# THE FINANCIAL PERFORMANCE OF CONTINENTAL ILLINOIS NATIONAL BANK: A CHRONOLOGY AND PEER GROUP COMPARISON

September 17, 1984

STAFF REPORT

TO

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

This report is the result of staff findings to date and does not necessarily reflect the views of the Members of the Subcommittee.

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## EXECUTIVE SUMMARY

This report presents information on the financial history of Continental Illinois National Bank and Trust Company of Chicago, discusses significant events which affected the Bank, and compares the performance of the Bank over time to other multinational banks and other Chicago regional banks. The report is divided into three sections. In the first section, we present (1) a chart which provides information on the increasing number of problem and failed banks, (2) a series of charts which highlight ratios related to Continental's performance in comparison with its peers, and (3) the consolidated statements of income and financial position of Continental for the period from 1970 through the first quarter of 1984. The second section presents a comparative financial analysis of the Bank in relation to its peers. The third section discusses the economic environment surrounding the Bank; changes in the Bank's organization and management; and the Bank's financial performance throughout the period from 1970 to date. The section also discusses significant events which contributed to the Bank's failure and subsequent rescue.

Continental Illinois Corporation, which commenced operations on April 1, 1969, is dependent primarily upon the financial condition of Continental Bank, accounting for approximately 95 percent of the holding company's consolidated assets. Through a network of subsidiaries, branches, and representative offices, the Bank provides a broad range of banking and related business services worldwide. At its peak in 1981 the Bank was sixth among other multinational banks and the largest domestic commercial and industrial lender, employing more than 12,000 employees.

The financial condition of the Corporation through 1981 was achieved primarily as a result of annual growth in assets and loans significantly in excess of its peers. However, by year-end 1982, the Corporation's ability to function as a viable entity was in extreme jeopardy. During 1982 and 1983, the Bank's financial condition deteriorated severly. The Bank's allowance for loan losses, net charge-offs, and nonperforming loans increased dramatically. Among the factors that lead to this situation were the failure of Penn Square Bank, the bankruptcy or depressed condition of Continental's once blue-chip customers, and Continental's dependency on short-term rate-sensitive funds.

Significant asset quality problems in the Bank's oil and gas lending department were highlighted by the Penn Square failure in July 1982. At year-end 1982, the provision for loan losses amounted to $492 million, which included a $220 million provision related to Penn Square. But, problems were not limited to just oil and gas lending alone. During 1983 and 1984, the Bank experienced significant credit quality and documentation deficiencies in all aspects of its loan operations. As a result, more and more loans were labeled as nonperforming. By June 30, 1984, nonperforming loans amounted to $2.7 billion.

After Penn Square failed, Continental's large uninsured depositors became increasingly concerned about the Bank's inordinately large amount of poor quality loans and its viability in general. By early 1984, cash flow problems had become critical. In May 1984, rumors of a possible failure or takeover circulated in the foreign money markets upon which the Bank had become so dependent. Soon after, major providers of overnight and term funds abandoned the Bank. Continental turned first to borrowing from the Federal Reserve and then from a consortium of other large banks, but it was unable to achieve stability. Consequently, on May 17, 1984, the Federal Deposit Insurance Corporation arranged an interim emergency assistance program and guaranteed all depositors of the Bank.



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# SECTION 1

Statistical Data on Problem and Failed Banks

Continental's Performance Ratios
in Comparison to its Peers

Continental's Consolidated Statements
of Income and Financial Position
for the Period 1970 Through
the First Quarter of 1984

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## SCHEDULE OF PROBLEM AND FAILED BANKS AND INSURED DEPOSITS

## FROM 1974 TO 1984

| Year | Number of Problem Banks | Failed Banks: Number Insured | Failed Banks: Insured Deposits (millions) |
|---|---|---|---|
| 1974 | 183 | 4 | $1,575.8 |
| 1975 | 349 | 13 | 339.6 |
| 1976 | 379 | 16 | 864.9 |
| 1977 | 368 | 6 | 205.2 |
| 1978 | 342 | 7 | 854.2 |
| 1979 | 287 | 10 | 110.7 |
| 1980 | 217 | 10 | 216.3 |
| 1981 | 223 | 10 | 3,826.0 |
| 1982 | 369 | 42 | 9,904.5 |
| 1983 | 642 | 48 | 5,541.4 |
| 1984 | 745 a/ | 55 a/ | b/ |

