown on this statement, 'Demand Loans Secured $127,868.75' is a note signed by President ____ and Director ____, secured by stocks and bonds valued at about $150,000. President ____ stated that the ____ Bank stock shown in this statement was taken out by him personally May 28th, in accordance with previous agreement. He further stated that the stock was acquired by and came into the Trust in connection with the purchase of the ____ Trust Co. An exchange of ____ National stock for ____ Trust stock was offered to the shareholders of the latter, and the ____ Trust was caught with this stock which was not accepted by ____ shareholders when market values declined last November."

This practice was again mentioned in March, 1931, in the following words:

> ". . . The bank's large investment in the ____ Trust debentures has long been criticized as illegal and has been very undesirable also, representing as it does, inter-bank financing of a nature which might prove disastrous in times of depression such as now exist."

## Profits Over Safety, Loans to Capture Business, and Loans as Service to Community

These three general practices were not frequently mentioned by the examiners, but where they occurred they usually led to difficulties.

Profits Over Safety. - The most important of the three practices was the emphasis on profits over safety. In case 67 the examiner wrote in 1921:

> "The present condition of this bank appears attributable mainly to partial crop failures and general market declines, and to a considerable extent to unwise business judgment on the part of officers and directors thru a too generous policy of extending credit generally, apparently always considering profits and increasing of the business, rather than keeping prepared for emergencies."

This bank suffered at the same time from the difficulties of declining commodity prices and from unwise loans to the owners of the bank.

In case 97 the emphasis on high earnings caused troubles beginning in 1926. In this case the examiner wrote in 1926:

> "Management appears capable but in their zeal to show a high earning power have over-stepped the bounds of conservatism in some instances and accumulated a rather large proportion of criticized assets."

At the following examination the examiner wrote:

> "The cautiousness that should have been employed has been lacking to a certain extent in the desire to get new business. The bank has not been able to command as select a class of business as its volume entitles it to."

This bank was also ambitious to build its balance sheet up to large totals with the following results, as described by the examiner in 1929:

> "Good, liquid bank credits in this town are limited in volume, and it is most difficult to operate properly at this point. This difficulty is accentuated in the subject bank by the desire which appears to animate Vice President B. to have a big bank. The business of the subject bank is 'forced,' meaning by that that the deposits do not represent accumulated savings of the community or reserves carried by depositors against contingencies or against current requirements. An unusually large percentage of their deposits are 'float.' Mr. B. should know that one cannot skate continually on thin ice with safety. He should know that he cannot do a 'big business on the basis that his bank now has.'"

In some instances a desire to make money was supplemented by an easy-going, amiable disposition on the part of lending officers, which promptly led to difficulties. This is well illustrated in case 6, where the examiner wrote in 1921:

> "The management of this bank is left entirely with the Cashier, Mr. A. He is apparently an easy going sort of fellow, anxious to make money, and in his eagerness to make money it appears that he loses sight of the principal to a great extent and can see only the interest or discount received."

In this case the liberal lending policy was in evidence at the earliest date given in the case history, which was June, 1920. At this time the bank had deposits of $356,000, loans of $479,000, and was borrowing $87,000. During the period from June, 1920, to April, 1921, this bank's loans continued at approximately the same level but its deposits were reduced more than one-fourth, and its borrowings increased 50 per cent, illustrating the frozen character of its credit extension.

In one instance the cashier of the bank resorted to forgeries to cover up losses sustained through unwarranted credit risks. The cause of the bank's difficulties was described by the examiner in 1922 as follows:

> "The Cashier is resourceful but inclined to take too many risks, or rather they could hardly be called a risk, more an attempt to finance too great a volume of business on his limited resources. He explained that the extended condition at this time is due to a change in county administration and the treasurer seeking other bank depositories. The records reveal this bank was greatly extended last season."

Later examinations describe the gradual recognition of the undesirable character of many loans in the bank. The directors were not active in correcting the situation and finally it was discovered that the cashier had substituted forged notes for items which had been classified as losses.

Loans to Capture Business. - Closely allied to the emphasis on profits over safety was the attempt to capture business by making loans as a matter of policy. In case 64 the examiner wrote in 1921:

> "Former Vice President W. used as poor judgment in making loans as it has been my privilege to observe, and Mr. X. who came into the bank a year ago, while a good collector and having a thorough knowledge of the bank's customers has not had suitable training for an active manager; in addition to which he has only mediocre assistance . . . . . Generally, the bank is enjoying more confidence than heretofore. Like others here, it has suffered from an over-anxiety for business, little attention being given to class or quality, but this is past history."

Case 112 was another instance of a bank very eager for business and having an incompetent lending officer. In 1922 the examiner wrote:

> "Management has been too eager for business, with result that many loans are frozen and heavy losses are likely to be sustained."

The next examiner wrote in 1923:

> "Past and present management are anxious for business. Many loans made as a matter of policy."

Later in 1923 the same examiner wrote:

"Former President A. deceased. President D. is following closely in footsteps of predecessors and conducting largely a one-man bank so far as he can handle matters. He appears very easy in extending credit or making too many loans as a matter of policy, and also very reluctant and timid in enforcing collection on criticised lines, apparently being afraid he might lose a customer directly or indirectly."

This bank was victimized by its borrowing customers, as indicated by the examiner's comments in 1927:

"He (the president) is one of the most pleasing men I have had the pleasure to come in contact with, but is inclined to let people impose on him, and some of his financing is subject to criticism. He tries to help people and concerns who do not even do business with the bank, and anyone can take up his time whenever they desire."

Later in 1927 a more drastic description of the weakness of the lending policy was made as follows:

"President D. continues to dominate and apparently directors cannot control him. Bank is overloaned, and President D. continues to make loans that will prove very slow and also continues to try and finance everyone in the community. Regardless of advice he receives from examiners and experienced bankers, he does not change his policies. I am afraid that if he does not change his ways he will find bank in a serious condition one of these days."

Service to Community. - Bank 69 was a case where loans were made on the theory that the community was entitled to credit, rather than on the basis of the financial standing and responsibility of the borrower. The difficulties arising out of that policy were set forth by the examiner in 1921, as follows:

"The directors of the institution are all farmers, each being actively engaged in farming operations. They have gone upon the idea that the farmers in their vicinity are entitled to the credit which they have received, rather than upon the strict business standpoint as against their financial standing. In fact, I feel that the directors have been very lax in their efforts to ascertain the true standing of the note makers of their institution. I do not believe that they fully realize their duties and responsibilities of the position which they hold."

Miscellaneous Lending Errors

In the case histories of suspended banks a number of errors in loans were described which cannot be classified. Several of these are illustrated by quotations below, but it should not be considered that the errors found in the case histories complete the catalog of bad lending practices. In spite of the wide geographical distribution of the case histories, it should not be assumed that they typify every weak lending practice in all classes of communities and under all conditions.

Loans to a Get-Rich-Quick Promoter. - The following quotation from case 10 illustrates the difficulties into which a bank was projected when it came under the influence of a certain type of promoter. The examiner describes the promoter as a man of striking personality, fluent speech, and empty promises. The following is a quotation from the examiner's comments in 1926:

"The date of this examination was advanced in order to determine more definitely the connection with the bank of one Blank of X, and, as far as possible, clean the bank of any paper bearing the taint of his wildcat operations. Some $6,000 of such paper was disclosed in my last report of examination, at which time I had only a slight suspicion of the character and credit standing of this party. For full information regarding this subject 'see file furnished by Chief Examiner.' The J. line listed in schedule of excessive loans has the taint and earmarks of a Blank promotion. President K misrepresented this line to me in my last examination, and at that time I had no occasion to question the information he gave me. This examination disclosed that the total line of the J's aggregated more than $60,000, $45,000 of this amount was made up of purported acceptances of lumber drafts represented to be legitimate sales. Upon discovery of the misrepresentation, I demanded payment of the entire line. This was partly accomplished by removal of lumber drafts and requiring President K. to furnish additional security for the remainder of line, $15,000. To raise this amount of money, Mr. K. called on the Y Bank of X, one of Blank's banks for assistance. They sent Mr. L, its Vice President, to work out plans of refinancing for him. A company was formed made up of local people and directors of the bank who made a note for $45,000, taking as security such lumber as the drafts represented and a blanket mortgage from the J's on all of their unpledged holdings. This note is to be handled by the X Bank for the new company without recourse on this bank. This will retire a like amount of borrowed money now being carried for the bank by X. I learned during the course of this examination that Blank was instrumental in K. acquiring control here. Last October K. bought out the C. interests, consisting of 151 shares, for which he paid $145.00 per share. Blank made the loan through the X Bank which now holds the stock as collateral; in addition, K. holds 19 shares clear. Not believing this a safe combination, I had K. execute an option and proxy to Director M. for the 151 shares of stock now held by the X Bank. This agreement or proxy is for a period of twelve months. I believe that this action will curb all future operations of Blank with this bank. I was unable to remove from the bank at this examination the N. and O. note of $1,500; the P. Company note of $3,000 and the note of Blank and P $1,000 all of which were taken into the bank upon the recommendation of Blank. If collectible, I believe that the Directors will see that they are paid at maturity. Q, a brother-in-law of K, and formerly connected with this bank as assistant cashier, bought out the Z Bank here in recent months using the same plans of high financing as was used by K. I am of the opinion that his bank is carrying same dangerous lines that are found here. Blank came here some time in last October; he is reported to be a man of striking personality, and to have a strong line of hot air. It seems that he promised the people many things, among these being a hotel to cost not less than $150,000, he to supply $100,000 if they would raise $50,000. He pointed out to them the many natural resources which were there for the taking, etc., etc. As a result, he got the little community of 500 or 600 people very much worked up and excited, with the result that they began trading in real estate among themselves believing in values which had nothing to back them up. This condition has generally inflated credits; the bank has taken on its share and the result is I find it badly extended."

<u>Loans Secured by Life Insurance</u>. - In case 1 the bank management followed the practice of lending freely, and then securing weak lines by life insurance policies. While this practice cannot be said to have closed the bank, since the primary reason for its failure was a large defalcation by the cashier, it was a very expensive practice for the bank. Loans with

life insurance security were first mentioned by the examiner in 1921 when he wrote:

> "The Cashier says he 'feels so safe' if he can secure loans with life insurance; that life insurance is a 'hobby' with him. The only way, apparently, to collect a good many of these loans is to kill off the borrowers."

The drain on the bank's earnings, as a result of these loans, became very apparent in 1923 when the examiner described the situation as follows:

> "While still loaded with many frozen loans, it appears that everything possible is being done to prevent a loss and these loans will be worked out as rapidly as possible. Many of these loans are secured by life insurance policies costing them approximately 3M per annum which of course materially cuts down their earnings."

In 1924 further deterioration in this class of loan was indicated and the examiner wrote:

> "Their condition is far from being satisfactory - their trouble appears to be the result of relying too greatly upon moral worth and extending credit without security beyond the limit and ability of maker to pay - when determined as doubtful bank officers attempt to secure by taking out life insurance, carrying the premiums in most cases, the conclusion of which produces a dangerous, slow workout condition, but which is beyond the ability of the Directors to solve immediately."

By the beginning of 1925 it appeared that many of these loans secured by life insurance policies were in reality losses, but the examiner merely classified them as doubtful assets. His statement follows:

> "The classification of loans is the result of a canvass of the notes, with the directors shown as being present. The lines classified as doubtful are in reality losses, as the directors admit the present insolvency of the makers, who are without present financial worth to either pay or secure and the ultimate liquidation of which is dependent upon the life insurance policies taken out to secure or an inheritance from some near relation most of whom are at present enjoying excellent health."

At the same time the examiner stated that actions by the management bordering on criminal intent had been indicated. His statement follows:

"The Cashier is doing all he can to eliminate items of criticism, some of his methods, however, are questioned, for instance, in the amount of estimated losses at last examination were a lot of small notes aggregating $3,000. endorsed by E, both makers and endorser of which were admitted insolvent, after charging off the various small notes (2 name paper) one note for the aggregate $3,000. was executed by the endorser E, secured by life insurance with no cash value, reinstating the amount charged off. In spite of such practices and the large amount of questionable, doubtful paper the directors withdrew $5,000. from surplus fund in order to provide and declare a dividend."

Automobile Paper. - In 1921 many banks experienced difficulties in collecting notes purchased from automobile dealers arising from the sale of cars. The methods of financing had not been standardized and many notes were taken for too large a portion of the purchase price of the car and without regard to the ability of the purchaser to pay. Two examples of this class of loan were mentioned in the list of 120 suspended banks used in this study. In case 63 the examiner wrote at the close of 1921:

"The Loans and Discounts are of an exceptionally slow and stagnant character, largely due to the purchase of considerable Machinery and Automobile sales paper."

In case 57 the examiner comments on the special undesirability of automobile paper in a coal mining town where a strike is possible. His comments in 1921 were as follows:

"Also buys much automobile paper from directors B and A, both dealers. Bank makes additional 2% to 4% on these notes; aside from fact that some are overdue there is no serious criticism. Your examiner has requested board to reduce amount of automobile paper carried and have also requested them not to make or buy any of this paper maturing later than April 1, 1922, when it is feared there will be a strike of coal miners. Should this strike occur in April and this bank would be holding a large amount of small monthly payment notes of miners, or even business people whose business depends to a large degree on mine pay rolls, the bank would be left holding some undesirable paper. Directors claim automobile season is over and amount will be reduced materially every two weeks from now on through the winter."

## CHAPTER IV

## INVESTMENT POLICIES

Only one bank of the 1921-1930 group of suspensions selected for this study was criticized by examiners because of its investments. In fact most of the banks in that group had negligible amounts of bonds. In the case of the one bank criticized the bond issue was the outgrowth of a poor loan and could not be construed as part of the true investment holdings of the bank.

Among the 105 banks selected from the 1931 suspensions, however, a number had large bond accounts, and serious troubles arose from their efforts to make their investments yield too high a return. This resulted in bond speculation, trading out of high-grade issues into low grade issues during periods of rising bond prices, and the purchase of undesirable bonds for the sake of a high return. Nearly one-third of these banks were criticized by examiners more or less severely for their investments, and a number of others held bonds of poor quality.

Bond depreciation was the primary cause of failure in 6 of the 105 banks selected from the 1931 suspensions, and an important contributing cause of failure in 4 other cases. Those 10 banks, where bond difficulties were either a primary cause or a major contributing cause of failure, varied widely in size, ranging in loans and investments from $400,000 to $8,000,000 at the time of their last examinations. Five out of the six banks whose failures were caused primarily by bond troubles had more investments than loans. In the 4 banks where securities difficulties were an important contributing cause of failure, but not the primary cause, investments were about one-half as large as loans.

A study of the causes of bank failures in one district in 1932 shows that bond depreciation was a much larger factor as a cause of failure in that year than in 1931.

While the failure record of 1931 did not indicate the seriousness of the effects of the major decline in bond prices, a study of the investment accounts of the suspended banks showed that serious depreciation had occurred in the holdings of nearly all grades of bonds.

To isolate and analyze the weaknesses in the investment portfolios a list of the bonds for each of the 105 banks used in this study was secured for three different dates: at the last examination before failure, one year earlier, and two years earlier. By studying the character of the bond lists of these banks in 1929, 1930, and 1931, together with examiners' criticisms, it was possible to determine the quality of bonds that these banks were buying during the period of prosperity.

The chapter is divided into three parts as follows: (1) quality of securities and depreciation; (2) faulty investment practices; and (3) bonds chiefly responsible for 1931 depreciation.

## Quality of Securities and Depreciation

Bond Quality Index. - The first step in the study of the bond accounts was to develop an index which would measure the quality of the bonds in which these banks invested. The method used was originated by the Federal Reserve Bank of New York, and consists of grading the bonds of a bank according to their rating. Bonds of the two highest ratings are graded 100 per cent; bonds of the third rating, 90 per cent; bonds of the fourth rating, 80 per cent; bonds of the fifth rating, 50 per cent; bonds of the sixth rating, 10 per cent; and all other bonds and securities receive a grade of zero. The ratings used are those assigned by important rating services, such as Moody's, Fitch, Standard Statistics, or Bond and Quotation Service. For the sake of uniformity the various rating nomenclatures used by these services were converted into a uniform rating classification developed by the New York Federal Reserve Bank and ranging from Ia, which is the highest rating, to IVc, which is the lowest rating. The following table will illustrate the manner in which the classification has been made uniform.

Table ~~26~~ 21 – Bond Rating Symbols

| New York Federal Reserve Bank rating | Moody's & Fitch | Standard Statistics | Bond and Quotation Service |
|---|---|---|---|
| Ia | Aaa | A1+ | A3 |
| Ib | Aa | A1 | A2 |
| Ic | A | A | A |
| IIa | Baa | B1+ | B3 |
| IIb | Ba | B1 | B2 |
| IIc | B | B | B |
| IIIa | Caa | C1+ | C3 |
| IIIb | Ca | C1 | C2 |
| IIIc | C | C | C |
| IVa | Daa | D1+ | D3 |
| IVb | Da | D1 | D2 |
| IVc | D | D | D |

In addition to the rated bonds there are subclassifications in the New York schedule for defaulted securities, stocks, and bonds either not rated or not listed. United States bonds to secure circulation and the miscellaneous items, which are commonly included under the general heading of bonds and securities in a bank balance sheet and which include foreclosures, claims, judgments, etc., are omitted from the calculation of the bond quality index. Bonds which a bank had borrowed or had purchased under resale agreement were included in the bond quality index if they were included in the examiners' lists. It was impossible to identify such bonds, but they were not an important item. Since these bonds are usually of the highest grade, their inclusion probably raised the bond quality indexes of a few banks.

In making the three annual bond quality indexes for each bank, the bonds were rerated each year. This was important because there was a general tendency for bonds to deteriorate during those years. A bank which had a high bond quality index in 1929 and neither bought nor sold a bond in the next two years would usually have had a lower bond quality index in 1931 than in 1929.

A typical case, 158, is given in Table ~~27~~ 22 in order to illustrate the method of computing the bond quality index. This illustration shows the 1929 bond holdings of a bank with a medium sized portfolio and a distribution of securities among most of the rating classes.

Table ~~27~~ 22 - Security Analysis of Bank 158

| Rating | 1<br>Book value | 2<br>Per cent of total | 3<br>Market value | 4<br>Apprec.(+) or deprec.(-) | 5<br>Desirability weights | 6<br>Index of quality (2 x 5) |
|---|---|---|---|---|---|---|
| Ia - U.S. | $ 24,718.75 | 1.9 | $ 24,218.85 | $ -499.90 | 100 | 1.9 |
| Ia - Other | 96,000.00 | 7.4 | 102,625.00 | +6,625.00 | 100 | 7.4 |
| Ib | 19,850.00 | 1.5 | 19,262.50 | -587.50 | 100 | 1.5 |
| Ic | 191,891.75 | 14.7 | 176,027.50 | -15,864.25 | 90 | 13.2 |
| IIa | 265,098.86 | 20.3 | 240,175.00 | -24,923.86 | 80 | 16.2 |
| IIb | 398,148.75 | 30.5 | 366,772.50 | -31,376.25 | 50 | 15.3 |
| IIc | 128,020.00 | 9.8 | 135,010.50 | +6,990.50 | 10 | 1.0 |
| IIIa | 58,366.25 | 4.4 | 55,977.50 | -2,388.75 | 0 | 0.0 |
| IIIb | 0 | 0.0 | 0 | 0 | 0 | 0.0 |
| IIIc | 0 | 0.0 | 0 | 0 | 0 | 0.0 |
| IVaIVbIVc | 0 | 0.0 | 0 | 0 | 0 | 0.0 |
| Defaulted: | | | | | | |
| Real estate | 11,500.00 | 1.0 | 5,000.00 | -6,500.00 | 0 | 0.0 |
| Other | 12,962.50 | 1.0 | 8,325.00 | -4,637.50 | 0 | 0.0 |
| Stocks | 87,808.50 | 6.7 | 68,740.00 | -19,068.50 | 0 | 0.0 |
| Not rated | 9,975.00 | 0.8 | 10,000.00 | +25.00 | 0 | 0.0 |
| Not listed | 0 | 0.0 | 0 | 0 | 0 | 0.0 |
| | 1,304,340.36 | 100.0 | 1,212,134.35 | -92,206.01 | - | 56.5 |
| Foreclosures, claims, judgments, etc. | 9,560.00 | | 10,760.00 | +1,200.00 | | |
| Total | $1,313,900.36 | | $1,222,894.35 | $-91,006.01 | | |

Note: Do not include U. S. Governments pledged to secure circulation, Federal reserve bank stock, or securities of company owning bank building.

In the first column of the illustration is given the book value of the securities owned by the bank classified by ratings. The bank had only $24,719 of United States bonds excluding circulation bonds. Its principal holdings consisted of bonds of the IIa and IIb ratings. In the second column are given percentages showing what part of the total security holdings were represented by securities of the various ratings. Foreclosures, claims, judgments, etc., are not included in total securities for this purpose.

The third and fourth columns, which are not used in computing the bond quality index, show the market value of the various grades of securities held and the appreciation or depreciation in the bond list when book value is compared with market value. A few bonds in the bank's list were given a market value of either par or book value because no current quotations could be found by the examiner. In those bonds there was probably some depreciation which does not show in the table. The total depreciation in the bond account is, therefore, somewhat understated. It will be noted that this bank had a depreciation of $91,006 at the time of this examination.

Column five lists the desirability weights, or percentages assigned to the various grades of securities. In column six the figures of columns two and five are combined by multiplication. In other words, the figures in column two are weighted according to the desirability or quality of the various grades of bonds. The total of the figures in column six constitutes the index of quality of the bond accounts. In this particular bank, the quality index is 56.5 per cent of a perfect score. If all of the bonds had been of Ia or Ib grade, the index of quality would have been 100 per cent.

The banks that failed in 1931 and were covered by this study fell far short of a satisfactory record in the matter of bond investments. Only 18 of the 105 banks had bond quality indexes over 90 per cent at the last examination before suspension, and only 30 had bond quality indexes over 80 per cent. Their records at earlier dates were not much better. Only 26 had bond quality indexes over 90 per cent one year prior to their last examination, and only 27 had bond quality indexes over 90 per cent two years prior to their last examination. On the other hand, 35 of these banks had bond quality indexes of 50 per cent or lower at the time of their last examination. This would indicate that their average bond holdings rated IIb or worse. One year before their last examination 27 of the banks used in this study had bond quality indexes of 50 per cent or lower, and two years before their last examination 17 had bond quality indexes of this very unsatisfactory character.

Unsatisfactory as the above figures show the bond buying habits of these banks to have been, they do not give an adequate picture of the holdings of those banks which were heavy bond buyers. In the list of 105 bank failures were a group of 49 banks whose bond holdings were small or negligible. Banks with very small bond holdings frequently hold nothing but United States Government bonds or high-grade municipal bonds, which are held for special purposes such as collateral for borrowed money or collateral for public deposits. Some of these banks hold nothing but

United States Government bonds simply because they do not pretend to know anything about other bonds and wisely prefer to place the small amount of their investment funds in Government securities whose soundness is beyond question. Other banks hold United States Government bonds to improve the appearance of their balance sheets.

For purposes of more intensive study the banks used in this survey were divided into two groups--those having marketable securities (at market prices and excluding circulation bonds and miscellaneous items) amounting to less than 15 per cent of their deposits in 1929, and those having marketable securities amounting to 15 per cent or more of their deposits in 1929. The dividing point between large securities portfolios and small ones was arbitrarily fixed at 15 per cent of deposits, without undertaking to take a position on the proper quantity of marketable bonds for a bank to own.

In Table 23 is shown the distribution of the banks in the first group (those with small bond accounts) according to the quality indexes of their bonds. The quality index distribution is given for three dates: the last examination before suspension, one year earlier, and two years earlier. It will be noted that 12 of these banks with small bond accounts had bond quality indexes ranging from 95.1 to 100 per cent. Most of these banks had few bonds other than United States Government securities. Two of the banks had no securities at the last examination before suspension. The remainder of the banks in this group had bond quality indexes ranging all the way from 95 to zero, showing that there was a great disparity among these banks in the grades of bonds held.

Table 23 - Bond Quality Indexes of Banks Having Less Than 15 Per Cent of Deposits in Marketable Securities in 1929

| Bond quality index | Number of banks: Last examination before suspension | One year earlier | Two years earlier |
|---|---|---|---|
| 95.1-100 | 12 | 12 | 12 |
| 90.1-95 | 3 | 6 | 5 |
| 85.1-90 | 5 | 2 | 5 |
| 80.1-85 | 0 | 2 | 2 |
| 75.1-80 | 4 | 3 | 5 |
| 70.1-75 | 1 | 4 | 2 |
| 65.1-70 | 4 | 1 | 2 |
| 60.1-65 | 1 | 4 | 2 |
| 55.1-60 | 2 | 0 | 3 |
| 50.1-55 | 1 | 2 | 0 |
| 45.1-50 | 0 | 3 | 1 |
| 40.1-45 | 5 | 2 | 1 |
| 35.1-40 | 1 | 0 | 0 |
| 30.1-35 | 0 | 0 | 0 |
| 25.1-30 | 0 | 0 | 0 |
| 20.1-25 | 1 | 0 | 0 |
| 15.1-20 | 0 | 0 | 1 |
| 10.1-15 | 0 | 0 | 1 |
| 5.1-10 | 1 | 0 | 0 |
| 0.1-5 | 0 | 1 | 1 |
| 0 | 6 | 5 | 3 |
| No securities | 2 | 2 | 3 |
| Total | 49 | 49 | 49 |

For the banks having larger bond accounts, that is, marketable bonds amounting to 15 per cent or more of deposits in 1929, the record of bond buying practices is even less satisfactory than in the group of banks with small bond accounts, as illustrated in Table 24. Only 3 out of 56 banks in this group had bond quality indexes above 90 per cent at the last examination before suspension, and only 10 had bond quality indexes above 90 per cent two years earlier. The remainder of the banks owned bonds whose average quality ranged from zero to 90 per cent, and in a large proportion of these banks the quality indexes were below 50 per cent.

Table ~~40~~ 24 - Bond Quality Indexes of Banks Having 15 Per Cent or More of Deposits in Marketable Securities in 1929

| Bond quality index | Number of banks: Last examination before suspension | One year earlier | Two years earlier |
|---|---|---|---|
| 95.1-100 | 1 | 4 | 4 |
| 90.1-95 | 2 | 4 | 6 |
| 85.1-90 | 4 | 3 | 2 |
| 80.1-85 | 3 | 3 | 8 |
| 75.1-80 | 1 | 7 | 5 |
| 70.1-75 | 9 | 5 | 6 |
| 65.1-70 | 5 | 8 | 6 |
| 60.1-65 | 4 | 5 | 7 |
| 55.1-60 | 5 | 2 | 5 |
| 50.1-55 | 3 | 0 | 1 |
| 45.1-50 | 3 | 6 | 3 |
| 40.1-45 | 4 | 5 | 2 |
| 35.1-40 | 3 | 1 | 1 |
| 30.1-35 | 5 | 2 | 0 |
| 25.1-30 | 1 | 0 | 0 |
| 20.1-25 | 1 | 0 | 0 |
| 15.1-20 | 1 | 0 | 0 |
| 10.1-15 | 0 | 0 | 0 |
| 5.1-10 | 0 | 0 | 0 |
| 0.1-5 | 0 | 0 | 0 |
| 0 | 1 | 0 | 0 |
| Total | 56 | 55(1) | 56 |

(1)One bond list not furnished to the Committee.

A study of the relative qualities of the bond accounts of banks in various economic subdivisions of the country indicates that the bond accounts of banks in the farming communities were of better grade than those of banks in the cities and mining communities. One explanation of this fact is that the bond accounts of banks in the farming communities were usually a smaller percentage of deposits than in the case of the city banks, and consequently, it was probably true that government bonds constituted a larger percentage of the total bond holdings of rural banks than of city banks. It is customary for most banks to have a "backlog" of United States Government bonds and then, if circumstances permit, to invest other available funds in general market securities. A second factor accounting for part of the better bond quality indexes of banks in the farming country is that those banks are large recipients of public deposits of minor government subdivisions. The government officials require collateral or surety bonds for these deposits and generally designate high-grade municipal and other securities for this purpose. Unfortunately, it is impossible to isolate pledged securities for special analysis. A third reason which appears to have accounted for some of the unfavorable comparison between the bond habits of city banks and country banks is the fact that the city banks were more exposed to speculative influences, and this speculative sentiment pervaded their bond policies.

Using the bond quality indexes two years prior to failure as the best test of the bond buying habits of the banks with the larger bond accounts, it was found that 7 out of 28 banks in farming communities had bond quality indexes above 90 per cent, whereas only 1 bank out of 11 in the large cities had a bond quality index above 90 per cent, and only

2 out of 10 banks in the smaller industrial and suburban cities had bond quality indexes of this grade. No banks in the mining communities had indexes above 90 per cent.

Securities Depreciation. - With the available material this study attempts to show the total amount of depreciation in the securities accounts of the banks which failed and the classes of banks suffering most heavily from securities depreciation. Two methods have been used to measure the depreciation in the securities accounts of the sample banks. The first was to compare the amount of depreciation with loans and investments and with capital funds. The second method was to compare securities depreciation with the book value of the securities owned.

The securities whose depreciation was compared with loans and investments and with capital funds were the total bonds and securities of each bank, excluding circulation bonds. Circulation bonds usually sell at a premium, and their price fluctuations are subject to influences quite different from those affecting other securities.

Table ~~30~~ 25 - Securitiss Depreciation per $100 of Loans and Investments
(Securities do not include circulation bonds)

| Depreciation | Number of banks: Two years before last examination | Number of banks: Last examination |
|---|---|---|
| Appreciation | 7 | 15 |
| $0 | 21 | 14 |
| 0.1 - 1 | 56 | 26 |
| 1.1 - 2 | 7 | 11 |
| 2.1 - 3 | 7 | 10 |
| 3.1 - 4 | 3 | 2 |
| 4.1 - 5 | 1 | 6 |
| 5.1 - 6 | 1 | 3 |
| 6.1 - 7 | 1 | 3 |
| 7.1 - 8 | 0 | 5 |
| 8.1 - 9 | 1 | 1 |
| 9.1 - 10 | 0 | 0 |
| 10.1 - 15 | 0 | 5 |
| 15.1 - 20 | 0 | 2 |
| 20.1 - 25 | 0 | 0 |
| 25.1 - 30 | 0 | 1 |
| 30.1 - 35 | 0 | 1 |
| Total | 105 | 105 |

Depreciation on securities, as shown in Table 25, was not large relative to loans and investments, even at the last examination of the sample banks. All but 9 of the banks had depreciation in their securities accounts of less than 10 per cent of loans and investments at their last examination. Of the 9 banks with depreciation of more than 10 per cent of loans and investments only 4 had depreciation of over 15 per cent of loans and investments, and only 2 had depreciation of more than 25 per cent of loans and investments. Two years before their last examinations none of the sample banks had depreciation in their securities accounts of more than 10 per cent of loans and investments.

Securities depreciation is compared with capital funds in Table 26. Capital funds include the capital stock, surplus, undivided profits, and sundry reserves of the failed banks.

Table 26 - Securities Depreciation per $100 of Capital Funds
(Securities do not include circulation bonds)

| Depreciation | Number of banks | |
|---|---|---|
| | Two years before last examination | Last examination |
| Appreciation | 8 | 15 |
| $0 | 21 | 14 |
| 0.1 - 10 | 58 | 33 |
| 10.1 - 20 | 7 | 14 |
| 20.1 - 30 | 5 | 4 |
| 30.1 - 40 | 6 | 3 |
| 40.1 - 50 | 0 | 5 |
| 50.1 - 60 | 0 | 4 |
| 60.1 - 70 | 0 | 4 |
| 70.1 - 80 | 0 | 1 |
| 80.1 - 90 | 0 | 0 |
| 90.1 - 100 | 0 | 2 |
| 100.1 - 110 | 0 | 1 |
| 110.1 - 120 | 0 | 0 |
| 120.1 - 130 | 0 | 2 |
| 130.1 - 140 | 0 | 0 |
| 140.1 - 150 | 0 | 1 |
| 150.1 - 160 | 0 | 1 |
| 160.1 - 170 | 0 | 0 |
| 170.1 - 180 | 0 | 1 |
| Total | 105 | 105 |

The second method of measuring securities depreciation was to compare the depreciation with the value at which the securities were carried on the books of each bank. The investments used in this comparison are those used in constructing the bond quality indexes. United States Government bonds held by these banks as collateral for national bank notes and miscellaneous items, such as foreclosures, claims, judgments, tax certificates, etc., were omitted from this tabulation. The miscellaneous items excluded from the total investments were usually a very small part of the total investment account, but there were a few exceptions. In 4 of the 105 failed banks used in the 1931 study, all or the greater part of the bonds and securities (excluding circulation bonds) consisted of these miscellaneous items.