a/ Information as of September, 1984

b/ Not available at time of printing



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## Performance Measures for Continental Illinois Corporation As Compared to Other Multinational Banks From 1976 to 1983 1/

| | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|---|---|---|
| **Profitability/Earnings** | | | | | | | | |
| Return on Equity | | | | | | | | |
| Continental | 14.00 | 14.14 | 13.69 | 14.37 | 14.82 | 14.88 | 4.56 | 5.95 |
| Peer Group | 10.65 | 10.94 | 12.33 | 13.68 | 13.54 | 12.75 | 11.53 | 11.15 |
| Return on Assets | | | | | | | | |
| Continental | .58 | .55 | .54 | .55 | .54 | .54 | .18 | .26 |
| Peer Group | .46 | .45 | .50 | .52 | .52 | .51 | .49 | .52 |
| **Asset Quality** | | | | | | | | |
| Net Charge-offs to Total Loans | | | | | | | | |
| Continental | .62 | .45 | .32 | .29 | .28 | .29 | 1.28 | 1.37 |
| Peer Group | .77 | .56 | .46 | .38 | .46 | .41 | .55 | .64 |
| Allowance for Possible Loan Losses to Total Loans | | | | | | | | |
| Continental | 1.27 | 1.13 | 1.01 | .91 | .90 | .89 | 1.15 | 1.24 |
| Peer Group | 1.04 | .99 | 1.00 | 1.03 | 1.01 | 1.03 | 1.08 | 1.21 |
| Non Performing Assets to Total Assets | | | | | | | | |
| Continental | 3.1 | 2.2 | 1.4 | 1.3 | 1.1 | 1.4 | 4.6 | 4.5 |
| Peers | 3.0 | 2.2 | 1.5 | 1.2 | 1.0 | 1.3 | 2.1 | 2.3 |
| **Capital Adequacy** | | | | | | | | |
| Equity Capital to Total Assets | | | | | | | | |
| Continental | 4.88 | 4.54 | 4.51 | 4.36 | 4.17 | 4.22 | 4.81 | 5.17 |
| Peer Group | 4.90 | 4.69 | 4.57 | 4.39 | 4.45 | 4.63 | 4.86 | 5.39 |
| Equity Capital + Subordinated Notes and Debentures to Total Assets | | | | | | | | |
| Continental | 4.88 | 4.54 | 4.51 | 4.36 | 4.17 | 4.22 | 5.27 | 5.64 |
| Peer Group | 5.67 | 5.34 | 5.17 | 4.98 | 4.93 | 5.04 | 5.70 | 6.26 |
| Equity Capital to Total Loans | | | | | | | | |
| Continental | 7.13 | 6.90 | 6.70 | 6.05 | 5.77 | 5.40 | 5.26 | 6.03 |
| Peer Group | 7.77 | 7.43 | 7.11 | 6.80 | 6.88 | 6.76 | 6.98 | 7.62 |



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**Performance Measures for Continental Illinois Corporation As Compared to Other Multinational Banks From 1976 to 1983** [1/]

| | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|---|---|---|
| **Liquidity** | | | | | | | | |
| Total Loans to Total Assets | | | | | | | | |
| Continental | 58.35 | 56.88 | 58.93 | 62.92 | 62.77 | 67.40 | 75.79 | 71.72 |
| Peer Group | 56.19 | 56.27 | 57.00 | 56.74 | 57.15 | 60.34 | 61.53 | 62.25 |
| Liquid Assets - Volatile Liabilities to Total Assets | | | | | | | | |
| Continental | -37.88 | -38.18 | -37.09 | -45.70 | -46.32 | -51.85 | -58.16 | -52.61 |
| Peer Group | -16.75 | -17.75 | -21.48 | -22.30 | -25.07 | -31.55 | -31.51 | -30.88 |
| **Growth** | | | | | | | | |
| Growth in Loans | | | | | | | | |
| Continental | N/A | 14.44 | 24.73 | 23.03 | 17.32 | 19.84 | 2.70 | -7.15 |
| Peer Group | N/A | 14.83 | 15.83 | 15.36 | 12.78 | 14.59 | 9.26 | 5.99 |
| Growth in Assets | | | | | | | | |
| Continental | N/A | 17.41 | 20.38 | 15.23 | 17.60 | 11.60 | -8.67 | -1.87 |
| Peer Group | N/A | 14.75 | 14.19 | 16.09 | 11.85 | 8.48 | 7.56 | 4.59 |
| Growth in Earnings | | | | | | | | |
| Continental | N/A | 11.80 | 17.25 | 16.68 | 15.39 | 12.69 | -69.41 | 39.07 |
| Peer Group | N/A | 15.63 | 27.16 | 24.77 | 14.92 | 9.73 | 4.19 | 10.79 |

[1/] More complete information on the composition of the ratios is contained in Section 2.