At the time of their last examination before suspension the 105 banks owned securities (excluding circulation bonds and $430,000 of miscellaneous items) with a book value of $69,753,972. The market value, however, was only $59,779,938, resulting in a depreciation of $9,974,034, or 14.3 per cent. One year earlier the book value of the securities of these banks was slightly higher and the depreciation amounted to only 7.3 per cent. Two years earlier the book value of the securities of these banks was about $2,000,000 higher than in 1931 and the depreciation was only 3.8 per cent. The figures for the three dates are given in Table ~~32~~ 27. (The figures on depreciation do not include depreciation on securities where no market price is quoted. Such securities are usually carried at book value in the examiner's tabulation of market value. The bonds with no market are usually a very small part of a bank's investments.)

Table ~~32~~ 27 - Investment Accounts of 105 Failed Member Banks

A - At the Last Examination Prior to Failure

(excluding circulation bonds and miscellaneous items)

| Location | Book value | Market value | Depreciation | Depreciation as per cent of book value |
|---|---|---|---|---|
| | Banks having marketable investments amounting to 15 per cent or more of deposits in 1929 | | | |
| 12 failed banks in cities over 100,000 population | $42,116,998.99 | $36,520,936.72 | $5,596,062.27 | 13.3 |
| 10 failed banks in other industrial and suburban cities | 5,578,119.35 | 4,289,917.65 | 1,288,201.70 | 23.1 |
| 6 failed banks in mining communities | 4,554,190.47 | 3,900,003.51 | 654,186.96 | 14.4 |
| 6 failed banks in north-eastern farming region | 2,213,356.76 | 1,540,928.66 | 672,428.10 | 30.4 |
| 22 failed banks in other farming regions | 5,501,284.10 | 4,628,287.41 | 872,996.69 | 15.9 |
| | $59,963,949.67 | $50,880,073.95 | $9,083,875.72 | 15.1 |
| | Banks having marketable investments amounting to less than 15 per cent of deposits in 1929 | | | |
| 4 failed banks in cities over 100,000 population | $ 6,379,713.97 | $ 5,933,710.73 | $ 446,003.24 | 7.0 |
| 6 failed banks in other industrial and suburban cities | 1,562,664.41 | 1,398,498.96 | 164,165.45 | 10.5 |
| 2 failed banks in mining communities | 57,557.42 | 49,144.43 | 8,412.99 | 14.6 |
| 4 failed banks in north-eastern farming region | 97,968.30 | 81,063.00 | 16,905.30 | 17.3 |
| 33 failed banks in other farming regions | 1,692,118.29 | 1,437,446.90 | 254,671.39 | 15.1 |
| | $ 9,790,022.39 | $ 8,899,864.02 | $ 890,158.37 | 9.1 |
| Total--all banks | $69,753,972.06 | $59,779,937.97 | $9,974,034.09 | 14.3 |

Table ~~52~~ 27 - Investment Accounts of 105 Failed Member Banks

B - One Year Prior to Last Examination

(excluding circulation bonds and miscellaneous items)

| Location | Banks having marketable investments amounting to 15 per cent or more of deposits in 1929 | | | |
|---|---|---|---|---|
| | Book value | Market value | Depreciation | Depreciation as per cent of book value |
| 12 failed banks in cities over 100,000 population | $44,124,432.74 | $41,071,352.91 | $3,053,079.83 | 6.9 |
| 10 failed banks in other industrial and suburban cities | 5,944,911.86 | 5,316,155.36 | 628,756.50 | 10.6 |
| 6 failed banks in mining communities | 3,786,749.51 | 3,421,280.64 | 365,468.87 | 9.7 |
| 6 failed banks in northeastern farming region | 2,424,095.20 | 2,169,783.05 | 254,312.15 | 10.5 |
| 22 failed banks in other farming regions | 4,950,744.13 | 4,683,643.06 | 267,101.07 | 5.4 |
| | $61,230,933.44 | $56,662,215.02 | $4,568,718.42 | 7.5 |
| | Banks having marketable investments amounting to less than 15 per cent of deposits in 1929 | | | |
| 4 failed banks in cities over 100,000 population | $ 5,354,028.50 | $ 5,164,479.50 | $ 189,549.00 | 3.5 |
| 6 failed banks in other industrial and suburban cities | 1,342,083.90 | 1,267,455.65 | 74,628.25 | 5.6 |
| 2 failed banks in mining communities | 163,003.42 | 158,976.92 | 4,026.50 | 2.5 |
| 4 failed banks in northeastern farming region | 111,719.19 | 109,704.40 | 2,014.79 | 1.8 |
| 33 failed banks in other farming regions | 1,700,797.40 | 1,468,747.36 | 232,050.04 | 13.6 |
| | $ 8,671,632.41 | $ 8,169,363.83 | $ 502,268.58 | 5.8 |
| Total--all banks | $69,902,565.85 | $64,831,578.85 | $5,070,987.00 | 7.3 |

Table ~~32~~ 27 - Investment Accounts of 105 Failed Member Banks

C - Two Years Prior to Last Examination

(excluding circulation bonds and miscellaneous items)

| Location | Banks having marketable investments amounting to 15 per cent or more of deposits in 1929 | | | |
|---|---|---|---|---|
| | Book value | Market value | Depreciation | Depreciation as per cent of book value |
| 12 failed banks in cities over 100,000 population | $42,853,377.29 | $41,538,629.54 | $1,314,747.75 | 3.1 |
| 10 failed banks in other industrial and suburban cities | 6,377,752.90 | 5,907,276.00 | 470,476.90 | 7.4 |
| 6 failed banks in mining communities | 4,555,722.79 | 4,166,289.96 | 389,432.83 | 8.5 |
| 6 failed banks in north-eastern farming region | 2,613,279.85 | 2,458,483.93 | 154,795.92 | 5.9 |
| 22 failed banks in other farming regions | 5,328,773.44 | 5,124,644.91 | 204,128.53 | 3.8 |
| | $61,728,906.27 | $59,195,324.34 | $2,533,581.93 | 4.1 |
| | Banks having marketable investments amounting to less than 15 per cent of deposits in 1929 | | | |
| 4 failed banks in cities over 100,000 population | $ 6,215,303.04 | $ 6,122,245.82 | $ 93,057.22 | 1.5 |
| 6 failed banks in other industrial and suburban cities | 1,543,239.01 | 1,488,507.47 | 54,731.54 | 3.5 |
| 2 failed banks in mining communities | 194,124.36 | 184,769.03 | 9,355.33 | 4.8 |
| 4 failed banks in north-eastern farming region | 118,570.57 | 115,731.74 | 2,838.83 | 2.4 |
| 33 failed banks in other farming regions | 1,788,443.57 | 1,771,099.13 | 17,344.44 | 1.0 |
| | $ 9,859,680.55 | $ 9,682,353.19 | $ 177,327.36 | 1.8 |
| Total—all banks | $71,588,586.82 | $68,877,677.53 | $2,710,909.29 | 3.8 |

The percentage depreciation in all three years was greater in banks with large security holdings than in banks with small holdings. Banks having marketable investments amounting to 15 per cent or more of deposits in 1929 had depreciation in their securities accounts at the last examination before suspension of 15.1 per cent, whereas banks having marketable investments amounting to less than 15 per cent of deposits in 1929 had depreciation of only 9.1 per cent.

Banks in various economic groups experienced marked differences in the per cent of depreciation in their investment holdings. Among the banks with larger investment holdings, banks in the large cities made the best record, with a depreciation of only 13.3 per cent at the time of their last examination. Banks in the mining communities ranked second, with a depreciation of 14.4 per cent. Banks in the southern and western agricultural sections ranked third, with a depreciation of 15.9 per cent. Banks in the smaller suburban and industrial communities were fourth, with a depreciation of 23.1 per cent. Banks in the northeastern agricultural section made the poorest showing, with a depreciation of 30.4 per cent.

Among the banks with small investment accounts, the record was quite similar, with banks in the large cities having the best record and banks in the northeastern agricultural section having the worst record.

## Faulty Investment Practices

This section describes and illustrates the more important mistakes in investment management contributing to the poor quality of the bond lists found in the 105 banks. To describe the investment mistakes a combination of examiners' comments and illustrations from the bond lists of representative banks has been used.

<u>Bonds Bought for Yield.</u> - A common mistake made by these banks in handling their bond accounts was to place the factor of yield above the factor of safety of principal in selecting issues. This weakness was not mentioned by the examiners in their criticisms very frequently, but a study of the bond lists of these failed banks shows that the criticism would have been merited in many instances. The examiners did not begin to criticize the purchase of securities on the basis of yield until the last year or so prior to suspension. The following is a typical criticism on this point, and is taken from the April, 1931, examination report of bank 157.

> ". . . the real malady lies in the bond list where yields have been primarily considered and secondary reserve is a forgotten quality. Depreciation in the class of bonds held has increased staggeringly between examinations. The bank seems to be a mark for bond salesmen with the usual result to the bank."

As a result of buying for yield rather than for safety, this bank had a bond quality index in 1929 of 60.2 per cent. At the time of the last examination before failure it had declined to 31.2 per cent. It is very evident that yield was an important factor in the selection of the bonds of this bank, since the average yield on the entire list at book value was 6.98 per cent. It was also very evident that safety was a secondary consideration, for the average rating of these bonds was only slightly above IIb. This was also indicated by the bond quality index of 60.2 per cent. Almost the entire list consisted of weak foreign and public utility bonds. There was only $1,000 of United States bonds in the entire list which totaled more than $125,000.

In periods of depression low grade bonds decline in price much more than enough to offset any additional income which may have been received during the period of ownership of the bond. The record of what happened to the price of those bonds which this bank held from 1929 until the time of its failure will serve to illustrate this. In this bank's portfolio a group of $46,380 of bonds was held through the two year period prior to last examination. The income from these bonds during the two year period was $5,695, but the depreciation, comparing market value in 1931 with book value in 1929, was $30,515.

Bond Trading. - Bond trading in the language of bankers generally refers to the practice of selling bonds at a profit in a rising bond market and reinvesting the proceeds in bonds which are selling at a discount. In a period of falling bond prices these banks generally sell those bonds with the smallest depreciation in order to avoid taking losses. Usually this practice involves two mistakes in policy: (1) Selling high-grade issues and reinvesting in securities of lower grade; (2) retaining poor bonds with large depreciations hoping to sell these securities later at more favorable prices.

During times of rising bond prices the faults of bond trading are masked by the large immediate profits secured by the sale of bonds which are quoted at higher prices than the value at which they are carried on the banks' books. In case 158 the examiner commented on the profit from bond trading. Nevertheless, his comments in January, 1929, showed that he was aware of the risk of this practice. His uneasiness was wellfounded, because within the next year the evils of bond trading had become very apparent. His comment follows:

> "The bank continues to profit considerably by its policy of actively trading in bonds, many of which are of a speculative character. Profits on sales of securities, since the preceding examination, increased the profit and loss account by over $30,000. It is believed that a responsible officer in one of the large ____ trust companies is advising President ____ in this connection. While the profits from this or any other legitimate source are badly needed, management has been advised that the corresponding risk must not be overlooked."

In bank 157, the examiner commented on the losses arising from bond trading in the summer of 1929 as follows:

> "Bond depreciation at present aggregates $12,488.75 although depreciation of $5,550, and losses on bonds sold $1,321.58, have been charged off since last examination. This position in the bond account has resulted from the fact that in the past the bank has actively traded in bonds, taking profits but allowing losses to remain in the bond account."

One illustration from the bank bond portfolios will serve to show the dangers and mistakes of bond trading. For this purpose Bank 157 is used. In June, 1929, this bank held $125,645 of bonds at book value. The market value of these bonds was $114,702, showing a depreciation at that time of $10,943, or 9 per cent. During the next fourteen months bonds were sold from this list with a book value of $53,632. The bonds which were sold were those with the smallest depreciation, indicating that the bank was selling its better securities and retaining its poorer securities in the hope that the price of the latter would recover in time so that the bank would not find it necessary to write off a heavy depreciation. This proved to be a forlorn hope, because during the period from June, 1929, to August, 1930, the bank wrote off $8,610, or 12 per cent of the book value of the bonds which they retained, and yet the depreciation on the book value of those bonds in August, 1930, was $11,565, which was $3,852 larger than the depreciation on the same bonds at their higher book value in June, 1929. It is thus seen that it was an expensive policy to retain these low grade bonds in the bank's portfolio.

During the same period (from June, 1929, to August, 1930) this bank purchased bonds with a book value of $50,236. The bonds which they bought were of a lower average grade than the bonds which they sold, as shown by the following tabulation.

Table ~~48~~ 28 - Bonds Sold and Purchased by Bank 157
Between June, 1929, and August, 1930

| Rating | Sold | Purchased |
|---|---|---|
| Ib | $ 4,487.50 | $ 0 |
| Ic | 4,662.50 | 9,450.00 |
| IIa | 28,850.00 | 15,595.25 |
| IIb | 10,647.50 | 12,553.75 |
| IIc | 4,985.00 | 4,550.00 |
| IIIa | 0 | 4,387.50 |
| Miscellaneous | 0 | 3,700.00 |
| Total | $53,632.50 | $50,236.50 |

During the period from August, 1930, to November, 1931, the same bond practices were followed by this bank with similar results. During this period bonds totaling $75,254 at book value were held in the portfolio continuously. In August, 1930, the depreciation on these bonds was $8,604, or 11 per cent of book value. Between August, 1930, and November, 1931, the bank wrote off $6,469, or 9 per cent of the book value of these bonds. However, the amount written off did not equal the decline in the market value, and in November, 1931, the depreciation on the same bonds as compared with their lower book value was $35,645, or 52 per cent.

In this period the bank continued the policy of selling its better bonds; for example, it sold during the year $38,385 of bonds at 1930 book value, with a depreciation of only 4 per cent, as compared with an 11 per cent depreciation on the bonds which they retained. As in the preceding year, the quality of the bonds purchased was lower than the quality of the bonds sold. This is shown by the following table.

Table ~~49~~ 29 - Bonds Sold and Purchased by Bank 157
Between August, 1930, and November, 1931

| Rating | Sold | Purchased |
|---|---|---|
| Ic | $ 9,450.00 | $ 0 |
| IIa | 11,160.25 | 9,162.50 |
| IIb | 14,425.00 | 8,040.00 |
| IIc | 3,350.00 | 13,207.50 |
| Miscellaneous | 0 | 5,700.00 |
| Total | $38,385.25 | $36,110.00 |

<u>Convertible Bonds</u>. - Several banks lost heavily through investing their funds in convertible bonds. A convertible bond is a bond which can be traded for stock of the same company under certain conditions. As the price of the stock advances, the bond can be profitably converted into shares of stock, while if the price of the stock declines, the holder of the bond can retain the bond, and in that way, hold a lien on the assets of the company issuing the bond, which ranks ahead of the stockholders' claims. The weakness of convertible bonds is that usually the holder

sacrifices something in the way of safety in exchange for the possibility of profit from a rise in the price of the stock. Convertible bonds are often "junior liens" and are not much better than the stock into which they can be converted as regards safety of the principal. Some banks attempted to combine speculation in stocks with investment of the funds under their management, with disastrous results. In bank 155, $711,381 was invested in convertible bonds in September, 1929, out of a total bond account of $1,593,573 at book value. At that time the convertible bond section of this list appeared to be much more desirable than the other investments, for the convertible bonds had an appreciation of $136,000, whereas the remainder of the bonds had a depreciation of nearly $34,000. It should be mentioned that the convertible bonds were carried on the bank's books at a price above par, and in some cases, the carrying prices were higher than the call price for the bonds.

By October, 1930, the relative desirability of convertible bonds and other securities had been completely reversed. The bank had purchased a few more convertible bonds, so that its convertible bond list at book value totaled $747,526, out of a total bond account of $1,973,813. The market value of the convertible bonds had decreased much more sharply than the market value of the other securities owned by this bank, so that there was a depreciation in the convertible list of $119,701, or 16 per cent, of book value, whereas the remainder of the bond account showed a depreciation of only $87,893, or 7 per cent.

By August, 1931, the plight of the convertible bond section of this bank's holdings had become much worse. Some of them had been sold, and the book value of those held in August, 1931, was $627,244. The depreciation on these bonds was $250,861, or 40 per cent. Many of the other bonds held by this bank had been sold by this time, so that the total bond account at book value was only $1,268,975. Many of the better grade bonds had been sold. The depreciation on the remaining bonds, other than convertibles, was $217,789, or 34 per cent.

The list of convertible bonds held by this bank contained many low grade issues, but even in the highest grade convertible issues it made some very bad mistakes. For example, in 1929 this bank owned $75,000 of one bond issue, the call price on which is 105, and yet the bonds were carried on the books at 137.3. At that time the bank probably thought that it had a very satisfactory investment, because there was a "paper profit" of 60 per cent on those bonds due to the exceptionally high price (218) at which they were selling in the market. This particular issue was given the highest rating by the various investment services, but that rating referred to the safety and marketability of the bond at par. No rating service attempts to rate the desirability of holding a bond above its par or call price.

One-third of these holdings of this convertible bond was sold before the next examination in October, 1930. On the latter date the record shows that the book value of the remaining portion of this issue had been marked up to 176.9. While this mark-up was contrary to good banking practice and was wholly unjustified when the call price is considered, the action of the bank may have seemed reasonable at the time because the market value of the bond reached a high point of 227 in 1929. The market price had declined to 152, however, by October, 1930, and while this value would have shown an appreciation on the bank's holdings at the 1929 book value, there was actually a loss of 14 per cent on the higher book value at which the bank was carrying these bonds in 1930.

Between October, 1930, and August, 1931, the bank made no change in the book value of its holdings of this bond. In August, 1931, the bond had declined in price to 129, so that there existed a depreciation of 27 per cent on the book value, whereas the depreciation would have been only 6 per cent on the 1929 book value, which was presumably the purchase price of the bonds.

The bank's method of handling its investment in low grade convertible bonds was equally faulty. A bond with a rating of IIIa, may be used as an illustration. In 1929 this bank owned $20,000, par value, of these bonds. The call price was 104½. The book value was 111½, indicating that these bonds had been purchased at a price well above their call price. However, the market price had declined to 95 by June, 1929, showing a "paper loss" of more than $3,000 at that time. By October, 1930, the market price of the bonds had declined to 64, whereas the book value on the bank's records remained unchanged. The depreciation, therefore, was $9,500. By August, 1931, the market value of these bonds had declined to 51½, but the bank's book value remained unchanged and there was a depreciation of $12,000.

The bank owned also in another convertible issue $75,000, par value, which was being carried in June, 1929, at a book value of 122.

The call price of these bonds was 102½. However, the market price at that time was 214 and there was an appreciation of market price over the bank's book price of $68,900. Between June, 1929, and October, 1930, the bank bought an additional $25,000, par value, of these bonds. The purchase was evidently made at a high price because the book value increased from 122 to 139. Subsequent to the purchase of these additional bonds the market declined to 95 at the time of the 1930 examination, and there was a depreciation of $44,000 in this issue. Between October, 1930, and August, 1931, there was no change in the bank's holdings of these bonds. The book value was reduced one point, to 138, by a charge against profit and loss. The market value of the bonds declined, however, to 87, leaving a depreciation of $51,000 in the bank's holdings of this issue.

<u>Unlisted Bonds</u>. - The majority of the banks used in this study bought bonds which were not listed on any exchange, and some of which had no market except the doubtful one of resale to the issuing house. The banks also bought large numbers of bonds for which the rating services published no rating. For these issues the bank was compelled to depend on its own information or the recommendations of banks, bond houses, and bond salesmen.

There were 592 of these unlisted issues and most of them were of medium or low grades according to the best information available. In fact, 109 issues out of the 592 had defaulted by the close of 1931. Table ~~38~~ 30 gives the distribution of these issues according to ratings assigned by the Committee's staff.

Table ~~36~~ 30 - Distribution by Ratings of Securities Found in Failed Bank Portfolios for Which No Ratings Were Given by the Usual Services

| Our rating | Number of issues |
|---|---|
| Ia | 5 |
| Ib | 22 |
| Ic | 58 |
| IIa | 82 |
| IIb | 54 |
| IIc | 73 |
| IIIa | 61 |
| IIIb | 16 |
| IIIc | 46 |
| IVa | 22 |
| IVb | 1 |
| IVc | 12 |
| Defaulted | 109 |
| Not rated because of insufficient data | 31 |
| Total | 592 |

Case 159 furnishes an illustration of a bank whose holdings of unlisted bonds resulted in disaster. As early as 1923 the examiner criticized the bank for buying bonds with a limited market in an effort to secure a high yield. His comment follows:

> "....It will be noted that many of the issues in the Bond Account are not listed and the examiner could not find quotations in appraising their market values. The yield on the list is a little over 7% which accounts in a large measure for the handsome earnings which the bank enjoys. Examiner recommends greater caution in making purchases and that seasoned bonds and bonds having a wide or ready market be acquired. President and Cashier keep in close touch with bond market."

In the summer of 1926 the quality of the bond account was again criticized in the following words:

> "....The desirability of improving the quality of the bond account as well as the requirement with respect to credit data were discussed with Mr. ____ who agreed to make some effort to comply with suggestions. However it cannot be expected that the habits and practices employed by him for forty years will undergo much change at this late date."

In December, 1929, the bond portfolio was criticized moderately, as shown by the following words:

> ". . . Bonds and Securities need more attention as the report pages will show. Agreed to charge off only $15,000 depreciation in Bonds & Securities."

In June, 1930, the point of view of the bank management with regard to the purchase of second grade bonds is described and criticized in the following words:

> ". . . The chief cause of complaint is the bond list which is decidedly second grade. Bonds purchased with view to yield. The list yields 7%. Management figures that it is better business to charge off $25,000 a year and make that much extra in trading profits and yield than to purchase conservative bonds. Cashier purchases bonds for this bank as well as the X Bank _____ which list shows a large depreciation."

In February, 1931, the bank's bond buying habits were described as "reckless." The situation was stated as follows:

> ". . . This bank through the reckless purchases of bonds now finds itself facing a serious situation. The list is composed of speculative bonds of the worst kind. Many are in default and others on the way. List was analyzed by Standard Statistics Inc. Their appraisal showed a depreciation of over $400,000 and it was their opinion that it was a gamble as to whether the bank could work out of this predicament. The affiliated bank at _____ is in the same condition."

The bank closed in March, 1931, at which time the full import of the faulty bond buying practices of the management had become apparent. The situation was described as follows:

> ". . . Bank was closed by resolution of the Board at 9:30 P.M. March 11, 1931. Insolvency was due almost entirely to bond losses. Safety of principal has been absolutely disregarded for interest yield. Affairs of the bank have been dominated entirely by Cashier who is 73 years old. It would seem that the directors are chargeable with gross neglect of duty. Failure of the bank was due to incompetent management. This bank had been in operation sixty-six years and apparently had enjoyed the confidence of the community. Until the Cashier became the managing officer some seven or eight years ago it was probably worthy of such confidence but since he has been in charge he gradually traded the high grade investments into low grade speculative issues."

This bank was in the Northeastern farming area. Its bond quality indexes were as follows: June, 1929 - 42.4; June, 1930 - 34.9; March, 1931 - 17.8.

In case 189, the weak practice of buying unlisted bonds was further aggravated by the fact that these bonds were purchased from an investment house operated by one of the bank's directors. This undoubtedly gave the bank a false feeling of security and led to very serious exploitation of the bank by this director and his firm. As early as 1921 the examiner began to criticize the bond holdings of this bank on the ground that they were unlisted and that it was impossible to secure satisfactory market prices by which to appraise the present worth of the bond account. The examiner's criticism follows:

> "This bank is conservatively managed by an attentive board and a capable cashier. A large portion of the bonds and securities are unlisted and it is almost impossible to appraise the entire list on a basis of what each item would bring on the open market. This matter was discussed with Director A, whose brokerage firm sold the bank most of their securities. While admitting that outside quotations could not be obtained in many cases, Mr. A claims the securities are good and stands on his past record of securities underwritten."

In 1923 the examiner's comment shows that the director continued to dominate the bond buying policy of the bank.

> "Director A is a member of the firm of ~~[illegible]~~, ____, Brokers, who handle a great many unlisted securities. No ready market exists for these securities and it is thought that the bank is investing too great a portion of its funds in these securities. Information concerning such bonds is meager and values are listed at carrying value. Director A claims these bonds as good and the other directors rely on his opinion entirely."

In 1926 it was reported that the bank's bonds were mingled with the securities of other customers of the director's investment firm. The examiner's statement follows:

> "....The bonds and securities of this bank are kept in a box at the ____ Co., ____, under the control of Director A and another officer of the bank. Some of these securities are held in box rented by A and Son, who has entire control. These securities are mixed with other securities belonging to customers of A and son and upon a verification of the banks securities some of the securities are presented from the latter named box as the banks assets."

In April, 1927, the examiner again criticized the bond list of this bank in the following words:

> "The bond list of this bank has improved considerably during the past five years, but there are still a number of unlisted items held and your examiner is compelled to take quotations from A and Sons, which concern is represented on the Board of this bank by A. While there is no reason to believe any of the items held are bad, your examiner considers this class of investments undesirable. Otherwise, the bank is in excellent condition and well managed."

In October, 1927, a more detailed criticism of the bond account of this bank was made, giving the examiner's reasons for suspecting the quality of the bonds held.

> "This bank's bonds, particularly industrials, have been subject to criticism for years because of being unlisted, of narrow market and in some instances weak. Since last examination the bank has made twenty-four (24) purchases of bonds and has sold 29 issues held at that time. Where issues are not listed your examiner obtained so-called market prices from A and Son, which firm through Director A attends to this bank's investments in bonds. While the list as reported shows an appreciation of $17,535.70 it is significant that none of this appreciation is in the industrials although prices on unlisted issues were obtained from A and Son. The bank may have a paper profit now, but it may also have some grief in the future. It is difficult for your examiner to definitely state that specific issues are not readily marketable, as his time and

facilities do not permit of an investigation as to the ready sale price of each bond, however, he is of the opinion that if the industrial issues in this report were offered on the open market independent of A and Son, they would bring much less than values shown even if purchasers could be found for all. Your examiner has discussed this matter with Mr. A several times over a period of several years and has come to the conclusion that further effort to have him correct this condition would be useless as far as your examiner is concerned. Local assets, and local management of this bank are good but the menace lies in A in whom the directors, who are not at all familiar with investment securities, have unlimited faith and who continues to place undesirable bonds with the bank."

In April, 1928, the examiner's comment showed that the faulty practices in handling the bank's bonds continued and that the bank was not willing to follow suggestions for improvement.

"....Bonds, Securities, etc.: Prices on all bonds except those marked # were obtained from quotation records available to your Examiner or from investment bankers other than the firm from which they were purchased. Inasmuch as quotation sheets and brokers quote a market price on these items your Examiner assumes that they are readily marketable at the amounts listed. Prices on items marked # could undoubtedly have been obtained from the firm from which they were purchased, but inquiry outside resulted in the information that there was 'No market available.' These items would seem to be in the class of one house bonds. Subsequent to last examination and under instructions of your office your Examiner advised the bank of specific issues of bonds which in his opinion did not conform to the requirement of marketability. This criticism was based on information and opinions obtained in ____, and is contained in Examiner's letter to bank under date of January 23, 1928, a copy of which was forwarded to your office. The management did not agree with the classification of your Examiner."

This condition apparently continued without much change for more than two years longer, for the examiner wrote in October, 1930:

"Your examiner has not been successful in past efforts to have this bank improve the class of securities held. The only result of written and verbal criticisms has been an exchange of letters which has accomplished nothing. Director A is a member of the firm of A and Sons, Investment Bankers, of ____, and can naturally out-talk your examiner in defending objectionable bonds. In view of the number of defaulted issues and the size of the aggregate depreciation it is respectfully requested that this bank be required to charge off the amount listed as loss. These bonds could not be priced during examination, consequently, your examiner was unable to advise the bank as to the amount of depreciation."

In the summer of 1931 the bank's officers and directors finally decided to attempt an improvement in the bank's affairs, as shown by the following quotation:

"Heavy depreciation in Bond Account and numerous defaulted issues due to character of securities. Slow and Doubtful Loans. Total of Doubtful and Loss classifications exceeds Surplus & Profits. Statutory Bad Debts and Other Overdue Paper. Officers not adequately bonded. Lack of financial statements. Credit information too general. Bank expecting to pay regular semi-annual dividend of $3,850.00. Officers and directors are now cooperating to improve this bank's condition although President X contends a continuation of dividends is essential to maintain confidence of the community. No objection is expressed to charging off losses as required and reducing Surplus when necessary, although this charge off was deferred until an actual appraisal of the bond account could be completed. The required charge off at this time was calculated to make due allowance for a voluntary $15,000.00 charge off on May 27, prior to date of examination. However, that charge off was accomplished by means of writing up Banking House $10,200.00 and $2,500.00 voluntary contribution by directors. President X agreed to charge off, (and promptly advise your office that this had been done), such amounts as would be required as a result of this examination. To further improve this bank's condition, officers have voluntarily accepted a reduction in salaries and directors have waived their fees. Moody's limited service has also been employed in an effort to improve the bond account. Average net earnings before losses and dividends, for past two years, show but $6,175.00 semi-annually and consequently any material improvement in bank's condition is dependent on improvement in the bond account which includes many weak issues. Based on bond depreciation, capital shows an impairment of $11,694.33 which should be made good and Mr. X agreed to come to ____ for a conference in the Chief Examiner's office when requested and this conference will be held in the near future."

The bond quality indexes of this bank were as follows: March, 1929 - 59.8; April, 1930 - 49.5; June, 1931 - 43.6. This bank was in the Northeastern farming region.

Real Estate Bonds. - Several banks were criticized by examiners for holding undesirable real estate bonds. However, there were no comments extensive enough to be quoted in this section.

Bank 216 was criticized for its sale to customers of a large volume of undesirable real estate bonds which later defaulted. The examiner stated that a moral obligation to protect the purchaser of these bonds from loss rested on the bank, but the history of the bank does not show whether the moral obligation resulted in any repurchases of real estate bonds. ~~by this bank.~~ Nevertheless, it was obvious from the comments that the reputation of the bank for integrity was at stake. In March, 1930, the examiner made the following statement:

> "In considering this situation the fact should be carefully weighed that this bank has sold out approximately $6,500,000 of real estate bonds on which a very real moral liability exists and at the time of this examination there was past due principal and interest affecting one and one-half million dollars of these bonds."

In September, 1930, this matter of moral obligation was again mentioned by the examiner in the following words:

"In considering the situation it is necessary to take into consideration that the bank has sold some \$5,600,000 real estate bonds to customers on which there is \$166,000 in default in interest and principal, affecting bond issues totaling \$2,155,000. While there is claimed to be no liability on the part of the bank, either written or verbal, there is unquestionably a strong moral contingent liability which it will be difficult to avoid."

Irrigation Bonds. - In case 254, the bank suffered serious losses from the purchase of a large amount of irrigation bonds. These bonds were a popular form of investment several years ago, since they generally bore a high rate of interest and were exempt from taxation and were apparently well protected by the ability to tax the land holders benefited by the irrigation project. However, in many such projects, it later developed that the tax burden necessary to pay the irrigation bonds was greater than the benefited communities could bear. Land was abandoned in many irrigation districts and the irrigation bonds defaulted. This general experience affected the prices of all irrigation bonds.

The experience of this bank with irrigation bonds was first mentioned in April, 1928, when the examiner commented as follows:

"....The bond account of the bank is very unsatisfactory. Most of the depreciation is occasioned by irrigation bonds. At a meeting held with the directors April 19, 1928, they agreed that in the event the Bond House from which they purchased the irrigation bonds, did not replace them by good saleable bonds, they would make up the depreciation, and a proper minute entry was made of such decision."

Further detail was given in September, 1928, as follows:

"....The bank's bond account shows a goodly depreciation, occasioned principally by Irrigation Bonds, the most undesirable of them being the X bonds. These bonds have not as yet defaulted but are badly off on the market and not readily saleable. As per agreement during examination made April 9, 1928, the Directors have paid in $6,375.00 to take care of depreciation in Bonds and an account in this figure is now carried on the books."