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## CONSOLIDATED STATEMENT OF INCOME
**Continental Illinois Corporation and Subsidiaries**

| Year ended 12/31 ($ in thousands) | 1984 (3/31) | 1983 | 1982 | 1981 | 1980 |
|---|---|---|---|---|---|
| Interest & fees on loans | 803,734 | 3,453,274 | 4,683,350 | 4,796,322 | 3,448,973 |
| Lease financing income | 20,979 | 95,907 | 125,073 | 90,327 | 65,838 |
| Interest on deposits with banks | | 214,107 | 499,437 | 747,149 | 658,355 |
| Int.& dividends on investment securities: | | | | | |
| Taxable income | 25,323 | 105,316 | 129,565 | 148,910 | 133,215 |
| Income exempt from Fed.inc.taxes | 10,702 | 49,759 | 59,667 | 64,194 | 70,951 |
| Trading account interest | 9,859 | 29,182 | 34,308 | 34,032 | 29,307 |
| Int.on Fed.funds sold & securities purchased under agreemts to resell | 90,149 | 29,499 | 47,876 | 83,281 | 65,374 |
| **Total interest income** | 960,746 | 3,977,044 | 5,579,276 | 5,964,215 | 4,472,513 |
| Interest on deposits | 572,309 | 2,191,239 | 3,100,409 | 3,316,677 | 2,397,443 |
| Int.on Fed.funds purch'd & secur. sold under agreemts to repurchase | 124,932 | 512,868 | 1,056,749 | 1,405,811 | 1,048,795 |
| Interest on other borrowings | 79,046 | 301,163 | 400,266 | 354,953 | 230,884 |
| Interest on long-term debt | 35,219 | 141,632 | 131,252 | 80,993 | 65,097 |
| **Total interest expense** | 811,506 | 3,146,902 | 4,688,676 | 5,158,434 | 3,742,219 |
| Net interest income | 149,240 | 830,142 | 890,600 | 805,781 | 730,294 |
| Provision for credit losses | 140,000 | 395,000 | 492,000 | 120,000 | 96,000 |
| **Net interest income after provision for credit losses** | 9,240 | 435,142 | 398,600 | 685,781 | 634,294 |
| Trust income | 15,857 | 62,369 | 60,428 | 53,600 | 44,309 |
| Secur.trading profits & commissions | 5,318 | 19,648 | 39,882 | 27,888 | 6,122 |
| Foreign exchange profits (losses) | 7,224 | 10,587 | (1,428) | 31,155 | 32,284 |
| All other income | 72,483 | 309,525 | 221,882 | 209,764 | 160,422 |
| **Total other operating income** | 100,882 | 402,129 | 320,764 | 322,407 | 243,637 |
| **Net int.& other operating income** | 110,122 | 837,271 | 719,364 | 1,008,188 | 877,931 |
| Salaries and wages | 80,702 | 309,639 | 293,575 | 265,614 | 227,758 |
| Pension, profit sharing, other employee benefits | 21,250 | 74,750 | 61,071 | 74,877 | 61,473 |
| Net occupancy expense | 20,134 | 87,410 | 72,726 | 65,747 | 53,314 |
| Eqpt rentals,deprec.& maintenance | 12,475 | 44,918 | 41,095 | 36,857 | 36,801 |
| Other expense | 83,357 | 204,462 | 204,727 | 180,759 | 178,874 |
| **Total other operating expense** | 217,918 | 721,179 | 673,194 | 623,854 | 558,220 |
| Income before inc.taxes & securities gains or losses | (107,796) | 116,092 | 46,170 | 384,334 | 319,711 |
| Applicable income taxes (credits) | -- | 16,174 | (38,206) | 124,019 | 95,568 |
| **Inc.before security gains or losses** | (107,796) | 99,918 | 84,376 | 260,315 | 224,143 |
| **Secur.gains or (losses) less** applicable income taxes [1] | 575 | 1,245 | (6,489) | (5,692) | 1,798 |
| Extraordinary item, net of tax | 136,628 | 7,156 | -- | -- | -- |
| **Net income** | 29,407 | 108,319 | 77,887 | 254,623 | 225,941 |
| Per common share: | | | | | |
| Income before extraordinary item | | $ 2.46 | $ 1.95 | $ 6.44 | $ 5.75 |
| Extraordinary item | | $ 0.17 | $ -- | -- | -- |
| Net income | | $ 2.63 | $ 1.95 | $ 6.44 | $ 5.75 |
| Cash dividends declared | | $ 2.00 | $ 2.00 | $ 1.90 | $ 1.70 |
| Average common shares outstanding (in thousands) | | 40,045 | 39,777 | 39,537 | 39,256 |

[1] **Gain on sale of charge card operations.**

* **Due to the availability of information, certain line items have been rounded or reasonably approximated. Also, inadequate information has prevented certain line items from being stated individually. In some cases, totals were used to maintain consistency for comparative purposes.**



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## CONSOLIDATED STATEMENT OF INCOME
**Continental Illinois Corporation and Subsidiaries**

| Year ended 12/31 ($ in thousands) | 1979 | 1978 | 1977 | 1976 | 1975 |
|---|---|---|---|---|---|
| Interest & fees on loans | 2,437,870 | 1,496,957 | 1,022,987 | 918,572 | 1,017,596 |
| Lease financing income | 39,190 | 34,294 | 29,772 | 24,918 | 22,050 |
| Interest on deposits with banks | 455,931 | 307,933 | 224,991 | 217,617 | 152,619 |
| Int.& dividends on investment securities: | | | | | |
| Taxable income | 75,955 | 67,970 | 71,628 | 69,116 | 77,397 |
| Income exempt from Fed.inc.taxes | 77,568 | 75,789 | 70,903 | 63,607 | 46,107 |
| Trading account interest | 19,510 | 12,265 | 11,060 | 10,326 | 13,169 |
| Int.on Fed.funds sold & securities purchased under agreemts to resell | 62,103 | 39,000 | 12,000 | 8,000 | 7,000 |
| **Total interest income** | 3,168,127 | 2,034,208 | 1,443,341 | 1,312,156 | 1,335,938 |
| Interest on deposits | 1,739,743 | 1,049,519 | 696,809 | 661,192 | 668,449 |
| Int.on Fed.funds purch'd & secur. sold under agreemts to repurchase | | | 253,530 | 182,784 | 189,919 |
| Interest on other borrowings | 806,611 | 444,161 | 27,398 | 23,603 | 14,077 |
| Interest on long-term debt | 47,920 | 33,665 | 23,712 | 12,089 | 28,309 |
| **Total interest expense** | 2,594,274 | 1,527,345 | 1,001,449 | 879,668 | 900,754 |
| Net interest income | 573,853 | 506,863 | 441,892 | 432,488 | 435,184 |
| Provision for credit losses | 70,000 | 62,500 | 53,500 | 75,000 | 75,000 |
| **Net interest income after provision for credit losses** | 503,853 | 444,363 | 388,392 | 357,488 | 360,184 |
| Trust income | 37,434 | 34,521 | 34,082 | 33,618 | 31,845 |
| Secur.trading profits & commissions | 15,730 | 11,255 | 10,954 | 17,299 | 17,282 |
| Foreign exchange profits (losses) | 12,583 | 15,267 | 15,005 | 7,152 | |
| All other income | 141,983 | 105,713 | 79,395 | 66,953 | 56,175 |
| **Total other operating income** | 207,730 | 166,756 | 139,436 | 125,022 | 105,302 |
| **Net int.& other operating income** | 711,583 | 611,119 | 527,828 | 482,510 | 465,486 |
| Salaries and wages | 199,501 | 166,358 | 145,600 | 131,937 | 119,386 |
| Pension, profit sharing, other employee benefits | 51,187 | 44,456 | 37,180 | 32,048 | 29,606 |
| Net occupancy expense | 41,401 | 33,838 | 30,228 | 25,509 | 25,640 |
| Eqpt rentals,deprec.& maintenance | 27,549 | 20,889 | 18,658 | 18,888 | 15,347 |
| Other expense | 144,894 | 118,401 | 91,231 | 85,898 | 80,346 |
| **Total other operating expense** | 464,532 | 383,942 | 322,897 | 294,280 | 270,325 |
| Income before inc.taxes & securities gains or losses | 247,051 | 227,177 | 204,931 | 188,230 | 195,161 |
| Applicable income taxes (credits) | 52,925 | 58,453 | 60,727 | 57,468 | 76,164 |
| Inc.before security gains or losses | 194,126 | 168,724 | 144,204 | 130,762 | 118,997 |
| Secur.gains or (losses) less applicable income taxes | 1,681 | (907) | (1,081) | (2,958) | (6,107) |
| Extraordinary item, net of tax | -- | -- | -- | -- | -- |
| **Net income** | 195,807 | 167,817 | 143,123 | 127,804 | 112,890 |
| Per common share: | | | | | |
| Income before extraordinary item | $ 4.99 | $ 4.49 | $ 4.02 | $ 3.63 | $ 6.49 |
| Extraordinary item | -- | -- | -- | -- | -- |
| Net income | $ 4.99 | $ 4.49 | $ 4.02 | $ 3.63 | $ 6.49 |
| Cash dividends declared | $ 1.52 | $ 1.32 | $ 1.26 | $ 1.18 | $ 2.23 |
| Average common shares outstanding (in thousands) | 39,195 | 37,336 | 35,537 | 35,130 | 34,758 |