In March, 1929, the irrigation bond troubles were again briefly mentioned as follows:

". . . The Bond Account is very unsatisfactory. $13M of the $19M in depreciation is occasioned by Irrigation Bonds. The market is not only off, but badly slipping daily, and it is believed that eventually a heavy loss will be taken in these bonds."

In June, 1929, the inexcusable concentration of the investment funds of the bank in irrigation bonds and the subsequent difficulties of the bank were described as follows:

". . . The entire capital of the bank was on its organization invested in undesirable irrigation Bonds, the market for which is slipping badly. The directors voluntarily contributed $6,375.00 a year ago to a charge off on these bonds. At this examination $10,978.13 was written off and further loss, it is believed, is bound to develop. There is no real market for the bonds and to dispose of the entire amount of these bonds at the market values given would be impossible. The values given represent the price here and there where a sale has been made. All of these bonds no doubt could be disposed of in a very short time, but the price would be about one-half of what is quoted here. It is necessary to shop around and find a buyer interested in this class of investments in order to obtain fair values. A large investment house is cooperating with the bank hopeful of retiring all issues of the Irrigation Bonds with as little loss as possible."

The further history of the difficulties with irrigation bonds in this bank was not given in the case history because irregularities were found in the management of the bank, and the examiner's entire attention during the last two years of the bank's existence was centered on an attempt to effect a reorganization or sale of the bank to other interests.

<u>Bonds Chiefly Responsible for the Depreciation in the Investment Portfolios of the 105 Banks</u>

Further light on investment mistakes of banks failing in 1931 is obtained by a study of individual bonds contributing most to the securities depreciation of these banks. It should not be claimed that exactly the same list of bonds have been the principal cause of securities trouble in all

1931 bank failures. However, the list points to certain faulty practices in bond buying which were undoubtedly quite general. Among those practices were the purchase of convertible bonds at high premiums, the purchase of low grade issues, and the purchase of unseasoned issues.

<u>Method of Selecting Bonds Contributing Greatest Depreciation</u>. - A simple method was used to find the bonds contributing most to the bond depreciation of the sample banks. Only general market securities were considered. United States securities, stocks, claims, judgments, and other irregular items appearing in the securities records of these banks were excluded. A tabulation was made for each bank of the individual bonds with the largest dollar amount of depreciation whose combined depreciation amounted to one-half of the total depreciation in the

bank's general security account. The next step was to select the bond issue showing the greatest dollar amount of depreciation, and the second issue in point of depreciation, and the third and so on, until a total of depreciation had been built up approximately equal to one-half of the grand total depreciation in the bank's bond holdings.

The same procedure was followed for each of the banks which had substantial bond accounts (the banks with investments of 15 per cent or more of deposits in 1929).

The grand total depreciation of the bonds selected in this way was $3,664,727.

Based on the above described tabulation, a list was made of the fifty issues contributing most to the depreciation in the bond accounts of the banks used in this study. Each of these securities was an important problem in only a small number of banks, but their combined depreciation in 1931 was $2,208,340.

The two bonds contributing the greatest amount to the depreciation in the banks' bond portfolios were convertible bonds. The mistake made by banks was buying these bonds at prices substantially above par and the depreciation experienced was due largely to the wiping out of the premium on the bonds in the market. Of the first fifty bonds in point of depreciation only five had ratings of the first three grades in 1929. The remainder of the issues were of the fourth grade or lower. In periods of declining bond prices the issues of lower grade declined faster than the higher grade issues, with the exception of convertibles.

Table 31 - Ratings of Fifty Issues Contributing
the Greatest Depreciation to the
Portfolios of the 105 Banks

| Rating | No. of issues |
|---|---|
| Ia | 2 |
| Ib | 0 |
| Ic | 3 |
| IIa | 6 |
| IIb | 24 |
| IIc | 9 |
| IIIa | 2 |
| IIIb | 0 |
| IIIc | 1 |
| Defaulted | 3 |
| Total | 50 |

In some of the fifty bonds the per cent of depreciation to book value was small, but the large holdings created a heavy dollar amount of depreciation. In other bonds the large dollar total of depreciation was caused by a serious percentage depreciation on rather small holdings. The per cent of depreciation of the various issues was affected considerably by the dates of the reports, because the bond market was declining throughout 1931.

Every one of the fifty issues showed a depreciation of over 10 per cent from book value at the time of the last examination of the sample banks prior to suspension. All but one issue had a depreciation of more than 20 per cent. The depreciation ranged up to 100 per cent for the various issues, and for the combined list of fifty bonds it was 45 per cent.

The depreciation recorded would have been larger if the last examinations of these banks had all been at or near the time of their failure instead of some months earlier. The last examinations of fifty-four banks, or more than half of the list, were in the five months, March to July, 1931, before the most serious stages of depreciation in the general bond market began, and for 16 other banks the last examinations were prior to the beginning of 1931.

Of the first fifty bonds in point of depreciation the great majority were issued in the post-war period. Only four issues were brought out before 1923. Three of these four were railway issues and one was a joint stock land bank issue. Twenty-one issues, or 42 per cent of the first fifty, were brought out in 1928 or later. In other words, the bonds causing the greatest amount of depreciation were unseasoned issues, largely the product of boom conditions in the bond market.

Table 32 - Years of Origin of the Fifty Issues
Contributing the Greatest Depreciation
to the Portfolios of the 105 Banks

| Year of issue | No. of issues |
|---|---|
| 1930 | 2 |
| 1929 | 8 |
| 1928 | 11 |
| 1927 | 9 |
| 1926 | 3 |
| 1925 | 5 |
| 1924 | 5 |
| 1923 | 3 |
| Before 1923 | 4 |
| Total | 50 |

Table ~~56~~ 33 – Classification of the Fifty Bond Issues Contributing the Greatest Depreciation to the Portfolios of the 105 Banks

| Type of issue | Par value | Book value | Depreciation | Per cent of total depreciation in fifty issues |
|---|---|---|---|---|
| **Foreign** | | | | |
| Governments | $ 136,000.00 | $ 122,562.50 | $ 65,512.50 | 2.9 |
| Industrials | 103,000.00 | 100,312.50 | 62,356.25 | 2.8 |
| Rails | 30,000.00 | 29,475.00 | 16,975.00 | 0.8 |
| | 269,000.00 | 252,350.00 | 144,843.75 | 6.5 |
| **Rails** | 680,250.00 | 688,501.00 | 320,618.50 | 14.5 |
| **Public Utilities** | | | | |
| Telephone & Telegraph | 1,157,000.00 | 1,820,024.75 | 598,289.75 | 27.1 |
| Light, Heat & Power | 369,000.00 | 356,181.25 | 130,213.75 | 5.9 |
| Water | 54,000.00 | 53,117.50 | 26,367.50 | 1.2 |
| Street railway | 70,000.00 | 69,037.50 | 57,637.50 | 2.6 |
| Bridge | 20,000.00 | 19,950.00 | 17,950.00 | 0.8 |
| | 1,670,000.00 | 2,318,311.00 | 830,458.50 | 37.6 |
| **Industrials** | | | | |
| Woolen Mills | 309,000.00 | 292,922.45 | 210,264.95 | 9.5 |
| Oils | 176,000.00 | 172,245.00 | 96,495.00 | 4.4 |
| Coal | 240,000.00 | 239,107.50 | 146,232.50 | 6.6 |
| Foods | 92,000.00 | 90,693.50 | 56,493.50 | 2.6 |
| Theatres | 179,000.00 | 168,823.75 | 93,613.75 | 4.2 |
| Rubber | 41,000.00 | 40,216.25 | 34,040.25 | 1.6 |
| Cement | 45,000.00 | 44,212.50 | 26,212.50 | 1.2 |
| Silk | 35,000.00 | 31,075.00 | 17,425.00 | 0.8 |
| Miscellaneous | 99,500.00 | 76,417.50 | 46,604.00 | 2.1 |
| | 1,216,500.00 | 1,155,713.45 | 727,381.45 | 33.0 |
| **Financial** | | | | |
| Joint Stock Land Banks | 206,000.00 | 211,312.50 | 92,312.50 | 4.2 |
| Federal Land Banks | 25,000.00 | 24,250.00 | 15,250.00 | 0.7 |
| Investment Trusts | 245,000.00 | 267,362.50 | 77,475.00 | 3.5 |
| | 476,000.00 | 502,925.00 | 185,037.50 | 8.4 |
| Total | $4,311,750.00 | $4,917,800.45 | $2,208,339.70 | 100.0 |

The first fifty issues from the standpoint of depreciation were widely diversified as to type. Thirty-seven and six-tenths per cent were public utilities, 33.0 per cent were industrials, 14.5 per cent were railroads, 8.4 per cent were financial issues, and 6.5 per cent were foreign issues. No municipals were found among the first fifty bonds, due partly to the wide diversification of investments of this class which did not allow sufficient concentration of funds in any one issue for it to enter the group of leaders in depreciation. Moreover, many municipals have no market price and examiners were consequently unable to figure their depreciation. The distribution of the first fifty issues by type of issue is found in Table ~~42~~ 33.

## CHAPTER V

## OTHER OPERATING POLICIES

In addition to the examiners' comments regarding their loans and investments most of the suspended banks covered in this survey were subjected to criticisms regarding other policies and practices. The frequency with which these criticisms occurred is shown in Table 34 ~~43~~.

Table 34 ~~43~~ - Criticisms of Other Operating Policies

| Type of criticism | 1921-1930 suspensions (120) | 1931 suspensions (105) | Total (225) |
|---|---|---|---|
| Overextended condition | 40 | 66 | 106 |
| Continuous borrowing | 23(1) | 53 | 76 |
| Failure to keep up legal reserves | 15 | 21 | 36 |
| Overdrafts | 7 | 26 | 33 |
| Payment of dividends not currently earned | 12 | 17 | 29 |
| Excessive investment in banking house | 9 | 20 | 29 |
| Too high salaries | 9 | 10 | 19 |
| Too high interest rate on deposits | 12 | 6 | 18 |
| Large public deposits | 9 | 8 | 17 |
| Overoptimism | 1 | 10 | 11 |
| Write-up value of building, furniture and fixtures, bonds, or other assets to cover losses or earnings deficit | 5 | 5 | 10 |
| Bank understaffed | 2 | 7 | 9 |
| Bank too small for profit | 7 | 2 | 9 |
| Poor records | 0 | 8 | 8 |
| Lawsuit | 2 | 5 | 7 |
| Unwarranted endorsement of notes | 1 | 4 | 5 |
| Criticized asset removed by loan to director | 4 | 0 | 4 |
| Surety bond difficulties | 3 | 1 | 4 |
| Investing public deposits in local loans | 1 | 2 | 3 |
| Failure to depreciate bank building and furniture and fixtures | 0 | 3 | 3 |
| Reliance on permanence of large single deposit | 2 | 0 | 2 |
| Inefficient clerical force | 0 | 2 | 2 |
| Lack of proper supervision | 0 | 2 | 2 |
| Small net worth of stockholders | 1 | 1 | 2 |
| Bank undercapitalized | 1 | 1 | 2 |
| Bank overcapitalized | 1 | 1 | 2 |
| Miscellaneous criticisms occurring once each | 6 | 11 | 17 |

(1) The statistical analysis showed 42 cases of continuous borrowing in this group, or nearly twice as many as the examiners criticized.

Overextended Condition and Continuous Borrowing

Of the 225 suspended banks included in the study, 106 were criticized by examiners for overextended condition, and 76 were classed as continuous borrowers. There is no accepted definition of overextended condition, but from examiners' comments it can be inferred that they considered a bank overextended when it had a combination of the following characteristics: a large volume of loans relative to deposits, a very small volume of secondary reserves relative to deposits, a large amount of loans of a poor quality, and continuous or heavy borrowings from other banks. While not called an overextended condition, a similar situation occurs when a bank becomes burdened with a large volume of depreciated securities.

In the case of most examiners, there was apparently no attempt made to establish a connection between the causes of overextended condition and the criticism of the status quo. Overextended condition might develop as a result of bad management in overlending or slack collections or it might result from deposit withdrawals and economic reverses. However, in every case of overextended condition there was a large total of criticized assets, suggesting the fact that the frozen character of the assets was frequently the underlying reason for the overextended position.

The four conditions listed in the first paragraph of this section occurred in nearly all of the cases where the banks were criticized for overextended condition. For example, in case 33 the bank was criticized repeatedly in terms such as the following quotation from the May, 1925, report:

> "Bank continues to operate in an over-extended condition, has been a habitual borrower in large amounts, with an unsatis factory reserve record."

At the time this was written, the bank had loans of $645,000, which were in excess of its deposits of $618,000. The bank was borrowing $132,000. Its criticized assets amounted to $309,000, as compared with capital and surplus of only $50,000. It had only $15,000 of bonds and securities, none of which were marketable.

In case 21 it is evident that in the mind of the examiner overextended condition was more closely connected with the relation of loans to deposits than it was with any of the other factors mentioned above. Deposits decreased between December, 1927, and June, 1928, and although loans also decreased by a small amount, the bank was stated to have become overextended, inasmuch as it had been compelled to increase its borrowings in order to meet deposit withdrawals.

In case 26 the bank was criticized every year from 1921 to 1926, when it failed, for being in an extended condition. Throughout this period its loans exceeded its deposits, it had practically no investments, it was borrowing heavily, and it owned an unwieldy volume of criticized assets.

Illustrations from two case histories will serve to describe extreme cases of borrowing. Case 119 was a bank with a record of continuous borrowings during all of the war period. This bank was obviously overextended and paid insufficient attention to reserves during the years when its deposits were increasing. When its deposits declined in 1920 and 1921, it had no means of meeting withdrawals except to increase its borrowings heavily. In June, 1920, it was borrowing more than its total deposits and four times as much as its capital and surplus. The following table gives the statistics of its loans, deposits, and borrowings at various examination dates from 1916 to 1921.

Table ~~44~~ 35 - Loans, Deposits, and Borrowings in Case 119

(in thousands of dollars)

| Date | Loans | Deposits | Borrowings |
|---|---|---|---|
| 8-1-16 | $148 | $154 | $ 6 |
| 4-17-17 | 170 | 194 | 10 |
| 3-21-18 | 231 | 245 | 36 |
| 9-27-18 | 338 | 250 | 183 |
| 11-14-19 | 376 | 365 | 104 |
| 6-1-20 | 455 | 238 | 282 |
| 6-10-21 | 359 | 132 | 223 |

Case 109 shows a very similar condition. In February, 1920, it had deposits of $563,000 and loans of $754,000. Its investment holdings were negligible, amounting to $29,000. To support the volume of loans in excess of deposits, this bank was borrowing $116,000. During succeeding months, its deposits declined and its loans increased, so that it was compelled to increase its borrowings to $448,000 in September, 1921. At that time the examiner wrote:

> "This bank is in a very serious condition, as is shown on face of report. I called the directors' attention to this fact. However, they do not appear to be alarmed over the situation. Of their total loans, 67% are pledged to secure bills payable; of their total individual deposits, $100,000 represents state funds subject to call at any time. In the event a call should be made for these funds, they have no exchange to meet the same with, at present, and taking in consideration their liabilities for money borrowed it is doubtful with your examiner if they could find a bank that would be disposed to make further advances to them."

In many cases the failure to keep up legal reserves was a symptom of other difficulties rather than an original cause of trouble. It was sometimes due to heavy withdrawals or an overextended condition, but in some cases it was due to weak or careless management.

## Miscellaneous Criticisms

Payment of Dividends Not Currently Earned. - Only 29 cases were found among the 225 suspended banks where the examiners had criticized the management for the payment of dividends in excess of net earnings. The criticisms, however, do not cover all the cases. A survey of the net earnings and dividend payments indicates that a large proportion of the suspended banks paid dividends for a year or more after their net income had decreased to a point where dividend payments could not be made out of current earnings. In fact, if the losses set up by the examiner had actually been written off out of current earnings before dividends were paid, very few of the banks under survey would have been able to pay dividends as long as they did without dipping into their undivided profits or surplus.

Excessive Investment in Banking House. - In 29 banks, according to the examiners, the investment in the banking house constituted such a large portion of assets as to curtail the earning power of the bank. Case 9 was such an instance where the examiner wrote in 1922 as follows:

> "Handsome bank building is being pushed to completion and is expected to be occupied on or by October 1. When completed will cost some $250,000. In this connection, management states they have a prospective buyer of present banking house and adjoining property for $75,000 which, when sold, will be credited on new building, thereby reducing it to about $175,000. Our examiner has stated to President and Cashier that, in reality, they should have more capital and surplus, since the new building would be carried in excess of present capital, and surplus; further, that present deposits justified additional capital and this matter should be given consideration."

Later in the same year the bank building was completed and still appeared in the examiner's opinion to be too large for the size of the bank.

> "Since last examination, the bank has completed its new home and now has one of the most modern and well-equipped banking rooms in the state. The investment, at present, is somewhat out of proportion to capital and surplus account. In this connection, following previous suggestion of the examiner, President A. advised me that plans are under way whereby capital will be increased $50,000 and surplus $25,000 on the first of the year. This, it will be seen, brings the investment more in line, particularly after giving effect to the sale of the old home now carried, the proposed sale of which has been outlined by the bank to your office."

Early in 1925 the unwieldy investment in the banking house began to be noticeable in the earnings account, and the examiner wrote as follows:

> "The bank is making just enough money to pay their dividend and take care of the small losses that appear. This is partly due to the heavy investment in building and fixtures."

Too High Salaries. - In 19 cases examiners reported that salary paymente were too large, sometimes because a single official's salary was out of proportion to the earnings of the bank and sometimes because of a surplus of help. In case 47 the examiner wrote in 1930:

> "Vice President D dominates the bank. He is aggressive and is a good collector, and has made some progress in collecting slow and doubtful loans. He is a man of extravagant ideas. It was upon his suggestion that bank added Director G to its force of active officers, and also brought Asst. Cashier F in the bank. It seems as though a bank this size should be able to get along with less than nine active officers and employees."

Too High Interest Rate on Deposits. - High interest rates on deposits generally arose either from excessive competition between banks in a whole area or from the desire to attract deposits from outside of the local banking district. The difficulty of maintaining a low enough interest rate for sound operation under strongly competitive conditions was described in 1924 by an examiner in case 71:

> "The bank is having trouble in renewing some of its good loans at 10%, many borrowers insisting upon 8% money, at the same time the bank is paying 5% on time deposits. A letter from your Department insisting, if possible, upon a reduction to 4% would probably have the desired effect. I have been trying to get the banks to reduce to 4%, but it is impossible to expect one national bank to reduce to 4% and allow the others to pay 5% and 6%, when they are located in the immediate vicinity. I realize that some banks are in a better position to pay 5% than others to pay 4%, but if we are going to have any success in getting the interest rate reduced, it will be necessary for all of the banks to make the desired reduction."

High interest rates on deposits necessitated a search for investments yielding high rates of interest. In 1925 the examiner described the results of this practice as follows:

"This bank is owned by the Y-Z interests of _____ and _____, but the policy and management of the bank is left largely in the hands of the cashier, X, who has been able to build up an unusually large banking business for a village of this size and has established himself a reputation as a banker of more than average ability, but this has been largely accomplished by the paying of a large interest rate on time deposits. This has necessitated a higher loaning rate and, as this particular community could not absorb deposits obtained through this high rate, the bank was forced to go outside of its territory for loans, even entering other states, with the result that the bank is carrying a considerable amount of slow and doubtful assets and there is no doubt that the bank will suffer heavy losses through this policy. It was necessary to get a high interest rate on loans, which became the first attraction when loaning money, rather than the security of the principal. This apparently has been a policy of the Y-Z banks in _____ _____. They state they have reduced their interest rate to 5% on time deposits, but their loans have the appearance of 10% loans."

In case 68 the exasperated examiner exclaimed in 1924:

"How can a bank, with the volume of business of this one, with a capital of 25M, with 15M invested in bank building, with 24M invested in O.R.E., with loans of the type carried by this one, paying interest over a long (and probably indefinite) period on borrowed money amounting to about 100M, and paying (usually) 6 per cent interest on more than two-thirds of its deposits, hope to rehabilitate itself through its ordinary and usual operations? That's the main question to be solved here. The answer assuredly is not found in the 'Romances' of banking."

Case 88 shows evidence of outside funds being attracted by the high interest rate on deposits and the effects of those volatile funds on banking problems. In 1922 the examiner described the bank's ~~deposit interest~~ practice as follows:

> "Money is exceedingly tight locally. Before the war, I was advised, the bank paid 6% on time certificates. Now they pay from 6% to 8%, with an estimated average of a trifle over 7%. They are irregular in their amounts paid on savings. The two competing state banks are also hard up, so the cashier of the subject bank advises, and the banks practically bid for deposits. With the decrease in deposits, the bank is not making expenses, and no margin can be figured for possible losses."

A year later a new management had taken over the bank's affairs, but was finding the outside funds a special cause for worry. The examiner's comments were:

> "One item in the bank's affairs, that of the high interest rate paid on time deposits, (and of this time certificate money, approximately $90,000 belongs to certificate holders who live out of the state), made a new man taking over the management afraid of its withdrawal with a lowering of the rate. That was a big item in making the purchaser take ample precautions as to his safety. This item was slowly being corrected, the certificates as renewed being cut ½% or 1% all thru the past summer."

Mismanagement of Municipal Deposits. -- In several banks included in this study, weaknesses developed through the faulty management of deposits of municipalities, counties, and other Government units. The difficulties arose from the investment of such funds in loans not subject to liquidation upon demand or at short notice. Public deposits are subject to wide fluctuations. They are built up rapidly at tax payment dates and are then drawn down steadily to minimum balances before the next tax payment date. It has been a common practice for banks to furnish security for such deposits by the pledge of a surety bond, either supplied by a bonding company or entered into jointly by substantial stockholders of the bank. After furnishing such security, the bank was then free to use the funds in any way that its management wished. There were no cases where difficulties arose when the management invested these public deposits in readily marketable, high-grade bonds or open-market loans of suitable maturities. The difficulties arose entirely out of the investment of these funds in slow loans where there was a danger of inability to collect the loans when the Government officials demanded their funds.

In case 109 is found a good example of the unwieldy proportion of public and State funds sometimes included in the deposits of a bank. This bank had deposits of $232,000 in April, 1922, of which only $90,000 was local deposits, the remainder being public and State funds. At that time this bank had loans of $707,000 and was borrowing from other banks $423,000.

Case 37 illustrates the trouble arising from the mismanagement of public funds. In 1924 the examiner wrote:

"While the general condition of the bank's assets seems to have been improved, this bank for three years has been paying $4\frac{3}{4}$ per cent for public funds, ranging from $100,000 to $350,000. It has tried to invest these funds profitably in sundry bonds, and has finally invested $350,000 in local loans. It has contracted to accept these funds for two more years beginning in 1925 at $3\frac{3}{4}$ per cent, and the management has adopted the policy of extending local loans on the strength of these temporary deposits in anticipation of increased deposits during the next two years. Due to this short-sighted policy, the public funds are a constant menace, and it is believed the bank will experience difficulty in borrowing from its correspondents to cover the large fluctuations of public funds which occur in the fall of the year. If at the end of the two-year period the bank should lose the public deposit and has been during that period unable to increase its local deposits or reduce its loans, it will face a serious situation."

At succeeding examinations the large volume of public funds bearing a high rate of interest was criticized, but the practice of the bank management was not changed. In the spring of 1926 the usual increase in public deposits from the proceeds of tax payments occurred and the examiner criticized the bank's practice as follows:

"The bank has eliminated its borrowed money by the influx of public funds and it is forecast that they will again be heavy borrowers when withdrawals are made of these funds, since the bank has always been in a highly unliquid state, and these funds have been for years a decided element of danger to the bank, with the directors apparently unwilling to force their customers to liquidate their loans in anticipation of these withdrawals."

In the fall of 1926 the examiner's predictions came true, for he wrote:

"The situation at this bank has been most disheartening for a long period and since the last examination withdrawals of public funds have seriously embarrassed the bank, and its lean credit has been strained to the limit. On the date of examination, the bank was practically out of funds to meet cash letters."

In case 77, the examiner exposes the danger of this practice of handling public funds from the standpoint of the government subdivision owning the funds. In this case it was a county whose funds were placed on deposit with the bank, and the risk involved was well described in the following paragraph from the 1926 report:

> "If this institution is forced to suspend, which seems inevitable, it will practically bankrupt this county. The condition of the other two national banks is such, as your office well knows, that they could not stand a run. The First National Bank of 'Z,' an affiliated institution, could not hope to keep open. In fact, the First National Bank of 'XX' would probably be the only bank that could withstand the storm. Furthermore, it has always been the practice of the County Treasurer to deposit large sums of money in the subject bank during the months of December and January without security. The county balance at this time is covered. However, during December and January it will run $100,000 in excess of the security held."

This practice with its risk to the county continued to be followed up to the time of failure, for in April, 1927, the examiner wrote:

> "The cash position of the bank is stronger than was anticipated at this season of the year, and is largely accounted for by the County Treasurer's large balance. He has approximately $138,000 on deposit in the bank, with only $63,000 in collateral and surety bonds. It is impossible for the bank to properly collateralize this deposit, and, on the other hand, it is stated that the County Treasurer is unable to find security for county funds if deposited elsewhere. Should this account be withdrawn down to the amount of the supporting collateral, it would undoubtedly have a seriously crippling effect on this bank."

The successful handling of public deposits with surety bond security was sometimes threatened by the refusal of the bonding company to renew its bonds. No cases occurred in the bank histories studied where the bonding companies' refusals were final, but the threat of such action was mentioned in two cases, and the serious nature of this threat can be seen from the tone of the following quotations.

In case 66 the examiner wrote in 1921:

> "The situation was further complicated by the action of the bonding companies in refusing to renew bonds securing $45,000 of county and city deposits, which bonds expired the latter part of December and the first part of January. Your examiner, together with the county and city treasurer, was in constant communication with the agents of those companies both during the examination and after returning to ____, and I am now advised that the companies have agreed to renew for another year."

In case 115 the bank had been relying on its public funds to meet the local demand for loans. In the summer of 1924 there was some doubt in the examiner's mind as to the future attitude of the bonding company, for he wrote:

> "An unsatisfactory element is the fact that it has $175,000 in public funds on deposit, and six other large deposit accounts aggregating $125,000. There appears to be no reason though why any material withdrawals should be made on any of these accounts. No trouble has yet been experienced in obtaining renewals of depository bonds, but attitude of bonding companies in this locality has not been favorable."

The condition became precarious in succeeding months, and the examiner wrote in December, 1924, as follows:

> "A matter of grave concern is the fact that of $524,000 deposits, $146,000 is public funds and $102,000 is eight individual accounts. $100,000 of public funds are secured by depository bonds, and it is impossible to determine when all or a part of these bonds may be cancelled. About 90 days ago, one company served a cancellation notice of a $25,000 bond. A conference was arranged. Cancellation notice was rescinded."

<u>Mark-up of Book Value of Assets</u>. - Ten banks facing losses or deficits in earnings followed the practice of increasing the book value of their banking house, furniture and fixtures, bonds, or other assets. This bookkeeping transaction added a like amount to the undivided profits of the bank against which losses or excess expenses could be charged. In case 37 the transaction in 1925 was described as follows:

> "Bank has appreciated its banking house $10,000 since last examination so as not to show an operating deficit."

In case 86 the furniture and fixtures account was increased to cover an earnings deficit, as described in the following quotation from a 1923 report:

> "The furniture and fixtures have recently been replaced on the books by an increase in the building and fixture account to cover a deficit in the earnings due to a large amount of notes taken for interest on limit loans when the interest could not be paid in the past year. The amount at which the building and fixtures are carried is not excessive, and the building is thought to be readily marketable at the present book value."

In some cases such book entries were not illegal, since the true value of the assets involved was sufficient to justify the increase in the book value. However, this was not always the case. In case 2 the examiner questioned the validity of such an entry in 1925, as shown in the following quotation:

> "Board increased value of bank building and lots $10,000, new president J. contributed $6,291.31 on January 26, 1925, and balance of losses were then charged off as classified in report of January 12, 1925. Examiner does not exactly approve appreciating building $10,000, but property includes two lots and officers said they thought they could sell the adjoining lot for $7,500 to $8,000, which would leave banking house and lot on books at a reasonably fair value."

Early in 1926 the examiner reported that the lot adjoining the bank building had been sold for a sufficient amount to reduce the book value of the banking house to a fair amount.

Lawsuits. - In several cases lawsuits with the outcome adverse to the bank were the direct causes of bank suspensions. Case 55 was a small bank very well run according to the examiner's classification of assets. The bank lost a lawsuit in 1928, and was forced to suspend, but was later restored to solvency without the formality of going through receivership. The history of the lawsuit is given in the following quotation:

> "Herein is the history of the suit that caused this bank to close its doors, together with information incident to reopening for business.
>
> "The suit through which judgment was obtained was filed August 21, 1926 in the circuit court, and after many delays came to trial on October 1, 1928. It grew out of the sale of stock in 1920 and 1921 in what was called the X Company, a company incorporated under the laws of the State of D by some five or six promoters, of whom A then president of this bank was president. The purchasers alleged in their complaint and testified at the trial that A when soliciting these purchasers verbally agreed that when $25,000 worth of the stock was sold and paid for a meeting of the stockholders would be called and one of their number sent to B to investigate the project, return and report to another meeting of stockholders, at which time, if the report was favorable, a representative would be sent to B to expend the funds so raised to install and operate the plant for the manufacture of rubber products from cactus.
>
> "Money derived from the sale of this stock was deposited from time to time between June 1920 and July 1921 in the aggregate sum of $18,000, and beginning in November 1920 was checked out by the secretary and treasurer of the rubber company to various persons and companies until there remained in July 1921 a balance of only $65.70. The testimony of the defense by all directors except one who was unable, due to sickness, to attend the trial, and all of the active officers of the bank was that they had no knowledge of what was told these purchasers of this stock or of any agreement of any kind that these funds were deposited as a trust fund. The active officers testified the deposits were made by the office girl of the secretary and treasurer of the company in the regular manner as any other deposits, and subject to check by the secretary and treasurer of the company. The office girl of C., who was secretary and treasurer of the company who opened the account, made all of the deposits, testified she knew nothing of any agreement with the bank. A. who since has severed his connections with the bank, testified that he made no such agreement with the purchasers of the rubber company stock. The bank was unquestionably the victim of circumstances through this suit over which they themselves or your office could have no possible control, and it was due to this and this only that they were forced to close their doors for the short time."

Payment of Unsecured Produce Drafts for Worthless Drawer. - In case 99 an inexperienced cashier paid drafts amounting to a large sum for a worthless concern without first securing collateral to insure reimbursement. The details of this transaction are given in the following quotation from the 1929 examination report of this bank:

> "On April 29, 1929, I was instructed by Chief Examiner to proceed to X, as the Y National Bank there had suspended business. After arriving there it was disclosed that they had gotten into trouble through an incapable cashier, and the cashing of some $211,032.95 produce drafts of one Z Company, which had been returned to them unpaid, and on which the bank had no recourse for their money.....The drafts that were paid were all unsecured, drawn by the Z Company on various concerns in various places, mostly on D Company and the E Company. The only evidence of security was noted on some of the drafts by a certain car number notation, but being void of any bill of lading or other evidence of security, except as above stated simply a car number, and this was only on a few of them. When asked about the cashing of these drafts, etc., Mr. A. only answered: 'I just had confidence in these people and that so many were paid I felt that these would be also.' The records show that the bank first started cashing these drafts in November, 1928, and since that time the bank had cashed some $1,653,840.20 of these items, all having been paid except this amount of $211,032.95."

Cotton Speculation. - In case 105 the bank became involved in cotton speculation to a serious extent. Much of the blame for this trouble should be attributed to the dishonesty rather than the ignorance of the bank officials. The bank followed objectionable practices in connection with cotton financing for several years. It gradually became evident that the bank officials were themselves speculating in cotton, as shown by the following quotation from a 1924 report:

"The condition of this bank is deplorable, inexcusable and dangerous on account of the speculation in cotton by President A. Notwithstanding the promises made by him and other directors on April 4, 1924, as contained in their letter addressed to the Comptroller, the same condition was found at this examination, and, while their weekly report to the Department showed all bills of exchange paid, they were not in fact paid, and their statement was untrue. Furthermore, Mr. A. has been buying cotton since previous examination (which he promised he would not do), and carrying the checks he gave in payment therefor as "Cash Items" until the cotton was shipped and returns received. Mr. A. also wilfully borrowed additional funds from the bank since previous examination, knowing at the time he had an excess loan in the bank. The notes representing those loans being signed 'D Farm' and 'E Farm,' his name not appearing thereon, but upon close questioning he admitted that he signed the notes; that he owned the farms, and the notes were his direct liability. The examiner called a meeting of the Board and all who were available were present and all matters again gone over with them and their personal responsibility again explained to them and promises made that these matters would not be permitted in future, in which this examiner places no confidence, but fully believes that Mr. A. will do 'as he pleases' as long as he is connected with the bank in any way. (The directors are mere figureheads.) Mr. A. states that he expects to comply with his promise to retire from the bank within the time agreed upon with this examiner and contained in the directors' letter of April 4, 1924, (which statement is also not believed by the examiner). Should he continue in charge, it is merely a matter of time until he will wreck the institution and bankrupt himself and associates. Therefore, the only solution this examiner can see to protect the depositors is to file suit for forfeiture of the bank's charter or continue special examinations until the public become aware of something wrong and start a run on the bank, thereby forcing the closing of its doors."