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## CONSOLIDATED STATEMENT OF INCOME
### Continental Illinois Corporation and Subsidiaries

| Year ended 12/31 ($ in thousands) | 1974 | 1973 | 1972 | 1971 | 1970 |
|---|---|---|---|---|---|
| Interest & fees on loans | 1,249,113 | 716,490 | 356,674 | 318,388 | 373,238 |
| Lease financing income | 19,000 | 8,000 | 5,000 | 3,000 | -- |
| Interest on deposits with banks | 207,811 | 133,548 | 53,738 | 11,621 | 2,395 |
| Int.& dividends on investment securities: | | | | | |
| Taxable income | 73,816 | 50,515 | 45,295 | 63,059 | 41,837 |
| Income exempt from Fed.inc.taxes | 44,438 | 48,826 | 43,845 | 39,805 | 34,385 |
| Trading account interest | 25,076 | 14,546 | 6,983 | 10,733 | 34,236 |
| Int.on Fed.funds sold & securities purchased under agreemts to resell | 16,000 | 15,000 | 9,000 | 4,000 | |
| **Total interest income** | 1,635,254 | 986,925 | 520,535 | 450,606 | 486,091 |
| Interest on deposits | 915,323 | 538,834 | 243,052 | 208,939 | 198,962 |
| Int.on Fed.funds purch'd & secur. sold under agreemts to repurchase | 355,517 | 189,064 | 43,019 | 37,305 | 99,047 |
| Interest on other borrowings | 57,431 | 32,461 | 16,514 | 9,782 | |
| Interest on long-term debt | 9,135 | 6,652 | 6,357 | -- | -- |
| **Total interest expense** | 1,337,406 | 767,011 | 308,942 | 256,026 | 298,009 |
| Net interest income | 297,848 | 219,914 | 211,593 | 194,580 | 188,082 |
| Provision for credit losses | 32,900 | 15,300 | 12,353 | 15,262 | 14,221 |
| **Net interest income after provision for credit losses** | 264,948 | 204,614 | 199,240 | 179,318 | 173,861 |
| Trust income | 31,465 | 31,404 | 29,773 | 27,824 | 22,732 |
| Secur.trading profits & commissions | 13,246 | 9,381 | 2,303 | 4,299 | -- |
| Foreign exchange profits (losses) | -- | -- | -- | -- | -- |
| All other income | 64,000 | 59,000 | 33,000 | 26,000 | 17,563 |
| **Total other operating income** | 108,711 | 99,785 | 65,076 | 58,123 | 40,295 |
| **Net int.& other operating income** | 373,659 | 304,399 | 264,316 | 237,441 | 214,156 |
| Salaries and wages | 105,924 | 89,618 | 77,574 | 66,766 | |
| Pension, profit sharing, other employee benefits | 24,099 | 20,401 | 17,669 | 15,936 | 74,861 |
| Net occupancy expense | 21,009 | 17,679 | 15,940 | 13,276 | |
| Eqpt rentals,deprec.& maintenance | 10,749 | 8,652 | 6,886 | 6,491 | 45,556 |
| Other expense | 61,484 | 48,125 | 38,823 | 35,681 | |
| **Total other operating expense** | 223,265 | 184,475 | 156,892 | 138,150 | 120,417 |
| Income before inc.taxes & securities gains or losses | 150,394 | 119,924 | 107,424 | 99,291 | 93,739 |
| Applicable income taxes (credits) | 54,488 | 33,619 | 29,294 | 29,493 | 29,394 |
| **Inc.before security gains or losses** | 95,906 | 86,305 | 78,130 | 69,798 | 64,345 |
| **Secur.gains or (losses) less applicable income taxes** | (226) | (835) | 265 | 576 | (6,815) |
| Extraordinary item, net of tax | -- | -- | -- | -- | -- |
| **Net income** | 95,680 | 85,470 | 78,395 | 70,374 | 57,530 |
| Per common share: | | | | | |
| Income before extraordinary item | $ 5.51 | $ 4.94 | $ 4.55 | $ 4.11 | $ 3.38 |
| Extraordinary item | -- | -- | -- | -- | -- |
| Net income | $ 5.51 | $ 4.94 | $ 4.55 | $ 4.11 | $ 3.38 |
| Cash dividends declared | 1.10 | $ .97 | $ .92 | $ .88 | $ .82 |
| Average common shares outstanding (in thousands) | 34,716 | 34,583 | 34,453 | 34,264 | 34,584 |