In 1925 the examiner further described the irregular practices as follows:

"So far as could be determined, the numerous irregularities revealed by the October examination in the A. Brothers' cotton account had been adjusted. That is, the account showed to be settled. Reference is made to the promise made to examiner by A. at that time to discontinue buying cotton. While the records indicate that he effected the liquidation of the account as then shown, it appears that he practically engaged one F., a would-be farmer and cotton man, to buy cotton as it came in, and I found the line in the bank as is shown as excessive. Between examinations, the account has run much higher and in excessive amounts. At the time of previous examination, I took occasion to explain to all of the directors and Mr. A. the methods followed by conservative banks in handling cotton accounts which contemplate financing its purchase and sale, and only by requiring rapid sales is speculation avoided. It has always been A's policy to have the bank pay for cotton, ship it to cotton factors in Y., and draw against it, which practise lessened the burden on this bank in carrying it, but allowed him to speculate and throw the entire hazard on this bank. The factor never advances but a portion of the value and holds the actual cotton to secure him, while this bank is in the position of a second lien holder. As F. began to buy cotton, it was shipped to B. Cotton Company in Y., (which firm was holding the cotton belonging to A. Bros.) in the name of A. Bros. This was determined in trying to check the security represented to be held by the bank to secure F. line, which I could not satisfactorily do; nor could I ascertain even by inquiry from B. Cotton Company, for all the cotton they held was held for account of A. Brothers."

Finally, the ownership of the bank was changed and an improvement in the matter of handling cotton accounts was recorded. However, the cashier of the bank continued to manipulate the cotton accounts and finally brought about a situation where the bank failed and the cashier took his own life.

Customer's Check "Kiting." - In case 38 the examiner found in 1926 that a check "kiting" operation had been in progress which promised to be a serious matter for the bank. His comment was as follows:

"An examination of this bank was made at this time in view of the fact that a local concern had been kiting checks between this institution and two other banks. The ultimate loss to this bank at this time is not determinable, but examiner is of the opinion that it will not be to exceed $50,000."

Two months later the loss from check "kiting" had been definitely determined and it proved to be too large for successful handling by the bank management, as shown by the examiner's description of the situation. (This bank closed shortly after this examination.)

> "At the time of the last examination, there was a potential loss of approximately $50,000 as the result of a check-kiting scheme by a local concern. Since that time, directors of the bank have voluntarily removed $25,000 of this amount, and there is possibility for recovery of the other $25,000 from sale of the assets of this local industry. The directors of the bank were very much adverse to the levying of an assessment at this time which would necessitate an explanation of the loss to the stockholders and would, in turn, probably prevent an orderly liquidation of the concern's assets."

## CHAPTER VI

## CRITICISMS OF BANK PERSONNEL

Examiners' reports of the 225 suspended banks selected for this study contain many criticisms of the personnel of these banks. Among the matters criticized, those mentioned most frequently are illegal acts, inactivity of directors, weak management, exploitation of bank by management, and outside activities of officers. The frequency with which these and other criticisms occurred is shown in Table 36.

Table 36 - Criticisms of Bank Personnel by Examiners

| Type of criticism | 1921-1930 suspensions (120) | 1931 suspensions (105) | Total (225) |
|---|---|---|---|
| Illegal acts | 58 | 77 | 135 |
| Inactivity of directors | 59 | 42 | 101 |
| Weak management | 24 | 47 | 71 |
| Exploitation of bank by management | 24 | 22 | 46 |
| Outside activities of officers | 16 | 23 | 39 |
| Involved affairs of owners | 15 | 17 | 32 |
| Disregard for criticism | 4 | 27 | 31 |
| Overdrafts by officers, directors, and help | 5 | 20 | 25 |
| Refusal to admit questionable character of assets | 15 | 9 | 24 |
| Bank officer detrimental to bank | 1 | 20 | 21 |
| Natural death of officer or director | 3 | 10 | 13 |
| Managing officer ill | 2 | 10 | 12 |
| Land speculation by owners | 6 | 4 | 10 |
| President aged and infirm | 1 | 8 | 9 |
| Former management detrimental to bank | 1 | 5 | 6 |
| Suicide or disappearance of officer | 5 | 1 | 6 |
| Friction among officers and directors | 0 | 5 | 5 |
| Refusal to charge off losses as they occur | 0 | 2 | 2 |
| Refusal to pay assessment | 1 | 1 | 2 |

Note: Other criticisms occurring only once were: security speculation by owners; director also director of competing bank; reinstatement of objectionable officer; excessive drinking of cashier; purchase of criticizable paper from brokers who are large shareholders; loss of memory by officer; purchase of bank by promoters.

## Illegal Acts

One hundred and thirty-five out of the 225 suspended banks showed some evidence of violation of banking law on the part of the officers or employees of the banks. In some cases the offenses were of the most serious nature, as in the case of the 28 defalcations, 5 conversions of funds, 8 forgeries, and 27 false statements. Table 37 gives a classification of the illegal acts maintained by examiners and the frequency with which each occurred.

Table 37 - Evidences of Illegal Acts and Dishonesty

| Type of criticism | 1921-1930 suspensions (120) | 1931 suspensions (105) | Total (225) |
|---|---|---|---|
| Loans over legal limit | 32 | 63 | 95 |
| Disregard for law generally | 11 | 25 | 36 |
| Defalcation and embezzlement | 13 | 15 | 28 |
| False statements and entries | 12 | 15 | 27 |
| Unlawful real estate loans | 0 | 14 | 14 |
| Loans without consent of directors | 10 | 3 | 13 |
| Check "kiting" | 6 | 6 | 12 |
| Forgery | 4 | 4 | 8 |
| Effort to sell bank stockholdings to dodge assessments | 5 | 1 | 6 |
| Conversion of funds | 2 | 3 | 5 |
| Evasion of assessment | 2 | 1 | 3 |
| Illegal act unspecified | 3 | 0 | 3 |
| Cashier bribed to make loan | 1 | 1 | 2 |
| Overdrawing correspondent accounts | 2 | 0 | 2 |
| Replacing charged-off asset in bank | 2 | - | 2 |

Note: Other criticisms occurring only once were: use of bank's funds to support market for bank's stock; defalcation in affiliated bank; loan on bank's own stock; certification of a customer's check on an overdrawn account; efforts to sell bank stock by promising large credit extensions; illegal interest paid on C/D's; sale of worthless notes to bank's customers on promise to repurchase after examiner left; bonds held in safekeeping for customer pledged as collateral for bank loans; general dishonesty; misapplication of voluntary contribution; violation of guaranty; directors reimbursed for reserve penalties charged to them; failure to remit proceeds of collections made on rediscounts; rediscounted notes not shown on bank's books; crediting interest on "loss" paper to earnings to pay a dividend.

The most frequent of the violations of law mentioned by examiners was "loans over the legal limit" which was reported in 95 banks. In some cases these excessive loans were illegal in amount at the time of their granting, and in other cases they were increased to illegal size because the debtor could not pay his note at maturity and the bank was compelled to renew the note for its original amount, plus interest. In still other cases, loans became excessive through the reduction in capital or surplus of the bank after the loans were made. To avoid overemphasis on the frequency with which excessive loans appeared in the examiners' comments, there were included in the tabulation only those banks where excessive loans were a chronic condition.

## Inactive Directors

In 101 of the 225 closed banks selected for this survey, bank directors were criticized for paying too little attention to the affairs of the bank. In many instances the directors were merely appointed to fulfill the legal requirements as to the number of men on the board of directors by the self-serving managing officer owning the controlling stock in the bank. Such directors were usually controlled by the dominating official's wishes, and were also frequently lacking in business experience.

In other cases the directors considered that their positions were merely honorary and placed full reliance on the ability and honesty of the managing officers whom they elected. Directors' meetings were infrequent, and when they occurred they were mere formalities.

In case 15 is found a typical examiner's comment describing the board of directors of a "one-man bank." In 1929 the examiner wrote:

> "For many years, and until two years ago, bank was operated along the line of one-man policy. Vice President P, active, dominated his board of directors, as well as all employees of the bank. Until his own affairs became so badly involved, he was generally considered an able executive, and enjoyed the reputation of being able to work out bad situations. He owes the bank at this time in excess of $19,000, only partly secured. After exhaustive quizzing and close analysis of his financial statement, the conclusion is reached that he is insolvent. It further developed that he does not always confine himself to true statement of facts. For this reason and the condition of his personal affairs, he is not believed fitted for the position that he is now filling. The board of directors as a whole is weak in banking experience. Having been dominated for so long a time by Mr. P they hesitate now or are not qualified to render the aggressive assistance that is necessary under existing conditions. T, S and U are elderly men, representing substantial financial worth with their principal interest in farming. V is a banker of W, and an inactive di-

rector. He usually attends annual meetings. X, Cashier of the bank and a director, exercises no authority beyond the supervision of the detail work of the bank. His financial worth, if any, is small. Y is a general contractor. They have never had an expression from him at board meetings, his financial condition is close to insolvency, and he owes the bank in excess of $15,000, only partly secured. S, warehouseman, a young man, apparently making a success in his line. As above stated, he is the only member of the board who shows any aggressiveness or concern over the bank's condition."

In case 80 was found a typical inactive board of directors whose apathy and inattention to the bank's affairs led to forgeries and other irregularities by the cashier. In 1923 the examiner described the board of directors as follows:

"No change in management or control since last examination. Further investigations disclose the fact that the Cashier dominates and directs the bank's policies. This fact is more apparent by reason that the minutes of the meeting of Directors had not been written up and were completed during examination. By completed, it is meant were written up. The record is merely perfunctory and does not disclose the fact that the directors take active interest. The Vice President and Cashier both state that each day a meeting is held at which time the notes are discussed, though there is no record of such meetings. One director is a boy, a former employee, and now engaged in auto sales business, and is more or less under influence of the Cashier. Another director is a good business man, but moves along the line of least resistance. That the directors are not vigorous is disclosed by the volume of overdue, unsecured and concentrated lines."

Case 14 was a bank whose board of directore was composed of successful business men whose primary interests were so pressing that they neglected their duties as directors of the bank. The bank, as a result, drifted along under incompetent officers until shortly before insolvency when the examiner described the situation as follows:

"The bank is not overly well officered, nor do there appear to be the efficient, trained and experienced officers at the head which an institution of this size should employ and demand. One or more of the executive officials are handicapped and their efficiency retarded to a considerable extent on account of their own personal debts to the bank requiring much of their energy and time to care for personal needs and financing. There are some quite able and successful business men upon the board of directors of this bank. Some of those gentlemen, however, are getting pretty well along in years, and are tired, wish to retire, would prefer to resign on account of the continued criticism they have to face as to the bank, and their lack of interest is plainly noted, although it may be said to the credit of Messrs. L, R, JJ, J, KK and A that they remain loyal, and are believed to still have the interest of community and bank at heart, and who state they will go to the limit and even sacrifice home and other comforts and even necessities to the end that the bank may not have to close."

Case 36 provides a good illustration of the drift toward insolvency of a bank with an incompetent president and an inactive board of directors. In 1921 the examiner criticized the president in the following words:

"Policies appear to be dominated by the president who is nearly seventy years old. His knowledge as to the responsibility of borrowers appears to be rather limited. Whether this is due to carelessness or old age, I am unable to state. Other members of the board are also subject to some criticism."

In 1922 the president was again criticized, and it was apparent from the wording of the report that the board of directors was not functioning.

"The president shows poor judgment in extending credit and should not make loans without the approval of a competent discount committee. If the loans of the bank cannot be handled in this manner, it will probably be necessary to request a change in management."

The same situation existed in 1923, as shown by the following quotation:

"Management of this bank rests almost entirely with the president, who is considered not a good judge of credits, - evidenced by the condition of loans. In the past, the president has made practically all loans without consulting the discount committee, and at the next board meeting would submit such loans for approval. It was agreed that future loans would all be submitted to the discount committee before being made."

By 1925 the condition had become menacing, and the examiner described the management as follows. (The bank closed early in 1926.)

"Condition here is very unsatisfactory. President owns control of the stock and is not considered capable of correcting the condition. Directors are mere figureheads. No monthly meetings are held, and bank is rapidly drifting into the danger zone. Since last examination, additional excess loans have been made, which is conclusive evidence that no regard is paid to violation of law by these directors. The president has an excess loan and he is also mixed up in other deals in the bank which causes examiner to believe that he has indulged in speculations in the past. This bank is also paying 5% on time deposits, which is entirely too high. As a matter of fact, nothing is done right in this bank, and no letter was taken, as directors will sign anything just to get rid of the examiner. Their last letter was an absolute falsehood."

~~Inactive Directors Permit Bad Banking.~~ The case histories afford numerous examples of banks which were exploited by managing officers and in which the exploitation can be traced directly to the domination of the banks' affairs by one or more unscrupulous officers. Case 26 was such an instance. Early in 1921 the examiner reported the domination of the bank's policies by the president, and described the misuse of bank loans by the bank officials as follows:

"The president dictates the policies of this bank and, as he does not see fit to press collection of notes classed as capital at last examination, there has been no effort made to comply with instructions given at that time. Several of the directors have promised to devote more time to the bank's affairs and see that the loans were given attention. They state they thought this was being done, and had no idea the bank was in this condition.

"Former vice president, who has become rather heavily involved, is owing considerable money to customers of this bank. Present officers, with the exception of the president, are borrowing from this bank and elsewhere to speculate in real estate, and now find themselves owning quantities of land and cannot pay their debts. As soon as this is known, the customers of the bank will undoubtedly have the impression that the institution is being used for speculative purposes only, and, to a certain degree, this is true, for many of the loans have been made for that purpose. The large amount of paper carried past due can be attributed to neglect on the part of the officers."

The same combination of an inactive board of directors and a self-serving group of officers was further described in the fall of 1921 in the following words:

"The policies of the institution are dictated by the president who is the owner of 75 shares of stock. Other directors, aside from the cashier and assistant cashier, are farmers and do not profess to know much about the banking business. It has been the custom to allow the president to make loans and at the regular meeting following to approve loans without much investigation of the basis on which the credit was extended. $26,000 was charged off as loss at this examination, and the directors stated they had no idea that such a condition existed.

"The bank has been paying dividends as high as 40% annually, which indicates that they are more interested in that feature than giving the bank the attention it is entitled to and which is so necessary at this time. The last dividend was cut to 10%. All of the officers have been speculating in land, and their net worth consists entirely of real estate equities, while carrying charges are more than their salary, to say nothing of additional money which will have to be put into the land as per a regular schedule of payments. The president owes about $42,000 to different banks and individuals. Cashier's financial condition is becoming very much involved, and he is owing other banks and individuals $22,000. If there is no improvement in the cashier's affairs at the time of the next examination, it is believed that the interests of the bank can best be conserved by eliminating him from the bank."

Towards the close of 1923 the affairs of the bank officers had become more ~~badly~~ involved, owing to the speculative transactions reported in preceding quotations.

> "The president is attempting to handle the situation alone, and thus far has failed to materially improve it. The cashier is worse than useless and his personal affairs are very much involved, due to speculations in land. Assistant cashier is listless without a constructive idea, and his personal affairs are overextended, due to purchases of heavily encumbered land."

In January, 1924, the examiner reported that the directors continued to be under the domination of the president. His description follows:

> "President has for years dominated the policies of this bank. Cashier and assistant cashier, both dependent on their positions, have been serving as directors, and are not considered capable assistants to the president. Other directors have felt that they have had no voice in the management and think the president's domination has been absolute."

In January, 1925, the condition of the bank had become alarming, with slow, doubtful, and loss classifications of assets totaling $263,000, as compared with a capital and surplus of $38,000. However, the president of the bank continued to be optimistic as to the future of his institution, as shown by the following quotation:

> "The problems to be met in this bank are rendered more difficult through the apparent inability of the president to comprehend the seriousness of the situation. He thinks my estimate of losses too severe, his remarks being 'of course, if this land has no value, then none of the loans are good,' and this expresses fairly well the bank's weakness."

Finally, just before the bank closed in 1926, the examiner described the condition of the bank in the following words:

"Approximately 50% of total loans criticized. $119,000 in real estate loans taken as security for debt, very largely junior liens and the prior encumbrances in many instances are such as to question the value of the bank's equity. During 1925, the bank operated practically without profit, and charged off in excess of $28,000. Assessment of $26,250 was paid. Bank's surplus fund was originally $55,000, which, with the assessment paid, gives some indication of the losses which have already been charged off. Bank's record here as to reserves is known to be one of the worst we have had. Reports of examination and transactions with the bank create the impression that the situation is absolutely hopeless. The only strength in rediscounts or bills payable is in the paper taken."

Case 62 was one of the most flagrant examples of a bank with a dummy board of directors and an unscrupulous bank president. In 1920 a new director was elected to the board of this bank, and the unsatisfactory type of man selected was described in the following quotation:

"A new member of the Board was elected to succeed Director ____, who resigned, (never attended meetings). Serving his own purposes, President X had Assistant Cashier ____, an old-time employee entirely subservient to his every wish, elected Director. Cashier ____ frankly admitted that they were afraid to invite a good man on the Board because they knew he would not stay. There are at least a half dozen local and desirable men holding sufficient stock to qualify that could be selected."

The whole board of directors was apparently under the domination of the president who hoodwinked them at his pleasure, as shown by the following quotation from the same 1920 report:

"In response to inquiry as to why Directors had not answered office letters, President X stated that he had not been able to get them together, quite overlooking the fact that Directors had met three times after letter was received - twice for regular meetings and once to declare a dividend. The other Directors stated that they had not been advised regarding the Examiner's report or letters from your office. (Cashier ____ should be excepted from this, as he is conversant with all matters but a mere tool in the hands of the President.)"

Later in 1920 it was discovered that, while directors' meetings had presumably been held in accordance with the by-laws, it was common practice to neglect notification of two of the directors as to the time of meetings.

> "Directors' meetings have been held numerously during the past four months - eleven in all. At only one of these - a meeting requiring the approval of a bond for funds - were Messrs. ____ and ____, two employees of the bank, Cashier and Note Teller, present. Your Examiner noted this absence, and took the matter up with Mr. X and the two directors as to the reason for so many absences. Mr. X stated the meetings had usually been held about 5 P.M. and the boys had been too busy to attend, though in the banking room at most of the times. The two said that they had not been notified, and had been informed nothing important had come up, and there was a quorum anyway."

The lack of sense of responsibility of the board of directors was described in 1921 by the examiner as follows:

> "It was quite clearly demonstrated during the examination of the assets that aside from what little data the bank held on questioned items (most of which was in the nature of memoranda made by the President) and from statements made by the President, there was little hope of getting much real information from the other members of the Board, and they quite freely admitted that they did not know and that they have depended largely, if not altogether, on the President for information, and have been compelled to accept what he might choose to give them in connection with matters."

By the beginning of 1922 the exploitation of the bank by the president had gone to great lengths, as shown in the following quotation:

> "Notwithstanding the fact that this bank has been subjected to most severe criticisms by your Department, the Chief Examiner and Examiners for more than four years, its condition has been constantly growing worse. During this period of time, the administration of the bank's affairs has been completely dominated by former President X,

who has at all times unquestionably used the bank in many ways to further his own personal interests (most generally employing extraordinary methods in order to conceal the facts), and who has made numerous loans - both in large and excessive sums - of fixed, speculative and questionable character, apparently without any regard whatsoever as to essential liquidity, law and departmental requirements, and the natural consequences most certain to follow in connection with such reckless and hazardous procedure. As a result of the many things in connection with the manipulations of this management, the bank has finally been forced into a most precarious condition, giving due credit, however, to the fact that the somewhat recent general business depression has in no way benefited the situation."

Finally, the board of directors became aware of the serious state of the bank's affairs and were mindful of their duties and liabilities as directors of the institution. Their awakening was described in the following words:

"Other board members, after considering the bank's precarious condition with your Examiner, apparently have awakened to the fact that former President X has seriously mismanaged the bank's affairs, and have now taken a firm stand as to what the future business policies shall be. Directors appear to have lost all faith in X, and, as a consequence, have adopted a resolution asking for Mr. X's resignation."

In case 83, the bank was wrecked by the cashier's speculative loans which probably would have been kept out of the bank if the directors had been active. The attitude of the board of directors was described as follows:

"The _____ family owns control of the stock and the Cashier is the active management and dominates the policy of the bank. The directors do not give the bank the attention they should, but leave the management to the active officers. The officers are capable but lenient with their borrowers, due to competition."

A year later the cashier's unscrupulous acts were described as follows:

> "The bank is carrying a large amount of paper which no bank should carry or be allowed to carry. Along with having numerous loans of large amounts that are slow and will take three to five years to work out for local customers, it is also carrying at least $125,000 of paper for non-customers and non-residents, which is of an extremely speculative nature and should be removed from the assets of the bank. These loans are taken in deals in which the Cashier is largely personally interested."

In case 84 the domination of the bank by its president made it possible for that official to involve the bank in a shortage of $177,000, and other irregularities of at least $50,000. In this case the relationship between the board of directors and the officers of the bank was described as follows:

> "This institution is completely dominated by the President. The directors, with the exception of the President's son, are mere figureheads; they are clerks with official titles and, consequently, would not object to any of the President's practices, even if they were so inclined, for fear of losing their jobs. The President's methods are fast placing this institution in a very precarious condition, and were it not for his own financial responsibility, the situation would be alarming."

Weak Management

Seventy-one banks out of the 225 banks studied were criticized for weak management. In a number of other instances the managing officers were inefficient in some one part of the bank's operation, but these 71 banks had managing officers who displayed a general lack of ability.

In case 21 the Federal reserve bank credit department summarized the weakness of the management in the following paragraph:

"The history of this bank reflects inferior, incapable and careless management, lacking vision and alertness, and as its condition inevitably became more involved there were rumors of lack of integrity. Tendencies known to weak institutions were in evidence throughout most of its history; namely, unwise and unsound granting of credits - these on entirely too liberal a basis under current normal values and incomes - apparently lines increased under inflated values; evasion of loan limit by placing parts of lines with affiliated and other banks; lack of definite information on credits and evasive and deceptive attitude toward examiners; abuse of credit by officers and directors; loans in excess of deposits, with lack of secondary reserve; invested assets being practically all represented by local loans; overloaned and frozen condition, resulting in constant and heavy borrowings - oftentimes, with deficient reserves; lax collection policy, permitting loans to run indefinitely when, with proper action, many lossse might have been avoided; inefficiency reflected in bank's methods generally; board of directors failing to do their duty in correcting wrong tendencies even when so advised by Examining Department........... This was a weak bank under normal conditions, further weakened by inflations of the War period and that which immediately followed it. With no strength to survive falling values or reduced incomes, under other than favorable agricultural and business conditions, bank's weakness was very apparent and lack of confidence ensued. It had no strength to resist adverse conditions and closing was only a natural consequence."

In the excerpts from examiners' comments there were frequent criticisms of the inefficiency of the bank officials, such as the following from case 100:

"After a very thorough examination of this institution, both examiners were of the opinion that the present active officers can be charged to a great extent with the present condition of the bank. The active head, Mr. C, is absolutely inefficient, and admitted to his board, in examiners' presence, that he was a poor credit man, and was unable to make collections as he should. The large lines carried through good years without any liquidations are an evidence of that fact. If this institution <u>can</u> be worked out, it will require a far more aggressive man at the head of it."

General incompetency of the bank management was cited in case 68. The president of that bank was an outspoken man who made a very good impression on the bank examiners until 1923, when the first faint suspicion of his ability was voiced by the examiner in the following words:

> "X is considered a competent banker, has been in this locality for a number of years and is thoroughly conversant with conditions and the proper method of conducting a bank in an agricultural community. However, it must be said that in the past and I believe, even yet, he is inclined to err on the side of liberality in granting credits."

In November, 1924, the succeeding examiner stated that the domination of Mr. X had proved prejudicial to the best interests of the depositors. He also wrote:

> "His financial capacities are very limited, but his other capacities are good. For what he has done and tried to do he is to be commended. BUT HIS BANK STILL REMAINS A DISGRACE TO THE NATIONAL SYSTEM."

Case 120 was a one-man bank, dominated by its president, who enjoyed in extraordinary degree the confidence of the public. Based on an overly optimistic outlook for the future of city property, the president made a large amount of undesirable loans. His position in his bank was described in 1922 as follows:

> "President A is the dominating character. It is evident that he has in the past been reluctant to share any authority or responsibility with any other officers, or even directors, and has not been disposed to consult with the directors any more than absolutely necessary. The last report of examination, likewise letters written by the Comptroller addressed to the Board of Directors, have not been submitted to the directors, and no mention made in the minutes of board meetings. President A has taken it upon himself to answer such communications. Management has been far from aggressive, the borrowers have been educated to add interest to their loans whenever renewed if unable or not convenient to pay the interest, and it will be difficult for the officers to re-

verse such a practice or policy. President offered to resign and turn the management over to some one else, which is inadvisable. So far as public confidence in the bank is concerned he is its strongest asset. If the general public takes cognizance of the bank being frequently examined, it would create an alarm, that in the opinion of your Examiner would force the closing of the bank. President A is also downhearted and much worried over the bank's condition, all of which affects the welfare of the bank."

At the beginning of 1923 it began to appear that the salvation of the bank rested in the infusion of new blood in the management, as described in the following paragraph:

"Salvation and hope of this bank working out of its present difficulties depends on obtaining sufficient outside directors (other than active officers) who will and can curb the optimistic tendencies of President A in his free granting of loans without adequate credit data, (as well as to himself, relatives, friends, and other business associates.) Directors B, C and D are meeting daily, authorizing all renewals before made, as well as other loans, and they advised President A he must co-operate with them if he expected to retain his position and save the bank from ruination. President A still holds the confidence of the community, and it is inadvisable to remove him, the bank cannot afford to employ additional competent help, and it is very doubtful if any capable and experienced man would assume the worry and responsibility that would naturally be thrust upon him in the management of the bank's affairs."

In 1926 the examiner recapitulated the factors of weakness in this bank's management in the following words:

"Your examiner was of the opinion that the greatest danger at that time, after the new capital had been paid in, was the optimistic management, their disregard for the provisions or requirements of the National Bank Act, and an apparent utter disregard for instructions of examiners and your department. This, coupled with an exceptionally weak board of directors, dominated and influenced by President A left your examiner with a feeling of uneasiness as to the bank's future. President A in 1923 repeatedly admitted that he alone was responsible for the bank's unsatisfactory condition, and that no one else should be censured. Your examiner believes President A is chiefly responsible for the bank's unsatisfactory condition today. Examiner is of the opinion that with proper management, and had a policy of conservative banking been in effect the past three years, the bank would be on a dividend paying basis today. The bank has attained its growth in spite of the weak management simply because as a whole the territory tributary has been developed, the town has grown."

Sometimes it was not an individual but a group which dominated the bank in a manner adverse to its best interests. In case 8, family domination was apparent. In 1922 the examiner wrote:

"AA, President, and the father of CJA and CSA is somewhat the hidden dominating force, inactive, but exerts his influence by reason of family relations, etc. CJA, Vice President and Cashier, active in the management, apparently of honest purpose, but limited as to ability, carries the full responsibility of management and is burdened entirely too much with the detail operation of the bank. CSA, Assistant Cashier and brother of CJA, acts in the capacity of teller, my opinion is that he does not give his full time to the bank, is wholly indifferent to manner in which bank is run, and does not assume the duties or responsibilities that he should, his wife works in the bank and I dare say does not earn her pay. F, Assistant Cashier is only a fair clerk, and has the greater amount of general bookkeeping to do, but is thought could and would keep his work in good shape with proper instruction and supervision, two other clerks, a lady and a young man, are required to do the individual bookkeeping, which could easily be carried on with one with assistance from some other clerk, in other words they have at least one too many clerks if not two. Of the directors, G, C, and D, are believed of average ability both as business men and as bank directors, that is to say for a small town, but their interest and supervision is considerably subordinated to the A interest and control."

The inefficiency of this family group was further described by the examiner in 1924 as follows:

"The bank is dominated by the A interest and that principally the President, altho he is not active, nevertheless this is true. The Vice President and Assistant Cashier are both sons of the President and the Assistant Cashier's wife is also an employee of the bank. The opinion of your examiner is that CJA, Vice President and Cashier has a desire to conduct the bank as it should be, his methods are somewhat crude and his policies lenient 'tis true, but he indicated a desire to do the right thing, but he is restricted on every side in accomplishing anything for the reason he does not have the support and cooperation of the working force or his father who is President. At present the bank has no 'Head' that is to say, one with complete authority to see that things are done as they should be. The Vice President and Cashier tries to do and look after everything with result practically nothing is really accomplished. Assistant Cashier A does not appear concerned about the welfare of the bank, is not interested in complying with law and office instructions, he comes and goes at will, so does his wife, the individual bookkeeper does the same. Assistant Cashier F is connected with several outside interests besides numerous public affairs, all of which take some of his time, this leaves only one lady who is giving the bank full service and loyalty with it. Your examiner has endeavored to make himself very plain to the Cashier in this connection and has enumerated all of the above facts to him, further have advised him that the writer and your office were very much dissatisfied with the small progress they have made in adjusting matters of criticism. Replying the Cashier admits the fact he does not have the entire support of the organization and the justification of examiners remarks, he further promises to take these matters up in the immediate future with his board of directors in an effort to make such corrections in the working force that will insure proper correction of matters now under criticism, even if necessary for him to resign. Examiner has advised him that no person attempting to conduct the bank would tolerate the services of the remaining force, unless it is the one lady previously referred to. Whether or not anything is done in this respect remains to be seen. The opinion of your examiner is that things will run along pretty much as they are until the death of the President when no doubt there will be changes brought about."

In case 82, the bank was run by heirs of the former bank owner. These heirs had little banking experience, and furthermore were involved in continual bickering over seniority in the bank and patronage rights. The situation in 1928 was described as follows:

"During the administration of ____, deceased, former president of this bank, his nephew was its cashier in charge of the first teller's cage and ____, recruited from a ____ bank, was its Vice President, working under the President's close supervision. Upon the death of ____ four years ago, Mr. ____, being the older of these two and the more assumptive, appears to have declared himself the bank's manager and, being devoid of either ability or financial worth, to have proceeded to over-extend both the bank and himself to a dangerous degree, this, without regard for the admonitions of the Cashier, the directors of the bank, or your office. The Cashier, a thrifty lad, with access to the ____ fortune, but reticent about advancing on his own judgement, deferred to the Vice President until last summer when the advance of the boll weevil threatened the local cotton crop and insolvency threatened the institution, the directors advanced the Cashier to the management, an action which the Vice President resented and which finally brought the two to blows. Last December, directors ____, Mrs. ____ and ____ called your examiner to Mrs. ____'s home in ____ and expressed themselves as disposed to eliminate the Vice President and inquired if I would myself consider assuming the management of this bank or would recommend someone who might. Although their effort to find some suitable person was without fruit, the Vice President appears to have discovered it and to have summarily changed his course in an almost desperate effort to appease his board and retain his position. He now readily defers to the Cashier and works 'like a trooper.' His desk is now behind the fixtures and although his ability is extremely limited, he is doing some good. His office force lacks coordination, each clerk digging for himself so that the result is more the running about and barking of a dog-town rather than the united industry of an ant hill but he has two new men who are fair clerks and the records are somewhat improved. He has consolidated his personal borrowings, formerly scattered among the bank's correspondents, with the Cashier, who holds his bank stock as collateral. The Cashier, since the first of the year, appears to have assumed full charge of the bank's note case. He is slow and ordinarily is conservative. He throws back, however, to the former president's practice of overloaning a tenant farmer population, and all of the top-heavy new loans referred to in the criticisms of this report are his own and are specially set out in order to bring him to his senses. He made a good record in his collections from this fall's cotton crop, which saved his stockholders untold assessments. Now he should stay on his base."

Exploitation of Bank by Management

Managing officers or influential directors of a number of the failed banks included in this study used their positions to secure favors from the bank and at times to finance speculative or fraudulent transactions of their own. In some cases the exploitations were not of a vital nature, such as the abuse of the overdraft privilege; but most of the cases mentioned by examiners were much more serious.

In case 71 the cashier was stated to have loaded the bank with a sizable amount of "other real estate," as well as a large amount of loans based on second mortgages, where the indications were that these loans were originally real estate deals of the cashier. Other officers and directors also misused the funds of the bank, as shown by the examiner's statement in 1929:

> "Exploitation by officers and directors for their relatives and affiliated interests is the chief reason for the deplorable condition. Over $75,000.00 of placed paper emanating from their concerns has been charged out in the past, and every item appearing under their 'Large Line' should be charged out."

In case 42 the self-serving attitude of the bank president is well described in quotations from two examinations in 1929.

> February, 1929 - "The condition of this bank is far from satisfactory. A new president was elected recently to succeed A who is now looking after his personal affairs. In my opinion there is grave danger that A will still attempt to dominate the bank. Former President A during his tenure of office made large loans to his family and affiliated interests. While your examiner is not alarmed at the present time over these large lines, yet there is always a potential danger in large concentrations of credit to a single interest. The A estate has valuable properties, but the management of its affairs by former President A is worthy of some criticism. The personal habits of this man are not above reproach, and the public generally seem to know that he is addicted to the excessive use of liquor. During Mr. A's management of the bank, he had no regard for the spirit of

the law, and readily admitted to your examiner that he had violated the provisions of section 5200 by carrying accommodation paper for the benefit of customers whose borrowings had reached the legal limit."

July, 1929 - "At the regular election of officers in January, Director C was elected president, but due to ill health, retired on July 1, and Mr. A was re-elected. President A is the dominating element in the bank. He and his family own actual stock control. Mr. A's ideas of banking principles are fundamentally unsound. He has regarded the bank as being operated for the benefits of his own interests and the large line set up is concrete evidence of the result of his regime. Cashier D is no banker. He was formerly County School Superintendent. Cashier D is thoroughly in sympathy with the policies of President A and is unlikely to oppose him."

In case 49, a family dominated the bank and used it for their own interests, beyond the limitation of good judgment. In 1922 the examiner said:

"President A and his family exercise control in management. Bank has lately become involved in bankruptcy proceedings of a member of the X C. Co., whereby it is disclosed that President A received a bonus on material used in the road construction by the X C. Company, and the interest thus created in the enterprise evidently influenced him in granting loans to the company of $18,000, far in excess of the legal limit."

The bad effect of this lending policy was described in 1923 as follows:

"Bank still holds among its assets items resulting from the bankruptcy of the X C. Company. President A's connection with operations of the X C. Company have been reported in previous examinations. The tendencies of the As to become involved in various enterprises wherein they were to share in the profits in return for furnishing operators funds from the bank, has been apparently somewhat curtailed through their experience with the X C. Co., but this inclination will have to be kept in mind in examinations of the bank as long as the As are in active management."

In case 46, the vice president drew a salary from the bank without rendering any service for it. The condition was described in 1923 as follows:

"It was found during examination that Vice President A was drawing a salary of $1800 without rendering any service to the bank, other than attendance as director. Matter was talked over with the board and they readily agreed that it was unjust to balance of stockholders, but they were unable to help it on account of A controlling the majority of stock. It is understood that he draws salaries from other banks without rendering any service other than as a member of the board."

Case 108 was a bank purchased and wrecked by promoters. The method of operation of these men was described after the failure of the bank in 1924 as follows:

"In the spring of 1922 the A family had so misused and stolen the bank out that the writer called the Chief Examiner into conference. Mr. B, a director at that time, together with President C, guaranteed the solvency. Mr. B was worth enough to do this. At that time the bank was broke. It would hardly have paid 10 cents on the dollar. Mr. B was an old cow-man. He was lost in the bank. He soon grew tired of the banking business, after paying in some $46,000 to take out bad assets. He agreed to give the bank to his cashier, Mr. D, who was planning with some friends to undermine Mr. B, anyway. However, Mr. D could not make a go of it as it was still broke without the B and C guarantee. It was assessed 100%. D could not pay it, nor could his associates, Mr. E, a broke promoter who had readily lined up with D in a get-rich-scheme, and Mr. F who had formerly worked with Mr. D at the Federal Reserve Bank, and had been induced to leave the Federal Bank and came to X with his small savings on a rosy picture of the future by Mr. D. None of these men could pay the assessment. Mr. B could and was liable but he would not as he was sick of banking. He felt his life was in danger. He agreed to go to Y and borrow the necessary money, loan it to D, E and F to pay the assessment of $15,000, take their note secured by all but 15 shares, the other $10,000 in losses was to be provided for by the reduction of the capital from $35,000 to $25,000. D fell out with his associates who accused him of misrepresenting to them. Mr. G, a broke banker from Z, a friend of Mr. E, came over and agreed to take the presidency. Accordingly, G, E and F made a note to Mr. B for $15,000, which was paid into the bank. Instructions were left them as to how to proceed with the reduction of the capital from $35,000 to $25,000. They made only a pretense of reducing the capital. They never called a formal meeting of the stockholders. They never held a formal meeting of any kind, at least the minutes do not so record. Mr. F states that G, E and F, who owned over two-thirds, voted to reduce. Anyway, it was only a book entry and the capital was reduced on the bank's books to $25,000. This gave what I considered at that time a solvent bank, still somewhat burdened with slow paper. But a very weak board of directors and a management that was weak but honest. Mr. F is believed honest. He was active in charge. G was figurehead. E a promoter, was dangerous, but outside of being on the note had no say so to amount to anything. E had figured that he could resell this stock to substantial parties in the community, pay off B and have a $10,000 profit to divide with F and G. He was a promoter and insurance salesman and did have some ability along this line. He was advised that under no conditions could he place the notes representing the sale of stock into the bank. He then wanted to scheme out. Some way, G got in touch with a Mr. H and I. They examined the assets carefully. They agreed to buy the bank stock held by G, E and F, paying them $3,260 cash and assuming the note to B for $15,000. G, E and F, in their anxiety to get from under the loan to Mr. B, turned the bank over to Mr. I and H, who drew two drafts aggregating $3,260 on J, and paid off G and E and F. However, they were afraid to call B in on the trade for fear he would block it. From letters on file exchanged between I and H, I am sure it was a frame-up. These drafts were returned unpaid from J, as they knew they would be, and H and I placed their own worthless notes in the assets, now as they were in the saddle. B soon found it out and of course felt that he should have been consulted. He refused to release G, E and F off his note but did agree for I and H to go on now. But when his $15,000 note came due he came in and demanded the money. I could not pay and B caused such a racket and talked it over town as to how I and H had secured control of the bank that a run started. It was never entirely quieted and finally closed the bank."

In case 12, the management of the bank blamed their predecessors for the questionable loans in the bank. There was some ground for this blame, and yet the new owners soon placed the bank in a still more unsatisfactory condition. Their attempt to blame the former management was described by the examiner in 1922 as follows:

"The many other criticisms which when summed up clearly indicate that the bank is suffering from the effects of maladministration to a considerable extent on the part of former officers antedating the purchase of a controlling interest in the bank by D and C. This applies of course more to the criticised loans, and it must be said that the present management has succeeded in clearing up many unsatisfactory lines. It is typical of the 'one man domination,' and subject to all the evils incident thereto, as expressed in the number and character of criticisms. In view of the difficulties which have always surrounded the situation and the local conditions which have prevailed during the last two years, it has been your Examiner's desire to give the bank the benefit of every reasonable doubt, but the progress made has been disappointing and the time seems to have arrived when reestablishment of asset values has become necessary, regardless of who or what may or may not have been responsible for the bank's present condition. Mr. C has stated to your Examiner that he has achieved his purpose in life at thirty-four years of age, namely to be worth a million dollars and the solution of the problem in connection with the bank is believed to be in his ability to protect his large interest by making good the losses, since to charge them off and exhaust the surplus by so doing would no doubt imperil the bank's continuance."

By the fall of 1923 it became clearly evident that the new management was at least equally ~~as much~~ to blame for the conditions of the bank as the former owners, for the examiner wrote:

"To predict the outcome and future of this institution is very difficult. Like all stories there are two sides, and there is no exception to the rule in this bank. The officers tell the story that they have for a long time had much trouble among themselves, through former acts of mismanagement, unwise and unwarranted loans and extensions of credit, dissenting members of the Board leaving the directorate and now using their influence to injure the name and standing of the bank. The President, Mr. C, claims that he has neglected his own personal affairs and business to work for the bank in its difficulties and troubles and relates long stories of self-sacrifice, spending and depositing of money, traveling clear to England and making innumerable trips in the interest of the bank and proudly declaring the things he has accomplished. He is an interesting man, a good talker, shrewd, suave and diplomatic, keen and sharp. He puts forth his side of the story ahead of everything else. He loses sight of the fact that he and his enterprises have long 'ridden the bank,' self-served to the limit, caused much criticism to be heaped upon the bank on account of his actions, yet feels that he is and has been the means of 'saving the bank' as he terms the work. It apparently had not often occurred to him that by his own actions the bank had suffered fully as much as by the actions of others."

## Outside Activities of Bank Officers

In several cases bank officers were conducting business enterprises or were holding public office aside from their official bank duties. In such cases it was generally found that these outside activities absorbed so much time and energy that the bank officers slighted their primary work. In case 65, the managing officer of the bank was involved in local politics, liquor running, and oil prospecting. The difficulties in which this involved the bank were described in 1921 as follows:

> "I have never regarded the X's as of high caliber and now that a real crisis impends, X is telling the real truth about his loans, and they reveal a woeful lack of credit knowledge (friendship and good-fellow loans). X has also financed the running of whiskey to some extent (loss to result, or now present); also some of his old customers drifted into the liquor traffic. In fact, quite a number of _____ persons were at one time engaged in what appeared to be a prosperous, though hazardous and temporary business. X has also interested himself in the oil game, which in this state is the worst kind of wild-catting. He tells me he has not actually put money into a project, but has allowed his name to become publicly associated with interests connected with it. Another thing: X is Mayor of _____, being elected after a bitter campaign which apparently ended in a factional town 'fight'. These various activities have tended to cause comment and finally open talk not only in _____ but in the immediate vicinity, and a serious drop in deposits ($40,000) during the past thirty days is the answer. The bank has never been a prosperous one, but the X's have 'milked it' by the salary route; X's salary of $6,000.00 per year is absolutely ridiculous, not only from the point of his ability as a manager but also the bank's size and ability to pay such a salary. As to loans to the X's: I found that a considerable portion of the loans to _____ and _____ (mere clerks) were given for differences or shortages in warrant or similar accounts which their brother, X, has made them responsible for. That portion was ordered off the books at once. X is apparently thoroughly and completely disheartened with his problem, and this attitude (that of quitting) is the really serious thing about the bank."

In several cases the outside activities of bank officers were instrumental in bringing into the bank's assets a volume of undesirable loans. This matter has been mentioned in several other parts of this survey. Case 66 will serve to illustrate the point. In 1921 the examiner wrote:

"Control held by Y and X, vice president and cashier, respectively. It appears that in the past the management of the bank has been largely left by the directors with Messrs. X and Y, who are both active, and that Y probably dominated and directed the policy of the bank. X and Y are copartners, and for a number of years have been engaged in business outside of the bank, largely speculative, their dealings being largely in lands and livestock. Considerable of the paper criticised in this report has come into the bank through operations of this kind."

## Involved Affairs of Owners

Running through ~~all~~ the comments regarding weak management and the exploitation of banks by their owners, were comments showing that the owners gradually became involved in losses which depleted their capital and made their bank loans highly unsatisfactory. Case 69 is an example of this sort, where the examiner described the financial condition of the directors and president as follows:

"Too much confidence has been placed in the Cashier of this institution, and the Directors have not fulfilled their duties as prescribed by statute. In making up financial statements, the Directors did not include liabilities which they should have included. Directors _____, _____, _____ and the President have been reported to have speculated in grain, and they are reported to have lost $5,000.00 each; none of these men reported these losses as liabilities on financial statements to the Federal Reserve Bank. The indirect borrowings from the _____ Trust Company on a note of $12,000.00 for the bank was never reported, nor was it divulged to the examiner; other joint notes to the same concern in the amount of $11,500.00 of Directors were not reported in their financial statements. A loss of over $10,000.00 sustained by loans to _____ a renter on the land owned by the bank, was also never reported. The present payroll of the institution is now $675.00 per month; this, with current expenses, will result in daily loss, impairment of surplus and capital. Both Directors and Officers have executed notes personally and for the bank to such an extent that their personal guarantee is of no value, with the possible exception of _____ and _____. The Officers and Directors have also failed upon request to honestly state the condition of their personal standing, as well as the bank's, and have wilfully withheld necessary information."

## Illness and Death of Officers

All banks have the problem of furnishing substitutes or replacement for bank officials who are incapacitated due to illness or who die or are forced to retire on account of age. The failed banks used in this survey were no exception. There were frequent cases where managing officers became ill or grew aged and infirm and were unable to carry on the bank's affairs in a satisfactory manner. A few bank officials were involved in defalcations and committed suicide. One bank official lost his memory and since his bank maintained no adequate credit records, the bank suffered great embarrassment until its affairs could be untangled. Other officers disappeared, with a resulting loss of public confidence in their banks. The most serious results of these personnel difficulties occurred in the smaller country banks where the management was vested in one or two officials. In such banks substitutions in the work of managing the bank were difficult. The operating officers had no understudies. Where an official became incompetent on account of his age, it was sometimes impossible for the bank to afford the services of a second officer to take part of the duties of the first. All of these factors led to slipshod banking, especially in the matter of granting new loans and making collections.

## Difficulty in Removing Officers

Examiners repeatedly referred to the difficulty of removing bank officers who were incompetent, unscrupulous, or dishonest. Frequently these officers owned the controlling interest in their banks and dominated their boards of directors. In such circumstances the board of directors did not wish to antagonize the owner of the bank by voting for his removal as an officer, and, in fact, it is doubtful if such a method of removal would have served any good purpose as at the next directors' election the owner of the majority stock would have replaced the existing board of directors by another group of men who would replace him in office. In case 112, the examiner described the inability of an examiner to remove a bank employee in the following words:

> "Directors were advised that examiner had no authority to demand or request resignation of any employee, but that it was duty of examiner to make recommendations to directors for good of bank, and it was suggested that if present management did not show a desire or inclination to work with directors that directors should employ some one who would take charge of bank's loans and who would be responsible only to board and not subject to interference by president or cashier, and it was further suggested that directors compel officers to comply with resolutions passed that no new loans in excess of $500 be made without first being authorized by finance committee and that directors compel officers to furnish at board meetings information they desire concerning status of loans and other assets, and that if present officers are not competent in opinion of directors and the bank's welfare would be improved by a change of management that they give serious consideration to same."

In some cases the board of directors and the examiner recognized the weakness or detrimental influence of a bank officer, but allowed him to continue in office rather than to risk the loss of public confidence which might arise from a change of management. Case 70 was such an instance. In that bank the examiner reported in 1921 that the president had been removed from active management, but was allowed to retain his title. The examiner's statement follows:

> "Your examiner does not question the integrity of the president at this time, but his judgment has been exceedingly poor. He has permitted his customers to impose upon him, and is very optimistic even at the present time..... At the meeting with the board of directors, a resolution was passed prohibiting the president from making or renewing any loans whatsoever, and the directors are to hold weekly meetings and make weekly reports of the progress made to the Chief Examiner and your examiner. The matter of requesting the resignation of the

president was suggested to the board, but their disapproval of this course was unanimous. The president holds the confidence of the community and the directors felt that to have it known that Mr. X was no longer actively interested in the bank's affairs would work to the detriment of the bank. He is, however, to be practically relieved of responsibility in the management of the affairs of the bank."

It later developed that it was impossible to prevent further detrimental actions by the president of the bank, and in 1922 it was found necessary to remove him from office in order to secure further loans from the War Finance Corporation and the Federal reserve bank. This action was described in 1922 as follows:

"So acute had the situation become, it appears to your examiner that in late December or early January further accommodations sought and obtained in some measure through the War Finance Corporation was secured only after Mr. X had consented, whether voluntarily or otherwise your examiner does not undertake to determine, to renounce his powers and duties as active president; and since some date in January or February Mr. _____, who was elected as vice president, has been in active control and management and determining the policies of the bank. Under the terms of the resolution providing for his installation, there is a recitation that his employment is to continue until the War Finance loan is repaid. It is further proper to state that Mr. _____ has the confidence and support of the Federal Reserve Bank, and that the Federal Reserve Bank will continue its accommodations as long as he is in charge. Mr. X, the deposed president and his associates, some of them, at least, have control of the stock. So far as I have been able to discover, Mr. X has not interfered with the management and conduct of the bank during Mr. _____'s administration; and I can readily imagine that he has not concerned himself particularly to help or do any real lifting, so far as it may be apparent, at least, in the bank's present condition to get it into easier and more comfortable circumstances."

Later it became necessary to levy a 100 per cent assessment. The deposed president made it a condition of voluntary payment of this assessment that he be allowed to regain his position as president of the bank. This seemed to be the only possible way to avert the bank's closing, and he was allowed to resume his position.

In case 105, the president engaged in cotton speculation as previously described, and the other stockholders were very anxious to eliminate him from management. They even offered him more for his stock than it was worth, but he refused the offer and remained in control of the bank until 1926. The efforts to get rid of this man were described by the examiner in 1925 as follows:

> "His resignation has been obtained repeatedly but he continues to dominate the bank's affairs and will always do so until he disposes of his stock. He claims he has been trying to do this, but the examiner is reliably informed that he was offered more than the stock was actually worth and refused the offer. He is the hardest man to do anything with that this examiner has ever come in contact with, he will promise <u>anything</u> and never fulfills a promise."

In case 2, the examiner tried repeatedly to secure the resignation of the bank president who had engaged in check kiting and other forms of exploitation of the bank, but the president refused to sell his bank stock or resign. The examiner stated that the only possible chance to save the bank was to force a consolidation with the other bank in the town. However, in this case the president of the bank finally sold his stock to outside parties. It was not stated just what caused the president to take this action. The examiner's description of the situation follows:

> "At the same time President A was determined to dominate the policies of the bank and would not consent to anything else so long as he held any stock or had anything to do with it at all, but the public had lost all confidence in him and the bank on account of his management and his extended condition personally. A banker had offered to put $30,000.00 new money into the bank for its capital if President A and his board would agree to take out $25,000.00 of the worthless notes and the other real estate, to elect new directors, and place it on a sound basis, but he said he would not do that. Examiner could see this as only possible chance to save the bank, or to force a consolidation with the other bank here, as a last resort."

In one case the examiner stated that the only way to induce the president of the bank to retire on account of his age was to levy a heavy assessment against the stockholders. This ~~bank~~ was case 36, and the examiner's statement written in 1926 was as follows:

"The examiner believes that an assessment is highly desirable if for no other reason than to get the president out of the bank and his stock placed in responsible hands."

Case 60 presents the unusual occurrence of a group of depositors forcing the board of directors to reinstate as president a former cashier who had been removed for incompetency. The removal of this man by the directors in 1929 was described as follows:

"The directors of this bank continue to allow A to dominate the policies of the bank. He is largely responsible for the excessive loans and bank's general unsatisfactory condition. C, former assistant cashier and bookkeeper, resigned recently. The directors obtained the service of D, a local boy, who for the past few years has held a position as bookkeeper in one of the large X banks. He was elected as cashier and director; A being removed as cashier and director, but retained as assistant cashier.

"The change has not improved the situation. Mr. A continues at the same work and cashier D is the bookkeeper.

"Cashier D has not had the necessary experience to qualify as an executive. Mr. A spends considerable of his time in looking after his farm and his insurance business and the affairs of the bank have suffered.

"President B, who has been quite active in the past year is a man sixty-five years of age, now failing in health and is desirous of being relieved of the responsibilities.

"A meeting of the board was held during examination. The directors were urged to make the necessary changes with a view toward placing the bank in satisfactory condition."

The examiner was very much surprised at the time of his next examination to find Mr. A acting as president of the bank, and the reason for his return to authority was described as follows:

"The examination of this bank was made in the regular course. Your examiner entered the bank the morning of March 26, 1930 at 7:30 A.M., and found Cashier C in charge. A, former cashier, who resigned at the time of the last examination was elected president of the bank at the last regular stockholders' meeting. His election as president was brought about through demands on the board of directors by some of the large depositors that he return as an active officer or they would withdraw their money.

"Cashier C informed your examiner that the bank had lost about $20,000.00 in deposits and the directors were forced to take A bank into the bank."

## CHAPTER VII

## ECONOMIC, CLIMATIC, AND COMPETITIVE FACTORS

Among factors that eventuated in bank failures examiners' reports as a rule laid stress on those that were in large measure controllable by the management, and consequently they do not throw much light on general economic conditions in their relation to the suspension of banks. Some economic, climatic, and competitive factors are, however, included in the examiners' analyses of banking situations. The most frequently mentioned external factors were crop failures, lower commodity prices, bank failures in the vicinity, lower land values, and shut-downs of industry and strikes.

In case 39 the examiner criticized the banking structure of the community as being overdeveloped, as shown by the quotation from a 1926 report:

> "This bank is operated in a small town in competition with two other banks, and it is really a one-bank town. The banks are very bitter and one would do almost anything to hurt the other."

However, for several years before this criticism was made, the examiner had been criticizing the management of the subject bank for its weak lending policy. As early as 1923 the following comment appeared:

> "This community has been hard hit on land values. The slow paper is only fair and there is but little prospect for immediate improvement. The active president who is in charge has been away and is not considered a good credit man, nor does he appear to have the force to demand proper security after he is advised of the borrower's financial worth. Examiner attempted to impress upon directors and officers the lack of attention given to loans criticized. Unless energetic effort is made to strengthen the bank along these lines, it could easily drift into an unsafe condition. Too many loans are made without sufficient knowledge of the borrowers' ability to pay."

By the close of 1927, the bank's difficulties from its weak policies had become serious ~~series~~. The examiner wrote:

> "This bank is simply a mess from start to finish. To begin with the president knows nothing of banking, although he is actually trying his best to work things out. The new cashier is lazy and his services will have to be dispensed with. There is little, if any, improvement in the loans, mainly because there is not a real collector in the bank, and it is anticipated they will have many more losses. The directors even now do not seem to realize their responsibility, although they have been told plainly what they would have to do, both by the examiner and the department. Three of the directors have many old past-due loans in the bank resulting from endorsed paper, and still they make no effort to pay. The detail work of the bank is in a deplorable condition. The bank is located in a very small town in which there is another bank operating under a state charter. This state bank is known to be in poor condition, so the picture presents a poor farming community with two poor banking institutions and neither is in a position to take over the other, and a very bitter feeling exists. Close supervision is needed here and, no doubt, eventually this bank will have to close its doors."

Early in 1930 this bank closed, and the examiner described the combination of factors responsible for the failure in the following words:

"The general condition of the bank reflects a materially weaker condition than heretofore existed, due principally to procrastination on the part of the management in not obtaining security and forcing liquidation where essential, continued poor crops, unfavorable prices, deflation in real estate values, and the closing of the local state bank January 25, which has resulted in the withdrawal of $38,000 in deposits since that time. After two conferences with the Board of Directors at which plans were submitted to help effect a correction, a meeting was held at the chief examiner's office, after which directors passed a resolution ordering this bank closed on February 24, 1931."

Case 110 was a bank that was situated in a small town too near a medium-sized city. In 1925 the examiner described the faulty location as follows, but it should be noted that he did not blame the location alone for the bank's difficulties, for he stated that the bank had been badly managed.

"This bank is located not very far from X., a city of approximately 40,000 people, and, unfortunately, a large percentage of its business goes there. Competition is keen; the X banks have made a practise of handling farm paper at 8 per cent, it being customary for small country banks to charge 10 per cent. Local merchants and other enterprises are affected by the business that leaves here. This town cannot be considered a desirable banking point. As previously stated, this bank has been badly managed in the past."

The management was changed, but many poor assets remained in the bank, as shown by the following quotation from the 1927 report:

> "This little bank is situated too near X. on a paved road to ever amount to much. It has been just hanging on for the last two or three years, chiefly because the C. National Bank, X., believes in the ability and character of the present management. The writer also thinks well of Mr. A., the active officer in charge. The trouble is chiefly old lines that were placed here under a former mangement."

In January, 1928, the bank closed. The examiner, who was present at the time of failure, described the difficulties of the bank as follows:

> "This bank closed after the examination and before finishing report. For several years, this bank has been very weak. Under a former management, the loans became very extended. At one time the deposits of this bank reached $340,000.00. The stockholders of this bank have been fighting among themselves. They are dissatisfied on account of not having any dividends in years. All the bank's profits each year have been absorbed in taking care of old losses. President B. is an excellent character. He is about 81 years old and unable to work. He came to this bank some 5 or 6 years ago from the local state bank at the time the banks merged. He is too old to work. He held a contract between himself and the old directors that, while not legal, was difficult to break on account of his good reputation and advanced age. This contract called for a salary of $100.00 per month for life. Vice President A. has been somewhat of a disappointment. He receives a salary of $200.00 per month. The bank was hardly able to pay it. Cashier D. really did the detail work on a salary of $125.00 per month. The salaries of the officers caused the stockholders to hold secret meetings and fall out. As a result, the C. National Bank, X., which had been lending them the money to run on for years, withdrew its support."

Case 56 was another bank in a poor location, as shown by the following quotation from a 1921 report:

> "This bank is located away from the business district of XX and within 50 yards of the entrance to Y., which is a separate municipal corporation, where are located the stockyards. All or practically all of the real estate is owned or controlled by the large interests. The other bank, which is also located in Y., was organized by the same interests that control the yards in order to handle the banking business arising out of the sale of live stock, and is so advantageously located that the business of the yards flows to it naturally. This bank, however, has in the past been able to divert some of the business. During the past eighteen months it has, as many other banks have, experienced a very large decline in deposits. The future success of the bank depends upon its ability to regain its deposits. If that cannot be done, there should be a radical cut in expenses."

Later the bank changed its location to a more central part of the city and, as a result, secured over 1,000 new accounts and decreased its rent materially. Nevertheless, faulty policies burdened the bank with undesirable assets, and in 1924 the bank was forced to close. The examiner, who was present at the time of failure, described the causes of failure as follows:

"The bank's heavy losses are due principally to its weak management and the large concentration of credit extended the bank of Z. and its customers, and the loans to F. for $20,000. Had not these large losses developed, it is believed that this institution could have been reorganized."

Case 96 was a bank situated just across the State line from a group of banks operating under a State guaranty act which used this protective factor for destructive advertising. The examiner blamed the advertising of these competing banks for some of the difficulties in which this bank became involved, but other factors were much more important, as shown by the following statement made at the time of the bank's failure in 1923:

"This community has been particularly hard hit in the past few years, due to the rapid decline in the cattle market and the continued drouth. Had this bank been in a position to withstand the steady withdrawals for just sixty days more, and if the directors had been alive to the condition into which their bank was getting and resourceful enough to use their credit to aid the bank at the time it needed it instead of now, the bank would not be closed. Unfortunately, this little town is near the _____ border line where Guaranty Fund banks make a specialty of advertising the advantages of having one's money safe, and as soon as doubt of the strength of this bank got into the minds of the people they began to draw out their money and put it in Guaranty Fund banks. Cashier A., without any notice to the directors who are strong men financially, let the X. F. & G. Company cancel a bond securing the county funds and made no attempt to replace it with personal bond which could have been done under the new Public Monies Law. The country treasurer was notified on August 6th by the X. Company that its liability ceased 30 days from date. On September 4th, although A had had 30 days in which to prepare a personal bond and get it before the county commissioners, nothing had been done, so the county treasurer, in order to protect himself on his individual bond, presented a draft of $6,000 for payment and, as the bank could not make payment, it failed to open on the morning of September 5th."

Further light is thrown on the weak banking policy responsible for the failure of this bank by the following quotation from the 1922 report:

> "These people have permitted their entire capital and surplus to become tied up in six lines of credit, which are not the best lines in the bank, by any means; in fact, as is usually the case, they are the weakest. They have loaned the limit to the husband and then done the same thing with the wife, claiming they both run separate outfits, all of which, in my opinion, is simply an evasion of the law. At any rate, it is the poorest kind of banking, and needs prompt attention."

## CHAPTER VIII

## SUMMARY

In order to obtain a picture of typical conditions that have led to bank failures during the years 1921 through 1931, an intensive study has been made of 225 selected banks that have suspended during that period. The material analyzed was drawn largely from examiners' reports of the condition of these banks for a period of years prior to suspension. One hundred and twenty of the banks analyzed suspended prior to 1931, and 3 out of 4 of those were located in towns of less than 5,000 population in Federal reserve districts predominantly agricultural. One hundred and five of the banks analyzed suspended in 1931; of these, 47 were located in towns with a population of 5,000 and over, and many were in the industrial districts of the Northeast.

Assets and Liabilities of Suspended Banks. - Analysis of the balance sheets of 225 banks suspending during the years 1921-1931 indicated that the deterioration of assets which resulted in the final closing of banks was in most instances the result of a process developing over a period of years. According to bank examiners' classifications, the questionable assets of suspended banks a considerable time before failure assumed relatively large proportions when compared with the capital and surplus of these banks. In many cases these questionable assets were more than 200 per cent of the capital and surplus of the bank prior to suspension. Large borrowings were characteristic for a considerable period prior to suspension of the 225 banks. There were instances in which borrowings were several times the amount of capital and surplus. In 76 cases out of the 225, the management was criticized for continuous borrowing. The 105 banks which suspended in 1931 had for a considerable time before failure a higher proportion of loans and investments in loans to customers than did all member banks outside of central reserve cities. The suspended banks had a somewhat lower proportion of open-market loans and a somewhat lower proportion of investment securities. Among 225 suspended banks, the ratio of loans to officers, directors, and their interests was higher as compared to capital and surplus than was the case in a group of banks that did not suspend. Typically, the suspended bank prior to failure was advancing to officers, directors, and their interests a figure equivalent to about one-third of capital and surplus.

Criticisms of Loan and Collection Policies. - Examiners' reports constantly criticized officials of a majority of the 225 suspended banks because of lax and careless lending policies, which were often accompanied by slackness in collection efforts. Criticized lending practices were often associated with real estate mortgages and general loans to farmers. Frequently, loans were made to farmers without specific security, and in an effort to secure the loans junior mortgages on farms were subsequently taken. Examiners' comments showed that other types of capital commitment were common. Loans were made which could not be paid in the ordinary course of business at maturity, such loans were constantly renewed, and were thus furnishing capital to borrowers. "Placed paper" and the evasion of loan limits by splitting lines with other banks were often specifically criticized by examiners.

<u>Criticisms of Investment Policies</u>. - Among the 100 banks, which failed during the years 1921-1930, portfolios were heavily weighted with local loans and included relatively few investment securities. Among the 105 banks which suspended in the year 1931, however, a number had relatively large bond accounts. In this group of banks, difficulties with bond investments arose in part from purchases for yield rather than for safety. Bond trading, unlisted bonds, real estate bonds, and convertible bonds were often the specific causes of troubles. Nearly one-third of the 105 banks were criticized by examiners, more or less severely, because of their investments, and a number of others held bonds of poor quality. In several cases where bond depreciation was the primary cause of failure, investments formed a larger proportion of portfolio than loans. During the period covered by the study, depreciation in bond accounts was not found to be serious for many of the banks analyzed until the second examination of 1931. In the Northeastern part of the country especially, bond depreciation was a much larger factor in bank difficulties in 1932 than it had been in 1931 or previous years.

Criticisms of Bank Personnel. - In 135 out of 225 suspended banks evidence of disregard of banking law or regulations on the part of officers or employes was reported by the examiners. In some cases, the offenses were of the most serious nature, as in the case of 28 defalcations, 5 conversions of funds, 8 forgeries, and 27 false statements.

Exceeding the legal limitation on loans to one interest, failure to keep up legal reserves, payment of dividends not currently earned, and excessive investment in banking house were often alluded to by bank examiners. In 101 of the 225 suspended banks, bank directors were criticized because of their lack of attention to the affairs of the banks. Managing officers or influential directors of a number of the failed banks included in this study used their positions to secure favors from the bank, and at times to finance speculative or fraudulent transactions of their own. Attention was often called to the payment of excessive salaries to bank officials.