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## CONSOLIDATED STATEMENT OF CONDITION

Continental Illinois Corporation and Subsidiaries

| December 31 ($ in thousands) | 1984[1] | 1983 | 1982 | 1981 | 1980 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and due from banks | 2,039,281 | 2,569,866 | 2,199,386 | 2,513,080 | 4,361,504 |
| Interest-bearing deposits | 3,415,990 | 3,586,524 | 1,880,853 | 5,082,703 | 4,294,045 |
| Fed.funds sold and securities purch'd under agrmts to resell | 646,739 | 676,774 | 444,224 | 499,817 | 417,207 |
| Trading account assets | 761,664 | 561,589 | 853,460 | 169,164 | 128,065 |
| Investment securities | 1,814,334 | 1,762,394 | 2,064,744 | 2,169,303 | 2,505,924 |
| Loans: | | | | | |
| Domestic | { | 20,187,123 | 22,053,107 | 22,131,015 | 18,528,132 |
| Foreign | 29,329,847 | 10,203,246 | 10,817,214 | 10,044,482 | 8,381,566 |
| Lease financing receivables | 1,045,485 | 1,038,400 | 1,172,478 | 1,123,729 | 720,003 |
| Total loans and lease receivables | 30,375,332 | 31,428,769 | 34,042,799 | 33,299,226 | 27,629,701 |
| Less: Unearned income | 267,333 | 269,720 | 322,551 | 423,000 | 262,663 |
| Reserve for credit losses | 401,384 | 382,565 | 381,083 | 289,169 | 246,413 |
| **Net loans and lease receivables** | 29,706,615 | 30,776,484 | 33,339,165 | 32,587,057 | 27,120,625 |
| Properties and equipment | 325,599 | 337,045 | 342,241 | 298,715 | 276,479 |
| Customers' liability on acceptances | 870,015 | 859,318 | 690,442 | 2,469,917 | 1,898,071 |
| Other assets | 1,870,572 | 967,377 | 1,084,909 | 1,181,999 | 1,087,488 |
| **Total assets** | 41,450,809 | 42,097,371 | 42,899,424 | 46,971,755 | 42,089,408 |
| **Liabilities** | | | | | |
| Deposits: | | | | | |
| Domestic offices | 10,146,083 | 13,527,978 | 12,690,041 | 14,963,103 | 13,579,324 |
| Foreign offices | 18,132,704 | 15,903,490 | 15,484,980 | 14,630,902 | 13,734,343 |
| **Total deposits** | 28,278,787 | 29,431,468 | 28,175,021 | 29,594,005 | 27,313,667 |
| Fed.funds purch'd & securities sold under agreemts to repurchase | 5,192,723 | 4,830,645 | 5,920,332 | 7,998,482 | 7,361,000 |
| Other borrowings | 2,801,843 | 2,677,047 | 4,028,928 | 3,014,740 | 2,203,947 |
| Acceptances outstanding | 870,015 | 870,106 | 692,788 | 2,477,137 | 1,898,816 |
| Other liabilities | 1,231,387 | 1,210,578 | 1,100,169 | 1,314,402 | 1,110,719 |
| Long-term debt | 1,247,881 | 1,255,953 | 1,272,291 | 862,297 | 676,317 |
| **Total liabilities** | 39,622,636 | 40,275,797 | 41,189,529 | 45,261,063 | 40,564,466 |
| **Stockholders' Equity** | | | | | |
| Preferred stock | 89,400 | 89,400 | | -- | -- |
| Common stock | 200,780 | 200,780 | 199,761 | 198,009 | 196,690 |
| Capital surplus | 526,904 | 526,895 | 525,525 | 522,812 | 517,824 |
| Retained earnings | 1,021,457 | 1,014,539 | 989,244 | 989,871 | 810,428 |
| Accumulated translation adjustment | (10,256) | (9,975) | (4,433) | -- | -- |
| Total | 1,828,285 | 1,821,639 | 1,710,097 | 1,710,692 | 1,524,942 |
| Less - Treasury stock at cost | 112 | 65 | 202 | -- | -- |
| **Total Stockholders' Equity** | 1,828,173 | 1,821,574 | 1,709,895 | 1,710,692 | 1,524,942 |
| **Total Liabilities & Stockholders' Equity** | 41,450,809 | 42,097,371 | 42,899,424 | 46,971,755 | 42,089,408 |