In 71 out of 225 banks, examiners' criticisms frequently referred to weak management. Weak loan, investment, and collection policies referred to in previous paragraphs are additional indications of ineffective management.

# APPENDIX

Case Histories of Suspended Banks

Case 1

Bank Organized: 1871
Bank Suspended: 1926

Population of Town: 3000 (1910 Census)
3000 (1920 Census)
3000 (1930 Census)

Principal Crops or Industry Served by Bank:

Tobacco, grain, cattle, hogs, and sheep.

Important Excerpts from Reports of Examination: (Amounts in thousands of dollars)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrow- ings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|
| 4-26-20 Exam. S: | 100 | 63 | 917 | 821 | 202 | 99 | 13 | 1 |
| 11-26-20 Exam. T: | 100 | 67 | 833 | 690 | 280 | 240 | 15 | 8 |
| 3-14-21 Exam. U: | 100 | 63 | 791 | 673 | 194 | 85 | 24 | 9 |

6-13-21 Exam. P: "A very satisfactory response was made by the Board of Directors to the examiner's remarks. They are working hard; but thru careless extension of credit, they have gotten into such a condition that they cannot work out rapidly. The Cashier says he 'feels so safe' if he can secure loans with life insurance, that life insurance is 'a hobby' with him. The only way, apparently to collect a good many of these loans is to kill off the borrowers. It seems to me that if the next examination could be made in four months, instead of three, it could be seen better the progress made."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 6-13-21 Exam. P: | 100 | 58 | 781 | 636 | 212 | 96 | 1 | 0 |

6-20-22 Exam. V: "In your examiner's opinion, while this bank is in far from a satisfactory condition, still there seems to be no cause for alarm as a majority of the paper, while slow and unsatisfactory has more than even chance of eventually working out. The Board was impressed with the necessity of requiring reductions wherever possible and it is believed that after the crops have been harvested this fall, there will be substantial reductions in a number of the criticised lines. At time of previous examination your examiner required the board to make good on fines for deficiencies in reserve to the amount of $356.89. It was discovered that this sum was at a later date charged to the expense account and the directors refunded this sum. Since the last examination there has been additional fines of $172.34 making a total of $529.23 which the directors were requested to restore to the bank and which they promised to do, the Cashier stating that each account would be charged with his share and the expense account credited. It is thought that the next examination should be made in about four and one half months and so continued until the bank is in a more satisfactory condition."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 6-20-22 Exam. V: | 100 | 65 | 758 | 581 | 266 | 134 | 0 | 1 |

Case 1 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

12-1-22 Exam. V: "The management and directors of this bank seem content to let things drift along with the hope that conditions will get better without any effort on their part. There is no question in your examiner's mind but that the bank could have shown a much better condition this time if there had been some good hard work done by the management and board. It is true that their main crop (wheat) was a failure this year, but this is a good cattle and hog country and the condition of the other bank in town will show that this failure is not entirely responsible for this bank's extended and overloaned condition as they claim, but is entirely due to lack of aggressiveness on the part of the board and management. The board requested that they be allowed to charge off $3,500. each six months on the losses shown, but were advised that permission would have to be obtained from your office. Their reason for wanting this concession is that they might declare a dividend claiming that if a dividend was passed, it would wreck the bank, this is of course only an idea, and in your examiner's opinion would not have such a serious result. It is respectfully recommended that your office require a bond from the directors guaranteeing the bank against any losses in the paper classed slow and doubtful. The schedule showing directors' liabilities in call of September 15, 1922, is apparently incorrect to the amount of the indirect liability charged to A and possibly one or two others. The bank keeps no record of the directors' endorsements, and when questioned as to how he obtained the amounts, the cashier stated that he took the last report of examination and made his schedule from the amounts shown there. A letter was left with the Cashier to be signed by all its directors and forwarded to your office. In view of unsafe condition of the bank and seeming lack of effort on the part of the management and board, it is respectfully recommended that this bank be examined again in not more than sixty days."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 12-1-22 Exam. V: | 100 | 61 | 836 | 597 | 260 | 201 | 7 | 15 |

2-6-23 Exam. V: "The bank shows some improvement over last examination. Borrowed money has been reduced some $40M, Loans 20M (In addition 6M during examination) and deposits have increased some $30M. Regardless of these figures the management has improved fully 50% in that the directors are taking an active interest in the bank, have recently passed a resolution that everybody must pay at least 10% on their loans at each renewal and have so far lived up to this requirement. Your examiner believes that at last the board and management have awakened to the face that they must show some results, and it is believed the bank can be removed from the special list or at least allowed to run 4½ months before another examination."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 2-6-23 Exam. V: | 100 | 52 | 815 | 633 | 216 | 197 | 6 | 16 |

5-29-23 Exam. V: "Your examiner did not hold a board meeting inasmuch as all directors were not available, and furthermore the bank is seemingly having their attention. While still loaded with many frozen loans, it appears that everything possible is being done to prevent a loss and those loans will be worked out as rapidly as possible. Many of those loans are secured by life insurance policies on which the bank is paying the premiums. This item is costing them approximately 3M per annum which of course materially cuts down their earnings. The attitude of the management and directors has undergone a great change in the past six months, in that instead of being indifferent they are now on their toes and working hard to bring the bank back to a sound, solvent condition. This is evidenced by the follow-

Case 1 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

ing figures. Loans reduced since previous examination $52M. Borrowed money $96M and deposits have increased 31M. Your examiner is of the opinion that the bank can safely be removed from the special list and respectfully recommends that this be done."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 5-29-23 Exam. V: | 100 | 60 | 763 | 682 | 119 | 163 | 24 | 15 |

1-25-24 Exam. P: "Bank will probably take a long time to work out of present condition, the Cashier and other directors now seem to realize necessity for making every effort."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1-25-24 Exam. P: | 100 | 56 | 844 | 609 | 226 | 156 | 15 | 0 |

7-1-24 Exam. W: "As is shown by the face of the report and classification of this bank's assets, their condition is far from being satisfactory - their trouble appears to be the result of relying too greatly upon moral worth and extending credit without security beyond the limit and ability of maker to pay - when determined as doubtful bank officers attempt to secure by taking out life insurance, carrying the premiums in most cases, the conclusion of which produces a dangerous, slow workout condition, but which is beyond the ability of the Directors to solve immediately. A general curtailment of all lines is promised for purpose of reducing the bank's over-extension. The Cashier is intending to visit X next week and has promised your examiner to have a conference with the Chief National Bank Examiner, and to renew with him all promises and good intentions as shown in this report. As shown in the letter to be forwarded after signatures of directors are affixed, your office is to be furnished with a detailed report, weekly (copy to Chief National Bank Examiner), disclosing success in eliminating the numerous criticisms, the collection and further securing of all doubtful assets and reduction of borrowed money. It is not believed that more frequent examinations at this time would be of any special benefit and that the Directors are honest in their promise to assume general direction and to give all aid possible towards bettering the bank's conditions."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 7-1-24 Exam. W: | 100 | 56 | 846 | 640 | 230 | 195 | 58 | 16 |

1-31-25 Exam. W: "It was ascertained that about 1921 this bank sold to the Y National Bank a portion of their B/R's aggregating $69,000., said to have been done without recourse or repurchase agreement, but when your examiner attempted to reconcile the notes held as rediscounts and as collateral for money borrowed from the Y National Bank of Z of this bank, an aggregate of $44,000. was included in rediscounts which were not shown by the daily statement or general ledger of this bank, but a portion of which was shown as a line due this bank by entries on the liability ledger. It was also admitted by the Cashier that the notes aggregating $44,000. were endorsed with recourse on this bank, but as before stated, both President and Cashier insisted that they were the residue of the original sale of notes, aggregating $69,000.00. Your examiner then requested that a committee appointed by the Board visit the President of the Y National Bank, and procure a waiver of all liability pertaining to the $44,000. which was secured and reads as follows: 'Z, Feby. 3, 1925.- I hereby certify that the above list of notes aggregating $44,756.07 is held by the Y National Bank without any endorsement or guarantee of the B National Bank of C.' (Signed) President. - The books of the bank also show that they owe the War Finance Corporation $50,000.

Case 1 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrow-ings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

but have collected $7,250. of notes pledged as security for this debt which has not been remitted or credited, only entries made were reduction of B/R's and increasing of cash and due from banks. Should amount collected have been remitted, reserve deficiency would have been increased a like amount. The Cashier is hopeful of procuring consent to make substitutions rather than payment. The classification of loans is the result of a canvass of the notes, with the directors shown as being present. The lines classified as doubtful are in reality losses, as the directors admit the present insolvency of the makers, who are without present financial worth to either pay or secure and the ultimate liquidation of which is dependent upon the life insurance policies taken out to secure or an inheritance from some near relation most of whom are at present enjoying excellent health. The officers and directors, while admitting the losses as shown, beg that they be given an opportunity to make a concerted effort to procure security for the lines as shown and to charge off $4,000. on 6/30/25 and balance as requested by your office, begging, however, your utmost leniency. The situation here is very grave, requiring extreme cooperation and guidance by the Board of Directors. It is believed that a change of President at this time would be productive of great good to the bank. The President, being badly involved (line secured by life insurance 10M), although inactive, is dominated by the cashier, has very little stiffness in his back bone, lacks knowledge of general banking affairs or conduct of same. Mr. D, who is a member of the Board in excellent financial condition, would, if desired, accept the Presidency and work out the bank's problems to a favorable conclusion. He at the present time is on the verge of disposing of a portion of his holding for $300,000. all of which he assured your examiner he would use in protecting the bank's interests should he be chosen as President. Mr. D is a retired attorney, bears an exceptional reputation in his community, and is thoroughly acquainted with the financial worth of the customers of the bank; this with his knowledge of law and personal financial success, would indicate his especial adaptability for this situation. The Cashier is doing all he can to eliminate items of criticism, some of his methods however, are questioned, for instance, in the amount of estimated losses at last examination were a lot of small notes aggregating $3,000. endorsed by E, both makers and endorser of which were admitted insolvent, after charging off the various small notes (2 name paper) one note for the aggregate $3,000. was executed by the endorser E, secured by life insurance with no cash value, reinstating the amount charged off. In spite of such practices and the large amount of questionable, doubtful paper the directors withdrew $5,000. from surplus fund in order to provide and declare a dividend. Under liquidation the losses would probably aggregate considerably more than estimated as doubtful and loss as the bank holds a large aggregate of paper which to a large extent is moral, the enforced payment of which would result in a loss, but which if given time will work out."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1-31-25 Exam. W: | 100 | 52 | 762 | 583 | 183 | 230 | 70 | 16 |

8-27-25 Exam. W: "Practically four days were spent in endeavoring to strike a balance on the Loans and Discounts. Impossible to verify. Duplications were found in the note file, said to be errors in not taking out and returning notes satisfied by renewals. Notes discounted and collateral pledged cannot be reconciled with lists furnished by holding bank against this bank's records, nor can

Case 1 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrow-ings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

any borrower's liability be checked against this bank's liability ledger. The Cashier admits that 90% of the accounts are incorrect. Both President and Cashier I promise to immediately install a new liability ledger and see that it is kept in balance. Each and every loan was separately canvassed - Messrs. D, F, G, H and I being present and fully admitting the classification as shown throughout the report, before closing the examination; doubtful loans and losses were again gone over and declared by them to be a correct showing. It is promised that the entire report will be reviewed at the next monthly meeting at which time all losses will be charged to Profit and Loss, also that a full attendance of the board will be required. Crop conditions locally are very bad, in fact might be termed a failure and very small if any relief may be anticipated from the marketing of farm products. Business conditions at C are dependent upon the farmers' production. They have no manufacturing industries to stimulate business. The lack of farm production for past three or four years is reflected in this and other bank's condition in this section. In checking the earning and dividend report for June the 30th., it is found that the Cashier made a book entry of $3,000., debiting 'Unearned interest' and crediting 'Undivided profits' with like amount. This so stated was for the purpose of carrying out the director's promise to charge out losses of $4,000.00 and to provide funds to declare a dividend. In addition to the above, he added interest to items shown and admitted as being doubtful and losses in former report, crediting same to earnings. These entries were made for the same purpose. Last December, the Cashier had E give him a note for $3,000.00 which was credited to earnings, so called recoveries from losses charged off. E is a discharged bankrupt, has no assets and apparently no moral worth. His line in the bank as well as those of other members of his family is not collectible, except when guaranteed by responsible parties. The loans and discounts are carried in such a way that it is impossible to provide a method through which a satisfactory checking can be made. Some of the notes do not appear to be listed or entered upon the bank's books. Duplications found, but claimed to be errors in not removing the old note from the file. Demand notes (so-called) are kept separate, always in the custody of Cashier, quite a portion of which are nothing more than memoranda of amounts due. The Cashier is treasurer of the city, credit balance at this time about $3,000.00, but he is carrying in his bonds and other security accounts about $15,000.00 of warrants which are payable on demand and are not interest bearing, in loans and discounts are so called demand notes, of around $3,000. upon which interest is not and will not be collected, so stated. This practice covers quite a period. Cashier stated that he had plenty of funds in the other banks to pay these items, but was playing politics, in order to get the benefit of the proceeds of issuance and sale of $100,000.00 in bonds, about Sep. 1st. Liability Ledger cannot be depended upon, no effort has ever been made to put it in balance, even the lines of the directors are not correct. Assistant Cashier J has an unsecured borrowing line of $10,700.00 and in addition to this his account is overdrawn $1,000.00, habitually over an extended period; but the directors and other officers claim that this overdraft was produced without their knowledge or consent. J is said to own a home valued at around $5,000.00 mortgaged for $4,000, interest in his father's estate, which likewise is mortgaged for its worth. Unless his brothers and sister will come to his aid or he can get

Case 1 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

his friends to endorse for him the bank will probably lose this entire amount. The directors admit that it is all doubtful. J has an invalid sister whose affairs he is said to have charge of, her account is overdrawn $325.00 and in addition owes the bank for borrowed money $2,710.00. It is not known if she has sufficient assets to protect. It is thought both are borrowers in other banks, but amount not known. In looking through the check files, debit slips were found closing out small deposit balances, said to have been used by the officers in paying losses on overdrafts and shortages in the cash. Just how much has been used in this way cannot be learned as no record was kept and officers and employees claim ignorance as to the aggregate, and insist that it would be impossible to even partially establish the amount or the number of account. Stating that only very small balances were used and for the purpose of ridding the ledger of amounts too small to bother with, when transferring balances and opening up or installing a new system. The new President, Mr. D insists that he is going to renovate the bank, put in new and modern system of bookkeeping and see that the books are properly kept. While it is thought that he has the best of intentions, yet it is doubted if the present Cashier will co-operate with him or assist in the betterment of present conditions, as he has been in the bank thirty years and entirely satisfied with the way matters are and have been conducted. The directors are disposing of other real estate to Directors D and I, they having offered about $3,000.00 more than can be obtained from any other source. This sale together with the collection of City Warrants (which is promised) will restore the bank's reserve, and materially restore their cash position."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 8-27-25 Exam. W: | 100 | 49 | 620 | 526 | 95 | 133 | 79 | 52 |

7-3-26 Exam. W: "Especial attention is called to Page 6 which gives detailed information as regards the affiliation of the directors, combining of their lines both direct and indirect, and showing the full extent to which they are personally guaranteeing assets which would otherwise be classed as doubtful or loss. It is to be hoped that these lines may be reduced, as the bank's growth is hampered by reason that a large portion of the loans are frozen, and the reserve being habitually deficient, the bank is unable to take on new accounts or extend the business. As shown on page 11, under 'Recapitulations' the bank has doubtful assets aggregating $75,045.22 which in all probability will become determined losses. In addition to the foregoing losses of $5,947.84 under liquidation doubtful paper and losses would be increased, by reason that, should immediate payment be required of some of the lines shown as slow, makers could not pay and enforced liquidation would produce insolvency. However, at this examination the directors shown as present, passed upon or classified all lines both separately and collectively. A new liability ledger has been installed, but as yet has not been balanced. Due to the methods practiced in the handling of the loans, it is practically impossible to correctly aggregate or exhaustively determine the amount of loans due to duplications, lack of records for notes held as collateral for B/R's at various sources of borrowing, and those placed with the bank's attorney for collection. While reading the minutes it was ascertained that on June 30th, after an examination by a committee appointed from the board, it was ascer-

Case 1 (Continued)

| Date | Cap. | & Profits | Loans | Deposits | Borrow-ings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

tained that the bank's loans and discounts were short $2,596.37 which was cared for by the Ass't. Cashier and Custodian of the notes executing his note in the amount of $2,596.37 and same endorsed by the Cashier I. After a long run was made by your examiner, and the list checked back the loans appeared to be over only $1,976 but after taking off the liabilities of borrowers and comparing same with the amounts as shown from the liability ledger, an error of $3,500.00 was found in the extension of credit extended to the Cashier. The liability ledger showing only $9,950 while the notes and copies of notes found in the note case produced a total of $13,450.00. Mr. I when approached relative to the matter, immediately stated that there was an error, insisting that he only owed the bank $9,950.00 for direct personal extensions of credit. Upon producing evidence, or items in question proving the correctness of your examiner's line sheet, Mr. I stated that, there were two copies of note of $3,500.00 and there should be only one. (Destroying one). It could not be ascertained from the copy destroyed if such were the case, as it was not dated. However in checking the collateral pledged for B/R's it was ascertained that his contention was correct. Correcting this finding and one or two other minor errors in deductions of credits, resulted in a shortage of $3,370.91, this in addition to the amount corrected of $2,596.37 on June 30th. as before stated. It was then required that a run be made of the new liability ledger, this after being checked back produced a shortage substantially as was produced by your examiner from the notes. The directors were then requested, with the assistance of the active officers, to take the bank's loans and check them back with the liability ledger. The directors and attorney for the bank were requested to produce a full listing of all items lodged with him for collections."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 7-3-26 Exam. W: | 100 | 30 | 622 | 581 | 55 | 216 | 75 | 9 |

9-29-26 Exam. O: "Acting under instructions contained in Comptroller's letter of September 18, 1926, the writer went to C, September 29th, and made an examination of this bank. At conclusion of the examination it was found that a <u>MOST DANGEROUS</u> and <u>UNSATISFACTORY CONDITION</u> existed, and in order that the Board of Directors might be rightfully advised of the situation a letter was prepared and read to a quorum of the board who came at special request to a specially called meeting. As a copy of the said letter is sent with and becomes a part of this report, it is believed unnecessary to further list the contents of the same on this page as the <u>CRITICISMS</u> set forth fully include every item read to Board in the letter. It is feared that the bank is in such an unsatisfactory condition that little may be done at this date to save it. It was thought possible a consolida-with the other bank in town might be arranged but that does not appear among the possibilities. At the meeting of the Board the matter of resignation of I, Cashier, and the Assistant Cashier, was discussed. I, who is a director, appeared at the meeting. He was very much unconcerned. So great confidence have some of the members in I they refused to at first even listen to such an act as his resigning I stated he had done nothing wrong, however, if the whole board desired, he would arrange his affairs to possibly retire January 1, 1927. The LETTER FROM THE COMPTROLLER was then read to the Board and President D and Vice President G spoke very strongly and I presented the resignation of both himself and his son, as

Case 1 (Continued)

cashier, director and assistant cashier to become effective immediately. The Board accepted the resignations. Prior to the meeting and in the morning, Mr. I agreed to furnish the bank a personal statement and also by trust deed convey to the bank to secure his direct and indirect line all of his real property which includes farms, his home, town and city property which the Board claims have a net worth of some $225,000. It was pointed out to the Examiner that the public upon learning of the resignations would become very curious and suspicious and that an immediate run upon the bank would follow. Inasmuch as the examination of the other bank in town was to be made by the writer the day following it was agreed and understood that Mr. I would remain in the back room of the bank for a few days, without any title or authority to touch a book or paper and that his son, after being bonded for $12,000. would remain as teller for a few days. This was believed by examiner to be good judgment as Mr. I is popular and has many friends who persist in believing in him. It was reported to the writer that matters were quiet in C after this and up to Thursday morning, October 7, 1926, when President D, over long distance telephone, advised that he had found some shortages in savings bank pass books of the bank, which disclosed the fact that I was short at least $100,000. in his accounts through a long period of years in manipulation of the said pass-books, which Mr. D claimed could not have been discovered by the examiners had not Mr. I made the confession and disclosure to him. Mr. D stated he believed the bank was therefore INSOLVENT and he was advised by the writer to convene his Board of Directors, apprise them of the situation and if they so determined that the shortages would put the bank in the ABSOLUTELY INSOLVENT CLASS, to close the doors and have a notice posted upon the doors stating it was closed by the order of the Board of Directors. Such action was taken Thursday noon, October 7, 1926, the bank was closed, and Examiner was instructed to proceed to C at once and take charge of the bank, is now in charge, and states he so notified your office. This report will show there were determined losses aggregating $36,000. and with doubtful paper fully twice that sum and depreciation in bonds and overdrawn profit and loss account, hopes for the bank to long remain open were indeed not bright. However, up to the time of the departure of Examiner from C last Tuesday night (Oct. 5th) the directors and President D were determined to do their utmost to preserve the interests of depositors. Later disclosures of the shortage utterly overwhelmed them, and I's best friends now appreciate the fact they SHOULD HAVE LONG AGO GOTTEN RID OF HIM. In a late message received today from the examiner, he states the stealings have been going on for TWENTY OR MORE YEARS."

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|
| 9-29-26 Exam. O: | 100 | 25 | 629 | 538 | 130 | 289 | 73 | 37 |
| Receiver: | | | | 469 | | | 287 | 239 |

**EARNINGS:**

| | 1921 | 1922 | 1923 | 1924 | 1925 | Total |
|---|---|---|---|---|---|---|
| Net Income (Gross Earning less Expenses) | 4 | 16 | 20 | 10 | 10 | 60 |
| Recoveries | 14 | 1 | 1 | 12 | 31 | 59 |
| Losses Charged Off | 10 | 2 | 7 | 16 | 51 | 86 |
| Assessments before Suspension | 0 | 0 | 0 | 0 | 0 | .0 |
| Bad Assets Purchased by Stockholders | 0 | 0 | 0 | 0 | 0 | 0 |
| Dividends | 12 | 6 | 12 | 12 | 10 | 52 |

Case 2

Bank Organized: 1907
Bank Suspended: 1930

Population of Town: 2000 (1910 Census)
3000 (1920 Census)
3000 (1930 Census)

Principal Crop or Industry Served by Bank:

General farming, fruit & vegetable canning, cattle raising & marketing, lumber.

Important Excerpts From Reports of Examination: (Amounts in thousands of dollars)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrow-ings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|
| 3-29-20 Exam. U: | 50 | 9 | 248 | 378 | 13 | 10 | 4 | 0 |
| 10-7-20 Exam. U: | 50 | 11 | 263 | 384 | 61 | 7 | 2 | 0 |

4-5-21 Exam. U: "In view of the continued violations of Section 5200 your Examiner recommends that the bank be placed on the list for frequent examination."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 4-5-21 Exam. U: | 50 | 8 | 250 | 311 | 86 | 14 | 4 | 0 |

8-22-21 Exam. U: No Remarks

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 8-22-21 Exam. U: | 50 | 9 | 275 | 309 | 97 | 20 | 12 | 0 |

6-12-22 Exam. U: "Meeting of directors was called but none other than the active officers were available. By reference to Page two, it may be seen that the management of the bank is left to the officers as they and one other director usually comprise the directors attending the meetings. The President is resourceful and in good standing with other banks and can and doubtless will remove all paper under criticism in this report. Under his management no losses have developed up to the present."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 6-12-22 Exam. U: | 50 | 11 | 335 | 427 | 34 | 42 | 13 | 5 |

10-30-22 Exam. U: "While the President is using the bank for his own benefit to too great an extent, he is a man of worth and ability and is working out some slow and undesirable paper."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 10-30-22 Exam. U: | 50 | 9 | 345 | 362 | 37 | 50 | 0 | 0 |

4-13-23 Exam. U: "The large line of A should be reduced because it shows too much of the bank's assets being used for his personal benefit. The worth of A has been gone into thoroughly and although his statement shows a net worth of over 200M several of the assets are subject to a scaling down which would leave his worth at about 100M. The principal portion of this worth consists of land elsewhere, the purchase of which is the cause of his present extended condition. The fact that he is operating this farming land on principles which maintain here and at a distance which precludes close supervision, naturally makes for a condition which practically eliminates profits. He is capable and will be able, doubtlessly to dispose of his holdings to advantage before he becomes involved. His credit is good through this section and he has promised to move a large portion of the line criticised."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 4-13-23 Exam. U: | 50 | 8 | 344 | 420 | 0 | 36 | 11 | 0 |

Case 2 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrow-ings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

10-4-23 Exam. U: "Unless the health of President A fails it is believed that there is little doubt but that he can work out of his present extended condition. It is believed that a part of the large line is borrowed for his benefit but such cannot be traced through the records. In view of the continued violations of law as evidenced by excessive and non-conforming real estate loans; the extended condition of the president, as evidenced by the large line, and the large amount of doubtful paper it is believed that the next examination should be made in about ninety days."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 10-4-23 Exam. U: | 50 | 12 | 423 | 469 | 5 | 34 | 25 | 0 |

1-2-24 Exam. U: "The responsibility of the management of the bank has been assumed for so long by the president that officers and directors give it little attention except to approve his policies. He has been giving his time to his own interests to the neglect of the bank and having been appointed receiver for the X Co. has recently given half his time to it. He has promised to have all matters criticised in good shape by the time of the next examination which should be made in ninety days, because of the continued violations of law and large amount of slow and doubtful assets."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1-2-24 Exam. U: | 50 | 12 | 444 | 457 | 38 | 58 | 22 | 2 |

10-14-24 Exam. Q: "President A was absent on trip during examination, but Examiner saw him on his return the afternoon of October 15, 1924. At examination July 16, 1924, he was found 'kiting' about $35,000.00 to $40,000.00 and quite a lengthy session was held with him and the other directors before the matter was adjusted. He ventured the remark to your Examiner October 15, 1924, that we had accused him of 'kiting' but that his reserve ran low at Y, and that he had some money in other banks on which he gave checks to build up his reserve. This is mentioned to indicate just what type of man he is and to suggest what we must meet at this end of the line. It would appear that directors closely watched and prevented him from 'kiting' following the examination of July 16, 1924, and that he soon cleared out the amount. However, one of the directors said that he opened an account with his competing bank in the town, and 'kited' until banks finally realized what he was doing and some of his checks went to protest. Mr. B, Cashier, Z National Bank, C, informed Examiner that about $18,000.00 of his checks in favor of the D Bank, E, were returned through his bank, and that the E bank was alarmed for some days before A succeeded in arranging the amounts to their satisfaction. It would appear that he cleared the 'kite' out of his own bank under pressure of daily attention from his directors, but that when he succeeded in arranging the matters that he became antagonistic to frequent visits and attention from the directors. Directors probably would have asked him to resign, but he has so much more stock than they that they did not feel like it. They also felt that he would get enough support from his friends and relatives to control the annual election in January and that he would be able to have it as he wanted then. Some of the directors also think that he has become irritated on account of their close supervision since the examination of July 16, 1924, and that he will probably control the annual stockholders' meeting next January and elect an entirely now board to suit himself or such individuals as he can control.

Case 2 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrow- ings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

It would appear that as soon as directors cease their vigilance or daily watch that he will operate HIS bank to suit himself. It is really more than could be expected of a board of directors to have to watch transactions and his account daily or so often, and if he could be driven out of the system it would be good work well done. He has a small amount now which has the appearance of a 'kite' as shown by question 5, page 3 of this report, and this matter was called to the attention of Directors F and G during examination. This has been done in spite of his letter of July 18, 1924, but the checks were issued by his secretary and he would probably contend that she had no instructions to do so. It would now appear that some of the country banks know more about him than they did, and that this information will be circulated until most of them will know of this matter in the course of a few months. He admitted liabilities of more than 100M to your Examiner at the examination of July 18, 1924, but they probably are much more. He said that his assets would aggregate about 500M. However, it is doubtful if they would liquidate 25% of that amount, and when all the banks of this section call him as they probably will do as this information becomes circulated, it may yet cause some embarrassment. In other words, this is a proposition which cannot well be solved so long as he is in active charge or control of the bank. Also, as the information becomes circulated, further withdrawals of deposits may result. It would appear that there have been some withdrawals since last examination, and one of the directors said there had been in their time deposits. He had an offer to buy from two sources, but was said to have asked 150% for his stock which was not worth more than 75%. Then he would expect to sell without buyer making an examination which is scarcely probable. Examiner informed directors that losses impaired their capital, and advised them that if they desired to discuss the matter further he would see them at his office Saturday, October 18, 1924, but they did not come. However, President A called over long distance to discuss some matters. He was informed as to some of the items that must be removed from the assets, and asked a little time. Examiner informed him that it would be 15 to 30 days before letter from Washington, D. C. reached him or his board, and that in the meantime they could prepare themselves to arrange matters. President A has indicated his intention of giving his commission as receiver of the X Company to the bank to reduce the loss to the bank, but that has not yet been determined as to the amount. However, it soon should be ascertained, and he now should know about how much of the loss in that line he will remove. They will not make a move to clear the matter until forced to do so, and in opinion of examiner it is time for the bank to be relieved of the losses as listed. The items listed otherwise undesirable in the report should be removed from the assets as well as the losses listed as there may be some loss in items listed otherwise undesirable but for lack of information desired by examiner that was about the only classification the items could be given. It is recommended by Examiner that these items be required to be removed just the same as the losses. There may be some contention from President A that Examiner has been too hard in his classification, but examiner is ready to meet him or his board in regard to any line or classification. A State Bank Examiner made H Bank, I, and reports 'kite' cleared about the middle of August, and that he had some ten or twelve dollars left to his credit there. Your Examiner will again make this bank in regular course unless it should be assigned to Chief National Bank Examiner or some action taken in meantime."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 10-14-24 Exam. Q: | 50 | 6 | 393 | 427 | 44 | 124 | 0 | 24 |

Case 2 (Continued)

| | | Surplus | | | Borrow- | Classified Assets | | |
|---|---|---|---|---|---|---|---|---|
| Date | Cap. | & Profits | Loans | Deposits | ings | Slow | Doubtful | Losses |

1-12-25 Exam. Q: "Examiner was requested by telegram to begin an examination of this bank Monday morning January 12, 1925 with the understanding that Chief Examiner would join him for conference Tuesday morning January 13, 1925. The examination soon revealed that the bank was in a very serious condition, and examiner could see but two ways in which to save it. It may be recalled that President A was 'kiting' to the extent of $35,000.00 to $40,000.00 and that it was with difficulty that your examiner succeeded in getting it stopped after spending three days in the bank and a visit by Chief Examiner was necessary. The bank also had some losses, and it would appear that the public gradually became aware of the condition of the bank. Deposits had reduced some at the examination October 1924, and more recently withdrawals had been very heavy until bank was in a very extended and serious condition. The certificates of deposit have a 30 day notice clause in them, and on Friday Jan. 9, 1925 directors found it necessary to enforce the notice of 30 days to keep the bank open longer, and when examiner arrived at the bank a few certificates had been presented for payment at the expiration of the 30 days and more were presented during the examination. Some demand deposits, or checking accounts, had been closed with prospects of more being closed and local people were withholding their deposits. At the same time President A was determined to dominate the policies of the bank and would not consent to anything else so long as he held any stock or had anything to do with it at all, but the public had lost all confidence in him and the bank on account of his management and his extended condition personally. A banker had offered to put $30,000.00 new money into the bank for its capital if President A and his board would agree to take out $25,000.00 of the worthless notes and the other real estate, to elect new directors, and place it on a sound basis, but he said he would not do that. Examiner could see this as only possible chance to save the bank, or to force a consolidation with the other bank here, as a last resort. Chief Examiner arrived about 10:30 A. M. Tuesday, Jan. 13, 1925, and the matter was discussed in detail. However, while examiners were at lunch, the unexpected happened. President A and J signed contract in duplicate by which the said A sold all his stock to J and agreed to have at least 260 shares of the stock transferred to J. Then the annual meeting was held and the following gentlemen were elected directors:

| | | | | | |
|---|---|---|---|---|---|
| J | Y. | Retired - estimated worth 200M | | | |
| K | do | Tannery | " | " | 25M |
| L | do | Garage | " | " | 20M |
| M | O | Merchant | " | " | 7M |
| N | Y | V.P. CC Ry. | " | " | 50M |

Examiners met with new board, and discussed matters of criticism as listed onpage 12 of report, and especially as to the condition of the bank and the losses were disclosed to them with request that directors inform us how the impairment in capital would be made good. Directors at that time said perhaps by assessment of the shareholders, and your examiner recommends that the usual impairment notice be mailed to the directors in regular course. Everybody whom examiners met after the matter had been closed had remarks of confidence in the new management, and it would appear that confidence had been restored and the run ceased with pros-

Case 2 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrow-ings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

pects of an increasing line of deposits. J will be president, and P will be active vice-President severing all other business connections at once, and present cashier and assistant cashier will remain with bank. While the new directors are thought to be fairly good business men, they are not experienced in banking, but have the confidence of the community and represent some worth and should bring some good accounts to the bank. It is also the intention of President J to secure the services of a good bank man with ample experience to assist them in familiarizing themselves with their new business venture and connection for two, three or four months. The Cashier is familiar with the clerical work and records. Please note attached clipping from local newspaper which went to press when the annual meeting was in session and soon after would be distributed to subscribers through the mails to different parts of the community as well as in the town of Y."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1-12-25 Exam. Q: | 50 | 5 | 340 | 307 | 59 | 140 | 1 | 26 |

8-3-25 Exam. Q: "On January 13, 1925, while Chief Examiner, Examiner and Assistant were at lunch, A sold his interest in this bank to J and associates and it has been intention and efforts of new board and management to work assets and affairs into a more satisfactory condition. In the deal A took out note of Q for $5,300, board increased value of bank building and lots $10,000, new president J contributed $6,291.31 on January 26th, 1925, and balance of losses were then charged off as classified in report of January 12th, 1925. Examiner does not exactly approve appreciating building $10,000 but property includes two lots and officers said thought could sell the adjoining lot for $7,500 to $8,000 which would leaving banking house and lot on books at a reasonably fair value. Since last examination and elimination of A he filed a petition in bankruptcy on May 9, 1925, and his realty all now would appear to be mortgaged and while he lists assets of about 400M and liabilities about 238M it is not thought more than 10% can be realized from the receiver and that it will be a long drawn out matter. Some of the assets he lists have been found worthless, his realty is listed more than it is worth and also found to be mortgaged. The largest asset is a farm and it has been found not worth anything near what he had claimed and contended it was worth. In fact he filed a statement with some local banks during 1924 indicating a net worth of about 400M and some of them are considering prosecuting him now. It would appear that line is almost a total loss. President J spoke to examiner about July 20th to 23rd, 1925, about line but only saw him a few minutes and he did not indicate it was quite so near a total loss. He then said as soon as loss was determined he expected to personally remove it from the assets of the bank and it is also recorded in a recent minute of board meeting that he expected to remove it and that an assessment on shareholders would not be necessary. When examination was made he was away on vacation for some two or three weeks and could not make any arrangements with him in the matter. He may want to wait until bankruptcy case has been closed through courts, but it no doubt will be a long drawn out matter and some litigation and assets of fixed nature and slow sale. While President J made a bad deal and is taking a heavy loss in buying shares of A and feels he should have time to arrange the losses, he is becoming advanced in years and the sooner the matter has been arranged and losses removed the better for bank and for him. When he returns, reviews his copy of the report and gets letter

Case 2 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

from your office, examiner feels he will probably make arrangements to get money to take out losses."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 8-3-25 Exam. Q: | 50 | 0 | 318 | 358 | 36 | 132 | 8 | 27 |

2-4-26 Exam. Q: "Very satisfactory progress has been made by new management during the year since 1/13/25 when change was made. There are yet two excessive lines to workout, and this was discussed in detail. A new one occurred through not knowing how to construe Section 5200 U. S. R. S. and will soon be corrected. Lot adjoining building has been sold and reduced banking house and lot to a fair value. Have some negotiations now to sell farm which would mean a great deal to bank if can be consummated. One other piece of real estate has already been sold under new management."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 2-4-26 Exam. Q: | 50 | 3 | 327 | 380 | 11 | 118 | 1 | 0 |

10-5-26 Exam. Q: "The present management took charge of the bank January 13, 1925 and has made reasonably satisfactory progress in working its affairs into a better condition. The excessive lines of R and S were inherited from the old management for which the present directors and officers are not responsible and are making efforts to reduce to legal limit. It was stated that an effort would be made to have T pay the $1,000.00 thought to be an accommodation note and it was hoped that sale of timber to the extent of some $3,000 could be made to apply on the line of R which would reduce it to legal limit. The excessive line of U was thought to have been an oversight and correction at once was promised. A very short crop was had in the community during 1925, but a good crop has been had during the present year which should enable bank to collect some old loans and reduce others which have been in the bank quite a while. Some small losses are being taken from time to time on some of the old debts in the bank when the present management assumed control 1/13/25; some were charged off June 30, 1926 and now have two that look doubtful which may become losses. A great deal of work has been done and will be necessary to collect or secure many of the slow loans before assets have been placed in a more liquid condition. Community is supported by general farming including fruit and vegetable canning and raising and marketing cattle, and some lumber business."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 10-5-26 Exam. Q: | 50 | 3 | 386 | 424 | 2 | 96 | 3 | 0 |

4-5-27 Exam. Q: "Not so much progress has been made since last examination in working the affairs of the bank into a better condition, and more doubtful paper with some losses will be found at this time. It is now hoped that the balance of the loans and discounts will be found collectible even if slow. The two large items now doubtful may be collected in time, but it will depend on favorable conditions to avoid losses. Two excessive lines inherited from former board and management 1/13/25 are yet to be reduced to legal limit, and the one excessive line at this examination will be reduced to legal limit in a very short time. A large contract for construction of a water power project has just recently been commenced and is located a few miles from town and will put some new money into circulation in the community and town over a period of some months to stimulate local business."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 4-5-27 Exam. Q: | 50 | 4 | 395 | 446 | 0 | 92 | 7 | 1 |

Case 2 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

9-13-27 Exam. Q: "A little progress probably has been made between examinations in working the affairs of this bank into better condition, but a great deal of work is yet to be done. It is possible that may now have line of F in a better shape with the collateral than before or at last examination and it may in time be liquidated but not yet enforceable for the full line. 'Other Real Estate' yet to be sold and may take some loss on that part of assets before it has been removed from the assets of the bank. Fairly good general crops have been made this year in the community, and soon should be reaching markets. Deposits are low at this time, but then should increase some. It was agreed that your office would be advised when the excessive lines have been reduced to legal limit."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 9-13-27 Exam. Q: | 50 | 5 | 378 | 420 | 23 | 91 | 6 | 0 |

4-19-28 Exam. Q: "President J who, with his family, held control of this bank, died February 27, 1928 and the officers of the bank do not know what disposition of the holdings may be made. It was stated that some of the directors had made the heirs an offer to buy the stock, but that no action had yet been taken. It is the opinion of examiner that but little will be done to better the condition of the bank until the matter has been disposed of as officers of the bank have been expecting a son of former President J to assume the management of the bank. It is thought that President J suffered much financial loss in the later years of his life and that his estate may not now liquidate more than $50,000. It would be to the interests of the bank for some good local business men to acquire the stock and become interested in the affairs of the bank, but the disposition is as yet a matter of uncertainty. The bank is in such condition now that it should prosper under good management and ownership."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 4-19-28 Exam. Q: | 50 | 8 | 405 | 444 | 18 | 91 | 6 | 0 |

8-21-28 Exam. Q: "It was stated that have prospect to sell the 'Other Real Estate' but that probably would have to take a small loss on it. The examiner requested that a committee make special efforts to sell the remaining pieces of 'Other Real Estate' to relieve the bank of that frozen and undesirable asset. After the death of President J February 27th, 1928, the directors made an offer to the heirs to acquire his stock which it was intended to distribute with business men of the town and community. However, there has been no action on the part of the heirs of the deceased to dispose of their holdings. If the 'Other Real Estate' can be sold, it would mean much to the bank's affairs. Prospects for general farm crops are not encouraging on account of late spring and much rain, but some crops will be fair."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 8-21-28 Exam. Q: | 50 | 11 | 398 | 463 | 0 | 103 | 7 | 0 |

2-14-29 Exam. Q: "There will probably be some loss in 'Other Real Estate' yet, and an effort to dispose of it is to be made. While bank yet has a large amount of frozen loans, it is working into better condition. Deposits have increased satisfactorily between examinations. Fair crops were made during 1928, and some tobacco has brought some new money into the community. The estate of J, deceased, and sons and a brother still hold a controlling interest in the bank. The management appears to be fairly safe, but could be stronger. The directors and officers appear to be encouraged with progress made and with prospects and outlook for the future at this time."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 2-14-29 Exam. Q: | 50 | 12 | 414 | 550 | 0 | 72 | 6 | 0 |

Case 2 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrow-ings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

3-19-30 Exam. Q: "Fair general farm crops were made during 1929 and a good tobacco crop was made and a good price realized, but that does not reflect in the bank's line of deposits nor in its loans and discounts. It appears not to have made any progress since last examination which unfortunately was February 14th, 1929 delay having been caused by examiner being held on other work and sub-district behind with examinations. Examiner does not think it necessary to place bank on special list, but strongly recommends that a collect telegram be sent to the directors upon receipt of this report to advise whether or not the excessive lines have been reduced to legal limit and if not to advise when it will be done. The directors should give close attention to bank's affairs if Vice President V is to be retained in active management, and it is thought that a telegram instead of a letter will have a good influence and get results where a letter may not. Of course, a letter could then be written as to the other matters. If Vice President V is not going to keep his account in better condition it may be well for the directors to employ somebody else and let him resign. There are considerable doubtful loans and discounts and some little loss no doubt must be taken much of which may be determined at next examination which should be made in about four or five months."

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|
| 3-19-30 Exam. Q: | 50 | 15 | 465 | 536 | 0 | 85 | 15 | 0 |

10-1-30 Exam. Q: "General farm crops will be short in this community, but it was stated that a fair crop of tobacco has been had and is being cut at this time. Bank still has large amount of frozen paper and assets which should have vigorous attention to liquidate. Vice-President V stated to examiner (confidentially) that he was planning to make a change about the first of the year. He stated that he had not been able to obtain much help from directors as to the management and affairs of the bank. He promised to reduce to legal limit his excessive line and the others at once. A conference with Directors W (who is one of the executors of his father's estate which holds 237 shs.) K, and AA was had. Examiner suggested that since the K's held control of the bank that they should give enough time to it to make it a success, employ some competent man that could and would, or sell their holdings to somebody who could and would make it a success. Two bankers are to some extent interested in buying control and either would make it a success and the BB Co. would be glad to acquire control and place the necessary management in charge. Director P stated that he would give consideration to the suggestions to see what could be done. See earnings report 1925-1930."

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|
| 10-1-30 Exam. Q: | 50 | 14 | 453 | 472 | 43 | 99 | 7 | 8 |
| Receiver: | | | | | | | 88 | 17 |

| EARNINGS: | 1925 | 1926 | 1927 | 1928 | 1929 | Total |
|---|---|---|---|---|---|---|
| Net Income (Gross Earnings less Expenses) | 4 | 3 | 6 | 8 | 10 | 31 |
| Recoveries | 0 | 0 | 0 | 0 | 0 | 0 |
| Losses Charged Off | 32 | 3 | 1 | 1 | 5 | 42 |
| Assessments before Suspension | 0 | 0 | 0 | 0 | 0 | 0 |
| Bad Assets Purchased by Stockholders | 0 | 0 | 0 | 0 | 0 | 0 |
| Dividends | 0 | 0 | 0 | 0 | 0 | 0 |

Case 3

Bank Organized: 1889
Bank Suspended: 1926

Population of Town: 3000 (1910 Census)
3000 (1920 Census)
3000 (1930 Census)

Principal Crops or Industry Served by Bank:

Cotton and grain.

Important Excerpts from Reports of Examination: (Amounts in thousands of dollars)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrow-ings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|
| 4-14-20 Exam. S: | 50 | 22 | 441 | 452 | 18 | 18 | 0 | 1 |
| 11-4-20 Exam. T: | 50 | 20 | 484 | 230 | 248 | 258 | 16 | 1 |

4-7-21 Exam. T: "Transcripts of bank accounts have been omitted as the bank was examined in January; this action deemed advisable on account of giving correspondents cause to become uneasy, some of lines classed as slow previously, have been classed as doubtful, partly in order to assist management to reduce or collect. Management advised considerable cotton was still in locality and not sold by grower. Management expects material reductions in lines when Federal Land Bank begins business as contemplated in near future. It is recommended the bank be removed from the special list for frequent examinations as the management has been changed and special examinations will not help but be to the detriment of the bank, however, examinations should be left to the judgment of the Chief Examiner and it is suggested that before making another examination, if one is to be made out of order, the chairman be summoned to the office of the Chief Examiner prior and a thorough canvass of the situation be made; while it appears the bank has been saved from a receivership, resident Examiner has been materially assisted by the efforts of the Chief Examiner. It has been one of the most stubborn and hardest cases ever handled by resident examiner."

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrow-ings | Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|
| 4-7-21 Exam. T: | 50 | 16 | 335 | 129 | 213 | 48 | 108 | 0 |

11-14-21 Exam. P: "A comparison of this report with that made a year ago will show a great improvement in those matters in which improvement could be expected within that time. The slow and doubtful paper, with which the bank was saddled by the former management will be gotten rid of very slowly. It seems as if most of it should be collected in time. There appears to be a good deal of paper collectible this fall and the borrowings can probably be much reduced if not eliminated. Of the paper listed as doubtful, it would seem that the larger part is collectible, tho it will probably have to be carried for some time to come. A is very resentful at being superseded by the B's. C is, outwardly, satisfied and desirous of helping. The B's said that they were continually opposed, and thwarted by A, tho supported by D. They do not feel certain of C, suspecting secret opposition. A told the Examiner that it was his intention to get rid of the present Cashier. Examiner told him in plainest English that there must be no change in the present management as the bank showed great improvement since the removal of himself and C from active management, such a promise is embodied in directors' letter which Examiner saw signed by all directors except D. Unless it is signed by D also, an extension of charter is not recommended. It is believed that former management would soon reduce bank to condition that would

Case 3 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

force liquidation. Examiner was, recently, examining a bank in a town nearby. While seated in the hotel lobby he overheard a conversation during which a man remarking on a shortage that had just been discovered in a bank and on the fact that the defaulter was known to be a gambler made the assertion that C, Cashier of a bank here, was another gambler (with whom he himself had played) and should be watched. The speaker addressed his remarks to the Examiner of whose position he was unaware, and to another man. This incident is told to show why Examiner is insistent that the former management shall not be reinstated."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 11-14-21 Exam. P: | 50 | 14 | 322 | 166 | 172 | 99 | 55 | 0 |

4-24-22 Exam. V: "The bank has entirely gotten away from the influence of A and under the present management, it apparently seems will be able to work out, although they are at present in such shape that the least sign of weakness would undoubtedly cause the public to start a run which would close the doors. The present management has partially regained the confidence of the public, and seems to be getting a firmer hold each day. In view of this fact your Examiner after consulting with Chief Examiner, who also felt the proper course would be to do nothing to destroy this confidence, gave as reasonable a classification to loans criticised as could be consistently done. It is somewhat early yet to make any predictions as to crop for the coming year, still the outlook appears promising and unless some unlooked for event occurs to ruin the crops, a large part of the loans to farmers will be liquidated this fall and the bank will then be in a position to rid itself of a goodly portion of the bad paper now held. Your Examiner furthermore has been told that the Reserve Bank has promised to stand back of the bank to the last, it therefore seems that if not forced they will eventually work out. The present management is fully aware of the bank's condition and while some, with the exception of E and B, were connected with the institution when it was being loaded with bad paper by A, they all appeared to be willing to do everything possible to keep the bank open. Of course, it is impossible to get rid of a great portion of the slow and doubtful paper without charging it off which would mean the closing of the doors, therefore your Examiner in concurrence with Chief Examiner thinks the proper course would be to give the present management every encouragement and plenty of time to work from under and accordingly recommends that your office be as lenient as possible until the present management has clearly demonstrated its inability to handle the situation."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 4-24-22 Exam. V: | 50 | 16 | 287 | 123 | 161 | 75 | 65 | 11 |

10-23-22 Exam. V: "The bank increased on August 9, 1922:

| | |
|---|---|
| Furniture and Fixtures | $1,500.00 |
| Banking House | 2,000.00 |
| Other Real Estate | 5,000.00 |
| | $8,500.00 |

in order that they might charge off $10M of bad paper and increase their surplus $1M. As to whether these values are inflated is of course, problematical. Management claims that there is still an ample margin in these three assets."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 10-23-22 Exam. V: | 50 | 16 | 269 | 202 | 134 | 76 | 16 | 65 |

4-30-23 Exam. V: "None of the present board of directors are responsible for the excessive loans reported on Page six, these becoming excessive when the surplus

Case 3 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

was wiped out by losses, on loans, made by a former management. The lines reported as excessive will probably work out, without loss, although in each instance some time will be required. The officers are only too anxious to have this criticism removed and are doing all possible to have these lines reduced, but as before stated, some time will be required. Two other lines which were excessive due to the same reason as those shown, have been reduced below the limit. Your examiner feels sure if your office will be lenient in this case, that these loans will be reduced as soon as can consistently be done."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 4-30-23 Exam. V: | 50 | 4 | 169 | 192 | 52 | 52 | 2 | 0 |

11-26-23 Exam. H: "The new management has made decided improvement in the general condition of the bank and seems deeply interested in its future. Some old matters will require considerable time to be worked out. Salaries are large for the present business, though deposits show an increase of about $85,000 in last two months."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 11-26-23 Exam. H: | 50 | 1 | 163 | 237 | 0 | 72 | 0 | 0 |

6-13-24 Exam. AA: "There are a number of items in the assets of this bank which will be the source of considerable anxiety to those of its management until they are realized upon. They are so involved as to make their liquidation a matter of serious doubt. In various instances real estate is bought at tax sales hoping to acquire an equity which will strengthen a claim held by the bank. For two years the bank must patiently wait before it can know with any certainty just how they stand as the state law gives the owner of any property, sold for taxes, the right to redeem it within two years from sale. It is believed the situation here is known to the Comptroller's office even better than to this examiner. It is understood that the present management has improved the situation and it is believed those in charge are doing everything possible to collect or better secure the old debts which they inherited. A very few losses, however, would impair the capital as they have no surplus. The loans made by those in charge now are small and held to be without criticism. The present management unquestionably is to be commended for the manner in which they have operated so far. A loss of $1,290 was recently sustained by the bank on account of suit brought by X Bank, Y. $6,290 was really the total paid but $5,000 was from bond of former employee. The overhead expenses of operation appear to be large. There are six salaried employees. Altho the individual salaries are small it is believed three good men could easily take care of the bank's business. The president and others of the management impress the examiner as being conscientious and desirous of doing whatever is best for the bank. They seem very grateful for the help and good advice received at the hands of those in the Comptroller's office."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 6-13-24 Exam. AA: | 50 | 1 | 202 | 209 | 31 | 97 | 6 | 0 |

1-23-25 Exam. W: "The board as a body does not appear to be giving the proper attention and careful consideration that this bank is apparently in need of. It is believed that President B and his sons, who are the junior officers, are giving the matters their closest attention, and are apparently making good headway. But the bank still holds many loans that will be a great source of anxiety for several years to come. The officers admit the doubtful character of a large aggregate of their Bills Receivables but are hopeful that by nursing and petting they can eventually collect. A large portion classed as doubtful at this time, could not be collected by suit. It is respectfully suggested that your office write a let-

Case 3 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrow-ings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

ter to each member of this bank's board of directors urging them to get in harness and assist in every way possible towards effecting a more favorable position."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1-23-25 Exam. W: | 50 | 2 | 163 | 235 | 0 | 84 | 27 | 0 |

8-5-25 Exam. W: "Bank officers are unusually optimistic over the local crop outlook, estimated crop condition 90% for this county. Acreage about 10% increased. Crop about two weeks early. Are expecting heavy curtailments on lines classified as doubtful and insufficiently secured, and hope to eliminate the greater portion of criticised paper also dispose of their real estate. Quite a few inquiries for farm land, are in evidence through options that have been taken. Directors are now said to be fully cooperating and lending all assistance possible. Attendance of meetings poor. Officers promise to do all within their power to correct and eliminate all criticisms. Bank's condition slightly improved by reason of collecting and further securing items reported as doubtful and slow in previous report. Bank's condition however, is far from favorable and the most rigid attention will be required in the working out of their problems - many of which will be long drawn out, also quite a few of their D. P. C. loans will in all probability have to be either refinanced or taken over for the bank's protection, further increasing their slow or frozen assets. Practically every loan made since the reorganization is well secured and none admitted as slow or doubtful."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 8-5-25 Exam. W: | 50 | 2 | 203 | 203 | 36 | 51 | 30 | 1 |

2-2-26 Exam. W: "Bank officers are discouraged and are contemplating merging, if possible, with one or the other state banks here, provided they can furnish sufficient amount satisfactory assets for the acceptances of this bank's liabilities to depositors. A close canvass was made of the bank's B/R's which as shown produce doubtful assets aggregating $47,141.54. This aggregate the President admits. Under liquidation aggregate would be greater. Quite a large portion of the doubtful paper if collection were pressed would immediately become determined losses, as the bank has been compelled to add interest to principal in order to keep the paper current. The greater portion of the doubtful assets have carried beyond six years. Should the merger not be effected, your examiner is apprehensive of results due to lack of local confidence, street gossip, partially due to dissatisfied shareholders at not receiving dividend. Also their lack of knowledge as to bank's true condition. Bank also has other real estate aggregating $29,903.80 (including $6,000 not shown properly on bank's books) which if liquidation was enforced would probably result in a loss of around $3,000 but officers are hopeful of working out in full if values enhance. Considering the past season's crop production, largest ever experienced in this section and prices received, it is extremely discouraging to note that doubtful assets have increased and no additional security has been gained, for the weak and doubtful lines."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 2-2-26 Exam. W: | 50 | 3 | 184 | 264 | 0 | 66 | 47 | 0 3 |

**EARNINGS:**

| | 1921 | 1922 | 1923 | 1924 | 1925 | Total |
|---|---|---|---|---|---|---|
| Net Income (Gross Earnings less Expenses) | 1(1) | 0 | 2 | 1 | 0 | 2 |
| Recoveries | 1 | 10 | 6 | 1 | 4 | 22 |
| Losses Charged Off | 2 | 11 | 71 | 2 | 1 | 87 |
| Assessments before Suspension | 0 | 0 | 50 | 0 | 0 | 50 |
| Bad Assets Purchased by Stockholders | 0 | 0 | 0 | 0 | 0 | 0 |
| Dividends | 0 | 0 | 0 | 0 | 0 | 0 |

(1) Deficit

Case 4

Bank Organized: 1905
Bank Suspended: 1930

Population of Town: 800 (1910 Census)
700 (1920 Census)
1100 (1930 Census)

Principal Crops or Industry Served by Bank:

Cotton

Important Excerpts from Reports of Examination: (Amounts in thousands of dollars)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|
| 4-22-20 Exam. A: | 25 | 41 | 285 | 290 | 20 | 19 | 0 | 0 |
| 7-22-20 Exam. A: | 50 | 16 | 304 | 245 | 66 | 27 | 2 | 0 |

1-5-21 Exam. A: "The board blames Mr. A the former president for a number of their slow loans. Mr. A recently resigned as president and director of the bank. President B, who succeeded Mr. A as president promises to exert every effort to effect the collection of past due paper and correct all other matters criticised, and the balance of the board with the exception of Director C (who never attends a meeting) promise to lend their cooperation to this end. The farmers in this community have disposed of very little of their products, and the management of the bank will be compelled to insist upon liquidation in order to force their customers to market their crops at the deflated price."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1-5-21 Exam. A: | 50 | 14 | 300 | 209 | 97 | 53 | 14 | 1 |

7-19-21 Exam. B: "The condition of this bank is very unsatisfactory. Former President A seems to have unloaded considerable amount of slow and doubtful paper before leaving. The paper does not bear his indorsement and in nearly every instance is that of tenant farmers secured by live stock and future crops, the former inadequate and the latter undeterminable. The Directors of this bank are to blame for allowing this paper to come into the bank. All paper classed in this report as doubtful and remaining in the bank after this year's crop is harvested, should be promptly charged off. For your information and as a matter of record, A's balance is $20,981.23 and if he should withdraw his balance in the near future it might be embarrassing for the bank in their present extended condition. It is also my information that before A left he stated that if it wasn't for the Cashier he would draw his entire balance. The bank's ability to pay in that event remains to be determined."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 7-19-21 Exam. B: | 50 | 16 | 288 | 188 | 97 | 99 | 19 | 4 |

3-23-22 Exam. B: "A meeting was held with the Board and all criticised matters taken up. Directors were urged to reduce their borrowings and in this way help bring about a more satisfactory condition. Directors D and E are using the bank unduly and largely through indirect borrowing in form of discounted paper. Their statement does not warrant the lines extended. While the B line appears heavy it is believed, basing my opinion on their statement, that they are safe and rather conservative, however should be curtailed. By way of explanation of the analysis of a financial statement in this section, you are respectfully advised that many statements show large excess liquid assets, consisting mainly of bills receivable and these many times are notes of tenants and will probably be paid if they live long enough, consequently the statements are not as liquid as a first glance at

Case 4 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrow-ings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

the statement would indicate. Those last remarks apply to this section generally."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 3-23-22 Exam. B: | 50 | 16 | 241 | 199 | 43 | 80 | 13 | 1 |

12-12-22 Exam. B: "At the completion of this examination directors D and E were questioned in the presence of the other directors as to their worth. A statement of the X Co. was presented and discussed. This statement of last spring shows the concern operating at a loss and practically no liquid assets. These two gentlemen retired from the room and a lengthy discussion followed. The question of taking a mortgage on their property was brought up but abandoned, because of probable bankruptcy proceedings resulting. They are now putting on a sale and the outcome and success remain to be determined. The two of them being so badly mixed up with the X Company, it is difficult to ascertain the true condition of their affairs. The large amount of criticised paper other than that mentioned above is chargeable to former president A, who before his leaving converted all of his holdings into cash through the bank and the directors allowed him to get by with it. In view of the unsatisfactory condition of the bank it is recommended that it be again examined in ninety days. The directors' meeting closed at 11:30 P. M. having been in session from 7:30 P. M."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 12-12-22 Exam. B: | 50 | 12 | 215 | 233 | 0 | 82 | 32 | 1 |

3-5-23 Exam. B: "Very little if any improvement is noted in securing slow and doubtful paper. At the close of this examination $5,300.38 was classified as a loss and charged off. There is $16,606.60 classified as doubtful and it is my opinion that the greater part will result in a lose. Your particular attention is called to the direct and indirect loans of directors D and E as follows:

| | |
|---|---|
| D direct and unsecured | $2.083.32 |
| Guarantor $\frac{1}{4}$ note of $4,394.65 Y Co. | 1,098.66 |
| | $3,181.98 |
| E direct and unsecured | $5,092.72 |
| Guarantor $\frac{1}{4}$ note of $4,394.65 Y Co. | 1,098.66 |
| | $6,191.38 |
| E and D | |
| Sundry bills receivable (all overdue) aggregating $18,381.44 endorsed by them and carried at | 10,070.12 |
| Two notes of X Co. endorsed by them | 5,999.87 |
| | $16,069.99 |

The X Co. is a corporation, the stock of which is practically owned by E and D and is operated by them.

The X Co. has also discounted with the bank their bills receivable to extent of - $2,733.16 in addition to the above.

Summing up the direct and indirect liabilities of the above they amount to - $28,176.51. At a directors' meeting held last night the following plan was agreed upon and the consummation of this agreement should be insisted upon. E agreed to secure his obligations of $5,092.72 by real estate and such other collateral as is acceptable to the board. E and D agreed to have renewed the notes of $18,381.44 and carried at $10,070.12 and obtain additional security on these

Case 4 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

papers wherever possible. E and D agreed to secure the X Company's line at $5,999.87 with a mortgage or deed on the one story double brick building now occupied by them as the X Company. E and D are so badly involved that the matter is a delicate one because of probable bankruptcy proceedings and if such should take place it would not be a surprise to them or the board or your examiner. At the aforementioned meetings I told the board I was very much surprised at them for so little progress having been made since my last examination and apparently they had done very little towards getting results. Of the entire board the President would probably be the last to take the initiative and I endeavored to make him understand his responsibility as President of the Bank and also advised him to consult freely with the bank's attorney in the above mentioned matters. The lines of the B's should not be overlooked as they should be reduced and it is to be remembered that both are directors. It is believed that further frequent examinations would prove detrimental and with that fact in mind I recommend that the bank be removed and examined the next time in regular order provided the notes are secured as stated above and such other information as desired by your office is promptly furnished."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 3-5-23 Exam. B: | 50 | 17 | 239 | 252 | 0 | 76 | 17 | 5 |
| 10-8-23 Exam. B: | 50 | 11 | 232 | 237 | 11 | 106 | 19 | 7 |

3-19-24 Exam. B: "As stated at preceding examinations the present management is not directly responsible for the bank's condition. A meeting was held with the directors all being present except director C who resides elsewhere. $8,614.23 was set out as losses and ordered charged to profit and loss on the following day, and they stated this would be done. Other losses will develop and should be charged off as they are determined."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 3-19-24 Exam. B: | 50 | 14 | 240 | 269 | 0 | 86 | 22 | 9 |

8-19-24 Exam. C: "Note the tremendous amount of slow and doubtful paper. There is some apprehension on my part as to whether the directors and officers have the force or the will to rise to the occasion necessary to save the bank. I am in doubt as to whether or not they really appreciate the fact that the bank is in an almost serious position. For it appears they have become accustomed to its condition, and justify their personal position, each one of them, by the often repeated statement, 'You know we are not responsible - the fault is with our predecessors.' Apparently no positive efforts have been made - certainly not in a forceful and intelligent manner, to reconstruct the bank, in a handling of the many slow and doubtful items of assets. Reference back three, four or five years ago, to certain lines now standing, shows that such lines are now carried at an increase of from 200 to 500%. I had the board together, in a meeting, and brought to their attention the many matters of exception which are set up in this report. Some of the slow and doubtful paper can probably be salvaged by intensive work, by intelligent consistent action of the board, as the crops are better than the average in this section. If such an effort, continuous throughout the period for the balance of this year is not made, and this opportunity for reconstruction lost, losses will be definitely set, that will consume a large part of the capital. Note that the surplus, after the recent charge offs, has been practically eliminated. Required a letter from the directors."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 8-19-24 Exam. C: | 50 | 5 | 266 | 232 | 38 | 60 | 50 | 4 |

Case 4 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

8-13-25 Exam. D: "As will be seen from the report, the assets of the bank have been classed as follows: Slow $88,451.02; Doubtful $25,547.10; Undesirable $1,437.22 and Losses $11,951.13, making an impairment of Capital of $7,453.41. Of the total losses $4,072.86 were charged off during the examination, leaving $424.86 in Undivided Profits (No Surplus) to take care of the remaining losses of $7,878.28, or an impairment of $7,453.41 as outlined. The condition of the bank was thoroughly discussed with Directors W. B., M. B., F and G. Director C could not be reached. The Directors claim to be doing all they can to put the bank in satisfactory condition, but the amount of past due paper and general condition of the bank give the impression that they are either not doing what they should to relieve the bank or else have not the ability and force to rise to the occasion, and apparently do not realize that they are in a serious condition. They declined to take enough of the worthless paper out of the bank individually in order to save the impairment of capital, feeling that it was not up to them any more so than to the rest of the stockholders, excusing the present condition on the grounds that it is the fault of their predecessors. They asked that the following proposition be submitted to your office for approval: That they be permitted to carry the balance of the paper classed as Losses in their loans and Discounts until Spring of next year - the time that most of the bank's earnings are made - and in this way give them an opportunity to work it out, and consequently not only make it necessary to make an assessment but also would not make it necessary for them to show an impairment of Capital when the next published Report of Condition is called for. They state that they are doing all they can to work the bank out, that they have not paid a dividend for some time, that it is their intention to take their losses just as fast as the earnings of the bank permit, and that they feel sure that if they are permitted to carry this paper over into next year, their earnings will be sufficient to cover. While it might be possible for the earnings of the bank next year to take care of the losses as requested, the Examiner is of the opinion that with the amount of statutory paper and other slow and doubtful paper in the files of the bank, it will be about all the bank can do for some time to take care of other losses that will arise from time to time. While it is believed that it is the desire of your office to assist bank in every way possible to work out of tight places, yet it is not thought advisable to let this matter be carried as the Directors wish. It is therefore the recommendation of the Examiner (if such a recommendation is in order) that the Directors be advised that their request to carry the paper over into next year is not satisfactory, and that they then be given another opportunity to take the paper out of the bank individually or by voluntary contributions from the stockholders, and if they again refuse, that an assessment be made to take care of the losses as outlined in the report. Inasmuch as the bank is due another regular examination before the close of this year, it is not recommended that the bank be placed on the Special list unless it is the desire of your office that this be done."