[1] As of March 31, 1984.

* Due to the availability of information, certain line items have been rounded or reasonably approximated. Also, inadequate information has prevented certain line items from being stated individually. In some cases, totals were used to maintain consistency for comparative purposes.



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## CONSOLIDATED STATEMENT OF CONDITION
Continental Illinois Corporation and Subsidiaries

| December 31 ($ in thousands) | 1979 | 1978 | 1977 | 1976 | 1975 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and due from banks | 3,366,816 | 3,897,143 | 2,879,378 | 1,523,849 | 1,761,488 |
| Interest-bearing deposits | 4,035,140 | 3,926,679 | 3,932,661 | | |
| Fed.funds sold and securities purch'd under agrmts to resell | 308,174 | 361,591 | 183,324 | 3,942,564 | 3,235,981 |
| Trading account assets | 189,101 | 114,349 | 299,792 | 383,432 | 205,925 |
| Investment securities | 2,226,340 | 2,174,380 | 2,501,082 | 2,364,019 | 2,281,344 |
| Loans: | | | | | |
| Domestic | 16,366,150 | 12,796,075 | 10,883,300 | 9,601,343 | 9,334,256 |
| Foreign | 6,815,562 | 5,650,035 | 3,980,117 | 3,357,468 | 2,756,076 |
| Lease financing receivables | 609,668 | 451,816 | 400,394 | 324,865 | 274,967 |
| Total loans and lease receivables | 23,791,380 | 18,897,926 | 15,263,811 | 13,283,676 | 12,365,299 |
| Less: Unearned income | 215,374 | 143,305 | 121,027 | 107,000 | 97,000 |
| Reserve for credit losses | 212,180 | 191,237 | 168,164 | 163,271 | 161,890 |
| **Net loans and lease receivables** | 23,363,826 | 18,563,384 | 14,974,620 | 13,013,405 | 12,106,409 |
| Properties and equipment | 226,842 | 195,579 | 164,966 | 120,850 | 87,596 |
| Customers' liability on acceptances | 1,092,622 | 900,405 | 255,893 | 125,515 | 176,736 |
| Other assets | 981,258 | 925,155 | 608,564 | 511,265 | 360,264 |
| **Total assets** | 35,790,119 | 31,058,665 | 25,800,280 | 21,984,899 | 20,215,743 |
| **Liabilities** | | | | | |
| Deposits: | | | | | |
| Domestic offices | 12,517,200 | 12,142,717 | 10,089,704 | 8,708,640 | 9,351,904 |
| Foreign offices | 11,490,000 | 9,017,533 | 8,664,081 | 7,108,487 | 5,938,481 |
| **Total deposits** | 24,007,200 | 21,160,250 | 18,753,785 | 15,817,127 | 15,290,385 |
| Fed.funds purch'd & securities sold under agreemts to repurcha | 5,865,470 | 5,143,594 | 4,383,055 | 3,981,529 | 2,934,426 |
| Other borrowings | 1,901,351 | 1,492,881 | 450,272 | 325,028 | 313,159 |
| Acceptances outstanding | 1,096,924 | 905,557 | 257,764 | 126,269 | 177,268 |
| Other liabilities | 1,026,740 | 680,202 | 586,259 | 557,280 | 494,900 |
| Long-term debt | 529,532 | 450,457 | 357,050 | 265,293 | 180,000 |
| **Total liabilities** | 34,427,217 | 29,832,941 | 24,788,185 | 21,072,526 | 19,390,138 |
| **Stockholders' Equity** | | | | | |
| Preferred stock | -- | -- | -- | -- | 136 |
| Common stock | 196,095 | 195,839 | 177,824 | 177,335 | 173,937 |
| Capital surplus | 510,349 | 508,646 | 428,148 | 427,243 | 428,737 |
| Retained earnings | 656,458 | 521,239 | 406,123 | 307,795 | 222,795 |
| Accumulated translation adjustment | -- | -- | -- | -- | -- |
| Total | 1,362,902 | 1,225,724 | 1,012,095 | 912,373 | 825,605 |
| Less - Treasury stock at cost | -- | -- | -- | -- | -- |
| **Total Stockholders' Equity** | 1,362,902 | 1,225,724 | 1,012,095 | 912,373 | 825,605 |
| **Total Liabilities & Stockholders' Equity** | 35,790,119 | 31,058,665 | 25,800,280 | 21,984,899 | 20,215,743 |