| 8-13-25 Exam. D: | 50 | 4 | 228 | 233 | 11 | 90 | 26 | 12 |
|---|---|---|---|---|---|---|---|---|

12-10-25 Exam. D: "The bank, in the opinion of the examiner, needs the closest kind of attention to put it in a satisfactory condition. The Directors do not appear to be aggressive enough to give the bank the aid needed. Attention is directed to the large amount of statutory debts, most of which represent paper in suit and much of which has been in court several years without decision. Directors claim this is through no fault of theirs, as they are represented by the best attorneys available. All of which may be true, but they appear to rely too much on the fact that the paper mentioned was in the bank when they came into charge, and that it is not their fault. This is granted, but this is no cure for it, and unless they change their ways and actually get to work, it is the humble

Case 4 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrow-ings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

opinion of the examiner that the bank will eventually have to close. The bank should really be on the list for more frequent examinations. It is not recommended at this time, however, for the reason that the law suits in question will not again come up before April and an examination before that time would be useless, except for the fact that we would be able to keep in closer touch with the operations. It will be seen that after the losses were charged off, the capital will show a small impairment."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 12-10-25 Exam. D: | 50 | 1 | 196 | 276 | 0 | 81 | 19 | 2 |

5-4-26 Exam. E: "The condition of the bank is not at all satisfactory. Many of the loans are tied up with court litigation and have been in this same condition for a long time. The bank continues to make additional advances to tenant farmers who appear to be hopelessly involved. Aggressive action of the directors would in many cases help to clear out some frozen paper but the directors are of the easy going type and appear willing to wait and hope that loans will be paid voluntarily. Directors state that the bank was in very bad shape when they took charge and are prone to compliment themselves on the good work they have done in clearing up the situation. Most of this clearing up was done by charging off rather than by collection. If the loans classed doubtful are not paid or properly secured this fall they should be eliminated from the assets of the bank. It is believed the directors will come to the bank's aid with a reasonable amount of money. It was learned that there has been an application made to organize a state bank here. Directors were of the opinion that a charter would not be granted. If a new bank is organized and is able to draw many deposits from the present one they would probably experience some difficulty meeting the withdrawal if heavy. Directors' letter is respectfully submitted."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 5-4-26 Exam. E: | 50 | 3 | 202 | 266 | 0 | 98 | 22 | 1 |

6-10-27 Exam. F: "It is believed that the directors are doing their best to place the affairs of the bank in the condition it should be. There has been no reduction in the loans listed as slow and doubtful, but in most cases, the tenant farmers are making their crops with very little money advanced by the bank. Prospects for a crop are good at this time. The farmers have a good stand of cotton, and are feeding hogs. The loans and all matters of criticism were discussed with three directors and the Cashier. Loans listed as losses were charged off during examination, and directors promised to give other criticisms prompt attention. Reductions on slow and doubtful loans can not be expected until the crop is harvested. It is believed that the directors are doing all in their power to work out the lines, and it is recommended that no further action be taken until the crops are harvested. It is believed that if this is done, and loans are reduced in the fall the directors will take up the amount of losses that are determined rather than have an assessment of stock."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 6-10-27 Exam. F: | 50 | 3 | 210 | 222 | 20 | 84 | 20 | 1 |

11-18-27 Exam. F: "Loans listed as losses in this report have been carried for a number of years, without any progress in the way of reductions. In most cases they are loans to tenant farmers who have not been able to make any money except to pay advances for crops. Directors claim that these loans are old workout propositions handed down by a former management, and therefore feel that they should have time to work them out. Your Examiner endeavored to have the directors agree to take out the paper listed as loss and part of the paper listed as doubtful, and thereby give the bank a clean slate. It is believed that, if these

Case 4 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

loans could be cleaned out, the bank could make more than expenses and eventually pay a dividend. For the past two years, the undivided profits have been used to charge off losses. Inasmuch as no progress has been made in reducing the loans to tenant farmers, and some of the loans in hands of attorneys, your examiner believes that the loans should be reduced to the actual value of the security. It is recommended that a letter be sent to the directors urging them to make arrangements to pay in some new money and take up the paper listed as doubtful and loss, but if this cannot be done, the directors should review the doubtful paper and determine further losses, and an assessment of capital stock should be made. The detail work of the bank is well kept, and it is believed that the bank could be placed in good condition under present management, if the doubtful paper and losses are removed. Your examiner believes that the shareholders are well able to place the bank in a satisfactory condition, if they will."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 11-18-27 Exam. F: | 50 | 1 | 180 | 224 | 0 | 82 | 14 | 9 |

5-24-28 Exam. F: "The shareholders paid $10,000 into undivided profits on January 18, 1928, and losses of $9,152.70 shown in last report were charged off. The bank still has a large amount of slow and doubtful paper, payment and reduction of which will depend largely upon crops this year, and the attention directors will give toward collecting from returns of crops. Directors are believed to be holding down advances to farmers this year, and since losses listed in last report were absorbed, it is believed little can be done until fall of the year after crops are harvested. After crops are harvested this year, it is recommended that the directors estimate losses on all doubtful loans, and that the shareholders be asked to place the bank in satisfactory condition. Your examiner believes that letter from your office, urging directors to give their attention to collections and advising that they will be expected to correct conditions next fall, will help the examiner to make corrections."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 5-24-28 Exam. F: | 50 | 7 | 208 | 204 | 25 | 83 | 16 | 0 |

6-25-29 Exam. G: "At the close of examination, a meeting of the board of directors was requested. Director C lives in another town, and has never attended a meeting. Director G is a physician and was only present during review of criticisms and general discussion. Lines were discussed with W. B., M. B. and the Cashier. Correction was promised where possible but a number of matters cannot be corrected at present. This bank serves a community which has suffered from very adverse conditions for the past three years and this is reflected in the large volume of slow and doubtful paper, the large amount of Other Real Estate Owned, and the heavy borrowings. The future of the bank depends on recovery of farming in this vicinity for on that depend collections and ability to move Other Real Estate. Director G is a physician, the B's are merchants whose time will be occupied in the fall, and Director C takes no active interest in affairs of the bank. Your examiner suggested that additional help be obtained this fall, that the Cashier be relieved of all routine duties and devote his entire time to collections and 'following up' crops, with the active directors giving all available time in assisting him. The vacancy on the board was caused by the death of F. The stock of the bank is very closely held and sale is very difficult at the present time. The Cashier stated bank had corresponded with Office of Comptroller in regard to this matter. Considering the conditions revealed by this examination it is evident that this bank is in a very grave condition. The absence of any reserve strength in surplus and undivided profits account, the large amount of slow and doubtful paper, heavy borrowings, and small volume of business done, cause much concern. Crop conditions are reported favorable at present and if good crops

Case 4 (Continued)

| Case | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

are made and fair prices obtained, most of the doubtful paper will be collected or reduced to safe limits and much of the slow paper retired or materially reduced. In the event of unfavorable conditions, additional capital must be placed in bank for it to continue to operate. Whether stockholders can contribute additional to do this, could not be determined. Your examiner feels that no definite action can or should be taken until end of crop year. At that time some definite course of action should be decided upon and the bank required to 'clean house' by removing old and undesirable assets. Farming is chief industry with cotton as principal money crop. Last year's cotton crop was about 50% of normal and all has been sold. Acreage for 1929 about same as for 1928. Farmers are principally white with 65-70% of farming done by landowners. Only one failure in town reported. Number of real estate loans are pledged and details could not be obtained on some of these."

| Case | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|
| 6-25-29 Exam. G: | 50 | 8 | 212 | 184 | 40 | 125 | 23 | 1 |

1-28-30 Exam. G: "As will be disclosed in the report, this bank is in a most dangerous condition with doubtful and worthless paper amounting to $50,242.26, with no earning capacity, and with a large volume of slow paper. This condition is due to several causes. The large amount of tenant paper carried along in the assets of the bank, which under the adverse conditions prevailing in this section, has resulted in the accumulation of a large volume of doubtful and worthless assets, the limited volume of business handled by the bank, and the presence of an excessive extension of credit to the partnership of Directors B. The affairs of the bank were discussed with the local directors, and at the close of the examination the Examiner and Directors, G, M. B. and H went to a nearby town for a conference with the stockholders who live there. This was done in order to obtain some action looking to the restoration of the bank's capital. After somewhat lengthy discussion, Mr. I, representative of the C interests, told the gentlemen from here to return and obtain amounts needed as voluntary assessment, from the stockholders here and they would do their share. Mr. I seemed dissatisfied with the condition of the bank, especially with the poor earning capacity, and he did not think very favorably about going on with the operation of the bank. Your Examiner questions seriously the ability of the parties here to raise the money needed in reorganization of the bank, especially the B Bros. who own 136 shares of the stock. Even if reorganized the future of the bank appears very limited as there are strong banks in nearby towns which serve the same territory as this bank. While the bank is not insolvent, its condition is such that if immediate relief is not forthcoming in the way of new capital, your Examiner questions its ability to continue. Note: Bank has suspended operations."

| Case | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|
| 1-28-30 Exam. G: | 50 | 2 | 148 | 152 | 12 | 89 | 31 | 20 |
| Receiver: | | | | 132 | | | 113 | 30 |

**EARNINGS:**

| | 1925 | 1926 | 1927 | 1928 | 1929 | Total |
|---|---|---|---|---|---|---|
| Net Income (Gross Earnings less Expenses) | 4 | 4 | 2 | 2 | 0 | 12 |
| Recoveries | 0 | 0 | 0 | 0 | 0 | 0 |
| Losses Charged Off | 12 | 3 | 2 | 9 | 1 | 27 |
| Assessments before Suspension | 8 | 0 | 0 | 10 | 0 | 18 |
| Bad Assets Purchased by Stockholders | 0 | 0 | 0 | 0 | 0 | 0 |
| Dividends | 0 | 0 | 0 | 0 | 0 | 0 |

## Case 5

Bank Organized: 1907
Bank Suspended: 1930

Population of Town: 2000 (1910 Census)
3000 (1920 Census)
3000 (1930 Census)

Principal Crops or Industry Served by Bank:

Cotton, lumber, and hogs.

Important Excerpts from Reports of Examination: (Amounts in thousands of dollars)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrow-ings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|
| 2-12-20 Exam. H: | 100 | 33 | 273 | 375 | 50 | 8 | 0 | 0 |
| 9-16-20 Exam. H: | 100 | 43 | 427 | 357 | 30 | 10 | 0 | 0 |

2-25-21 Exam. B: "Number of directors has been reduced from seven to five. A and B having been dropped. When definite action is taken by the Board towards a correction of matters criticised the bank's condition will be greatly improved."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 2-25-21 Exam. B: | 100 | 54 | 403 | 327 | 25 | 51 | 1 | 0 |

8-6-21 Exam. B: "Bank closes at 4 o'clock on Saturday afternoons and reopens at 5 to accommodate out of town customers. Such transactions are carried over until Monday and are not included in the day's business."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 8-6-21 Exam. B: | 100 | 54 | 389 | 294 | 41 | 13 | 1 | 0 |

3-25-22 Exam. B: "Management regarded fairly well."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 3-25-22 Exam. B: | 100 | 53 | 405 | 292 | 63 | 27 | 1 | 0 |

12-7-22 Exam. B: "It was claimed that the excess loan to director C was an oversight and said it would be reduced at once. The excess loan to D and E is now in process of liquidation and I was told that the contemplated deal would probably be closed the next day and the loan satisfactorily adjusted."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 12-7-22 Exam. B: | 100 | 53 | 361 | 283 | 0 | 6 | 2 | 0 |

5-28-23 Exam. B: "No Remarks."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 5-28-23 Exam. B: | 100 | 59 | 401 | 288 | 19 | 36 | 4 | 0 |

10-5-23 Exam. B: "The death of President F has occurred since my last examination; however, he is believed to have left quite a valuable small estate. He is said to have had about $80M life insurance, payable largely to his wife. It was stated, that Mrs. F had questioned the liability of her deceased husband on some of the paper and that she desired to meet with your examiner and was called into the meeting by the President and Cashier. Mrs. F is executrix of the F estate and after your examiner had heard matters discussed by her and the officers of the bank, it would not be surprising if she gave the bank some trouble. Enclosed herewith is a directors' letter covering various criticisms, embodying promises to correct."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 10-5-23 Exam. B: | 100 | 50 | 376 | 280 | 18 | 18 | 6 | 0 |

3-24-24 Exam. B: "It appears that friction has developed among the directors, some of them it appears are desirous of making a change as regards the Cashier, and such a change, in the opinion of your Examiner would very likely be beneficial

Case 5 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

for he appears to have grown careless in the handling of the bank's affairs. Nearly one-third of the bank's paper is overdue, and of this amount nearly $12M is statutory bad. A letter was obtained from the Board at the time of my last examination October 5, 1923, and in this letter certain promises were made (copy is on file in your office), but have not been fulfilled. It is suggested and urged that the directors take a more active interest in the management, familiarizing themselves, as far as possible with the bank's details."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 3-24-24 Exam. B: | 100 | 53 | 373 | 333 | 7 | 102 | 6 | 8 |

8-20-24 Exam. C: "A large amount of paper is of indefinite value, information not being in hands as to value of lands securing real estate loans, or as to the amount of prior liens. Contingent losses are heavy, apparently running to 50% of Surplus if present estimate is substantiated. I was rather favorably impressed with Vice President G, who has recently taken charge. I am of the opinion, after a discussion with local directors H and C, that a change for the better, in management, is under way. I cautioned against a continuation of the one-man management."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 8-20-24 Exam. C: | 100 | 53 | 371 | 291 | 38 | 74 | 44 | 5 |

8-12-25 Exam. D: "Slow paper runs unusually high being more than 25% of total loans, showing the need of intensive work by officers in charge. Vice President G who has recently been put in charge of the bank seems to be very capable, but does not seem to have the proper appreciation for the laws that govern National Banks. The number of excessive loans and unlawful real estate loans bear out this fact. His former banking experience has been with State Banks. It is believed that he will give the bank his entire time. He at this time spends most of his time buying cotton, and apparently considers the bank a side issue."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 8-12-25 Exam. D: | 100 | 29 | 412 | 339 | 45 | 114 | 9 | 5 |

12-12-25 Exam. A: "While some of the detail work of the bank might show improvement, Vice President G, with whom the examiner went over the note case, appears efficient and seems to be getting results in collecting and securing the bank's paper. Conditions in general seem to be good. The condition of the bank is satisfactory."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 12-12-25 Exam. A: | 100 | 30 | 423 | 422 | 0 | 82 | 3 | 3 |

5-11-26 Exam. B: "Vice President G is in complete charge, is a son-in-law of President I and originally came from X where he was employed by the X Bank for several years. He has only average ability but an exalted opinion of himself. Too many loans are made to the X crowd and several of these loans are the ones that were criticised at X and elsewhere. It is the opinion of your examiner that the loans have not been actually paid in several years, but switched from one bank to the other. It is to be noted that some of these notes are called 'slow' in this report. Ground is being broken for a new building, but it is your examiner's opinion that the present quarters are adequate for several years to come."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 5-11-26 Exam. B: | 100 | 29 | 428 | 397 | 0 | 104 | 0 | 0 |

10-15-26 Exam. F: "There has been very little reduction in slow paper since the last examination, and only small reductions can be expected in slow loans to

Case 5 (Continued)

| Date | | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|---|

farmers on account of crop conditions. Farmers suffered heavy losses through damage to crops by storm, and low price of cotton. Notes of farmers are carried overdue until the crops are all ready for market when payments and renewals will be made. It will be necessary to carry loans for a number of farmers, but most of these are land owners and it is believed will work out without serious loss to the bank. Two excess loans were found at this time. The Y Company, a corporation in which Directors J, C and Vice President G are interested, was formed to buy cotton. They use the bank's room for their office and for storage of cotton samples. The bank holds warehouse receipts for cotton to secure the overdraft which caused the excess loan. This appears to be a case of the bank furnishing the capital to buy cotton. The line to K and L was also caused by an overdraft. In this case, the bank does not hold sufficient cotton to secure the overdraft. Cashier M stated that the cotton covered by warehouse receipts would be sold within a week, and the overdrafts would be made good. Two real estate loans, listed as illegal, have certificates attached showing values as listed. One loan is listed as illegal because of a prior lien. Cashier M agreed to check loans, and ledger accounts to locate and correct errors shown in this report."

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 10-15-26 | Exam. F: | 100 | 28 | 383 | 420 | 0 | 103 | 0 | 0 |

5-12-27 Exam. F: "The bank still has a large amount of slow paper. Very little reduction can be expected until the fall of the year. Security has been taken wherever possible, and all loans which appeared to be losses have been charged off. The bank moved into a new building on or about January 1st. It now has suitable and convenient banking quarters. The old building was small and additional filing vaults were badly needed. A committee of directors has been appointed to sell the old building and furniture and fixtures. They claim to have an offer of $6,000 for the old building, and expect that it will be sold in near future. Vice President G agreed to give special attention to all matters of criticism, and to loans listed in overdue and slow and doubtful paper."

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 5-12-27 | Exam. F: | 100 | 27 | 417 | 402 | 45 | 101 | 5 | 0 |

11-17-27 Exam. F: "Bank is believed to be well managed. Loans are closely followed, and few losses are expected. Bank's rediscounts and borrowed money will be cleaned up in a short time when cotton begins to move. Farmers and merchants are holding cotton, waiting for the market to steady. The bank has had several offers of $5,000 for the old bank building, but the directors are holding for $6,000 which they claim can be had in time."

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 11-17-27 | Exam. F: | 100 | 22 | 481 | 443 | 63 | 102 | 2 | 0 |

5-18-28 Exam. F: "Overdue and slow and doubtful paper is closely followed by the Directors and Officers. The total of overdue paper is large at this time, but a number of notes are carried overdue in order to urge reduction. The bank carries old banking house on the books at $5,911.49 and old furniture and fixtures at $1,500. Vice-President G states that the fixtures will be sold as soon as possible in order to eliminate this item. The old bank building is located on the same lot with the new bank building with a space of about twenty feet between the two buildings. The bank has been offered $5,000 for the building and lot. At a recent meeting the Board of Directors voted to hold the building, if the Comptroller would permit them to do so, and to repair the building so that it would be suitable for a tenant. It is estimated that the repairs would cost about $3,000, which would make a total investment of about $9,000 in the old building.

Case 5 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Classified Assets Doubtful | Classified Assets Losses |
|---|---|---|---|---|---|---|---|---|

The total investment in old and new buildings would be about $38,000. The new building gives the bank suitable quarters for years to come, and the only object in holding the old building would be to prevent erection of a building near the new building and thereby darken the banking room. Your examiner has urged the Directors to sell the property, and understands that President I is in favor of selling it. Cashier G stated that he intended to write to your office, for an opinion. It is recommended that the Directors be urged to dispose of the old property and thereby reduce the large total of real estate owned."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 5-18-28 Exam. F: | 100 | 27 | 455 | 451 | 61 | 76 | 4 | 1 |

10-12-28 Exam. F: "The bank is believed to be well managed. The large amount of overdue paper at this time is due to late crops, and the fact that paper matures in September and October, and is not renewed until returns for crops have been applied to loans. Several of the lines carried overdue since last year, have been so carried in order to reduce or come to some settlement at the end of this season. The condition of the loans and general affairs may be partly due to the fact that Vice President G has some outside interests that take up too much of his time. He buys cotton, sells fertilizer and is also interested in the mule business with a partner. President I, who is president of the Z National Bank, Z, and a successful business man of that place, is believed to be desirous of having this bank in first class condition. President I was notified of the examiner's visit, for the reason that he had requested to be advised so that he could discuss the loans and affairs of the bank, but he could not arrange to be present, and a board meeting could not be had at this time. However, your examiner expects to be in X in the near future, and will arrange a conference there with President I, and possibly Director J, to discuss the affairs. The loans are in most cases amply secured, and the bank is not believed in serious condition, but the slow lines, and the old overdue loans, need attention and your examiner also holds that every effort should be made to relieve the bank of other real estate owned, including the old bank building and furniture and fixtures. Vice President G stated that the directors have discussed these matters, and have been giving consideration to forming a corporation among themselves to take the old building and other real estate out of the bank, so that they can hold it for better prices. It is hoped that this may be done. The officers expressed the belief that the loans and discounts can be reduced a sufficient amount to pay up the rediscounts and bills payable within thirty days. It is requested that a letter be sent to the bank, urging directors to dispose of the old banking house, and other real estate, and the collection of overdue and slow paper."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 10-12-28 Exam. F: | 100 | 22 | 478 | 432 | 103 | 73 | 5 | 1 |

10-31-29 Exam. G: "A meeting of the Board of Directors was requested at the close of the examination. Loans and matters subject to criticism, were discussed with the directors present. Correction was promised on matters which can be remedied. The territory served by this bank had a very bad season and this has resulted in the accumulation of a large volume of slow paper, and quite a bit of doubtful and worthless paper. The depressed condition of farming in this section prevents the turning of real estate and low values of real estate have caused some of the estimated losses. The active management of the bank has been left to Vice President G in the past and he has also been in charge of the Y Company and other interests which have placed demands upon his time. He appears capable and realizes the

Case 5 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

condition of the bank. He is the son-in-law of President I. He had the reputation of drinking to excess at times, and N, a former director, resigned because of dissatisfaction over the way G managed the affairs of the Y Company and the bank. Mr. I told the examiner the board of directors informed G that any further indulgence in this weakness would result in his dismissal and he has kept sober, attended to business, and appears to be trying to do his work in the proper manner. Mr. I has been very attentive to the affairs of the bank and attends all the meetings. He is president of the Z National Bank, Z, a bank which is in excellent condition and he appears most capable. He will look after the affairs of the bank as much as possible and it is thought the directors will give the bank's affairs close attention in the future. Management hopes to retire Borrowings or reduce to small carryover. It was stated that bank has cleaned up in the past and effort would be made to do this. It seems that some carryover will be inevitable. The territory served by this bank is engaged in farming and lumbering. Cotton is the principal money crop. Yield was smaller than last year and is about 50% of normal crop. Some hogs are grown. The lumber holdings have been cut out to a considerable extent and it is estimated the holdings of timber in this section will last about two years longer. Deposits are off compared with previous years. While the condition of the bank is serious, the management and the directors appear to realize its condition and are trying to correct matters in every way possible."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 10-31-29 Exam. G: | 100 | 20 | 436 | 368 | 95 | 138 | 15 | 6 |
| Receiver: | | | | 312 | | | 290 | 113 |

EARNINGS:

| | 1925 | 1926- | 1927 | 1928 | 1929(1) | Total |
|---|---|---|---|---|---|---|
| Net Income (Gross Earnings less Expenses) | 15 | 11 | 12 | 12 | | 50 |
| Recoveries | 2 | 1 | 0 | 0 | | 3 |
| Losses Charged Off | 9 | 7 | 5 | 4 | | 25 |
| Assessment before Suspension | 0 | 0 | 0 | 0 | | 0 |
| Bad Assets Purchased by Stockholders | 0 | 0 | 0 | 0 | | 0 |
| Dividends | 8 | 6 | 6 | 7 | | 27 |

(1) Unable to obtain data for Dec. 31, 1929. Figures reported for June 30, 1929 as follows:

| | |
|---|---|
| Net Income (Gross Earnings less Expenses) | 5 |
| Recoveries | 0 |
| Losses Charged Off | 6 |
| Assessment before Suspension | 0 |
| Bad Assets Purchased by Stockholders | 0 |
| Dividends | 4 |

## Case 6

Bank Organized: 1901
Bank Suspended: 1924

Population of Town: 1100 (1910 Census)
1300 (1920 Census)
2000 (1930 Census)

Principal Crops or Industry Served by Bank:

Cotton and corn.

Important Excerpts from Reports of Examination: (Amounts in thousands of dollars)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|
| 6-7-20 Exam. H: | 100 | 103 | 479 | 356 | 87 | 13 | 1 | 1 |
| 11-26-20 Exam. H: | 100 | 106 | 474 | 332 | 143 | 10 | 10 | 2 |

4-7-21 Exam. B: "The management of this bank is left entirely with the Cashier Mr. A. He is apparently an easy going sort of fellow, anxious to make money and in his eagerness to make money it appears that he loses sight of the principal to a great extent and can see only the interest or discount received. A large amount of the loans are to negro farmers. The negro as a rule is poor pay and does not try to accumulate money and get ahead. Three negroes have borrowed from the bank a total of $23,192.57 of which amount $3,000. is admitted as being doubtful. There are many other notes of negroes but are for small amounts and in event of losses on this class of paper the aggregate will not seriously impair the profits. I do not look favorably upon the contents of the note case as a whole for the lines of credit extended are in my judgment too large in view of the security furnished and it will take some time to work out. A great deal depends on the crops this year and the prices received in the fall. The bank has $81,610.69 surplus and undivided profits and there is no immediate danger. The main crop is cotton which is being held up due to low prices offered for same, however there seems to be slight improvement in the market, and the anticipated marketing of same within the next few weeks will materially relieve the strained situation."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 4-7-21 Exam. B: | 100 | 107 | 467 | 278 | 126 | 300 | 9 | 4 |

5-18-21 Exam. B: "An examination of this bank was made in compliance with your office letter of May 12, due to the expiration of their charter on Aug. 16, 1921. When the following matters have been corrected, I recommend that their charter be extended. The line to the X Co., of $115,866.35 is paid or very greatly reduced. A says that the entire line will be paid by Aug. 1, 1921 and charter does not expire until Aug. 16, 1921. The doubtful and loss paper is completely charged off."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 5-18-21 Exam. B: | 100 | 101 | 450 | 244 | 151 | 74 | 34 | 2 |

4-11-22 Exam. B: "The large amount of slow paper is due to the lending of too much money to the farmers during the period of inflation. It appears that it will take several years to liquidate paper in general. It is to be noted that many loans are made to negroes in large amount. The Southern negro is as a rule very poor pay. One line in particular is that of B a negro tenant. This negro owes the bank $5,949.37 and his landlord owes the bank $14,673.30. When Cashier A was questioned regarding these notes, he stated that they were perfectly good

Case 6 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrowings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

and that B was helping his landlord pay off his mortgage on the farm, and I asked A what part of the farm the negro got when the mortgage was paid and he said 'None.' The above is related in order that you may better understand the situation and see it as it is."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 4-11-22 Exam. B: | 100 | 88 | 376 | 256 | 125 | 231 | 10 | 0 |

9-22-22 Exam. B: "It is to be noted from this report that a very unsatisfactory condition exists. From the manner in which the accounts were kept, I became very suspicious as to the genuineness of the various transactions and accordingly proceeded very carefully. While I was experiencing considerable difficulty in balancing the notes, my assistant was having similar experience with the bank's details. Cashier A is to blame for the condition that exists, and also the Board, to a certain extent. An earnest effort was made to impress upon the Board that they had certain duties to perform, which could not be delegated to someone else. At a directors' meeting on Sept. 20th, the board voted to decrease surplus account $25,000 and credit undivided profits with a like amount. It is to be noted that there is an outstanding judgment of $70,000 against the bank with a 10% penalty and interest. This judgment was obtained in the lower courts and sustained by the Supreme Court in connection with the bank's refusal to pay on deman to the executor of the estate of C because of an indebtedness to the bank of the X Co. a partnership composed of C et al and claiming an offset. The bank has asked for a new hearing in the case and the matter is now pending."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 9-22-22 Exam. B: | 100 | 75 | 298 | 277 | 79 | 105 | 57 | 0 |

3-8-23 Exam. B: "Federal Reserve Bank was paid by a new note on December 16, 1922 and has not been recalled. It was necessary to rediscount bills receivable to extent of $46,950.00 in order to pay off the claim of $84,845.01 including interest and penalty to the C estate. The shrinkage in deposits is due to the bank having lost the lawsuit against the C estate. Competition is keen between the two banks and a very unfriendly feeling exists."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 3-8-23 Exam. B: | 100 | 60 | 266 | 246 | 47 | 70 | 93 | 0 |

9-25-23 Exam. B: "There is unquestionably a large amount of slow and doubtful assets in the bank, requiring most careful attention. Litigation on account of the X Company continues and it is about a fifty-fifty chance of winning in the end. Because of the litigation the bank has met with unfavorable outside comments and no doubt has lost some business. All matters of criticism have been incorporated in the report proper with a view to bringing the bank's condition squarely before them. The cotton crop in this immediate vicinity has fallen short of expectations and their hope now is in the present crop, which is reported above the average."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 9-25-23 Exam. B: | 100 | 56 | 249 | 202 | 69 | 125 | 82 | 1 |

4-18-24 Exam. C: "There has been no improvement in the condition or management since the last examination. No constructive attention has been given to eliminate the objectionable features reported in the examination on Sept. 25th. 1923. A major portion of the investments are highly unliquid as the X Co., and the large capital loans, these lines running from $5,000. and below up to $13,000.00. It

Case 6 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrow-ings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

is merely a waiting proposition to determine what the outcome will be with reference to these investments. The bank is financing the Y Company in the amount of $28,896.82 in purchases in the form of acceptances or drafts, drawn on this concern at face value. The Y Company is said to be a corporation capitalized at $10,000.00, the stock owned in equal parts by A, Cashier, G. A. son of cashier, D, son-in-law of Cashier and E. The crops are not stored in an independent or bonded warehouse, but in the mill of the corporation and are therefore out of the possession of the bank and the advance would appear to be upon moral risk only, and constituting an excessive line. I inspected the plant and found that there was on hand some crops in bags, and some in bulk. No way to determine except approximately, the value on hand. A deposit of this concern was carried on the individual ledger amounting to $8,236.57, representing, I was informed, the proceeds of the sale of a part of the original purchase of crops. There is no doubt that the bank is carrying contingent losses in large amounts, in addition to the contingent loss in the Y Co. There is rather definite loss in the F paper. It would appear to be extremely hazardous to advance this party additional funds. This paper should be accepted as a loss and cleared off the books before the close of the year. The business of the bank is running very light. One man could take care of the clerical part of the work. Four men were on the pay roll on date of examination in addition to Cashier A. I understand, however, that one man was temporarily employed."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 4-18-24 Exam. C: | 100 | 46 | 238 | 215 | 70 | 109 | 98 | 0 |

9-25-24 Exam. C: "Note the decline in deposits since the last examination and this in the face of the fact that cotton is moving freely and deposits should (normally) be materially increased. The large amount of contingent losses, one item of which is known by the general public to be in contest, and being delayed in adjudication for so long a time, is evidently having its adverse effect upon the bank. This territory although adjoining one of the safest cotton producing sections of this state, is unfortunately located for the profitable production of cotton, the lands being more subject to the depredations of the boll weevil than those just south, and are therefore not attractive for investment purposes. And it is of this property that the bank is so abundantly loaded in 'Other Real Estate' and in loans upon the land, with a mere equity in most of these lands. Note the aggregate of slow paper, $104,437.63, and of Doubtful, $77,618.67 and the amount of loss charged off $12,738.33. The bank benefits only to a limited degree from the generally good crops in this section, for except in a few instances, as crop improvement over former years is shared by those whose obligations are in the list of the slow and doubtful loans, especially to the extent of lifting that paper out of the slow and doubtful column. Mr. A has been in bad health for several months. He has been in bed for possibly three weeks. I visited his home and went over the affairs at the bank."

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 9-25-24 Exam. C: | 100 | 41 | 244 | 195 | 102 | 104 | 78 | 13 |
| Receiver: | | | | 145 | | | 114 | 87 |

Case 6 (Continued)

| Date | Cap. | Surplus & Profits | Loans | Deposits | Borrow-ings | Classified Assets Slow | Doubtful | Losses |
|---|---|---|---|---|---|---|---|---|

| EARNINGS: | 1919 | 1920 | 1921 | 1922 | 1923 | Total |
|---|---|---|---|---|---|---|
| Net Income (Gross Earnings less Expenses) | 21 | 10 | 8 | 8(1) | 3 | 34 |
| Recoveries | 0 | 0 | 0 | 0 | 0 | 0 |
| Losses Charged Off | 1 | 6 | 13 | 17 | 3 | 40 |
| Assessments before Suspension | 0 | 0 | 0 | 0 | 0 | 0 |
| Bad Assets Purchased by Stockholders | 0 | 0 | 0 | 0 | 0 | 0 |
| Dividends | 4 | 12 | 8 | 4 | 0 | 28 |

(1) Deficit.