* Due to the availability of information, certain line items have been rounded or reasonably approximated. Also, inadequate information has prevented certain line items from being stated individually. In some cases, totals were used to maintain consistency for comparative purposes.



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## CONSOLIDATED STATEMENT OF CONDITION
Continental Illinois Corporation and Subsidiaries

| December 31 ($ in thousands) | 1974 | 1973 | 1972 | 1971 | 1970 [2] |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and due from banks | 1,905,849 | 1,556,970 | 1,779,892 | 1,340,999 | 1,803,907 |
| Interest-bearing deposits / Fed.funds sold and securities purch'd under agrmts to resell | 2,151,719 | 2,237,921 | 1,593,554 | 902,863 | 913,870 |
| Trading account assets | 356,048 | 339,825 | 181,290 | 181,992 | 413,528 |
| Investment securities | 1,774,445 | 2,069,506 | 1,802,936 | 1,707,646 | 1,519,447 |
| Loans: | | | | | |
| Domestic | 10,047,666 | 8,216,269 | 5,946,998 | 4,016,679 | 3,476,186 |
| Foreign | 2,607,592 | 1,777,829 | 1,173,004 | 879,614 | -- |
| Lease financing receivables | 102,819 | | -- | -- | -- |
| Total loans and lease receivables | 12,758,077 | 9,994,098 | 7,120,002 | 4,896,293 | 3,476,186 |
| Less: Unearned income [3] | -- | -- | -- | -- | -- |
| Reserve for credit losses | 157,378 | 142,950 | 129,530 | 125,639 | 123,782 |
| **Net loans and lease receivables** | 12,600,699 | 9,851,148 | 6,990,472 | 4,770,654 | 3,352,404 |
| Properties and equipment | 58,672 | 49,293 | 46,173 | 40,627 | 32,759 |
| Customers' liability on acceptances | 271,245 | 84,930 | 111,098 | 247,597 | 202,746 |
| Other assets | 522,070 | 537,637 | 194,526 | 762,729 | 445,037 |
| **Total assets** | 19,640,747 | 16,727,230 | 12,699,941 | 9,955,107 | 8,688,698 |
| **Liabilities** | | | | | |
| Deposits: | | | | | |
| Domestic offices | 9,752,612 | 8,576,870 | 6,936,739 | 5,764,402 | 4,980,456 |
| Foreign offices | 5,715,562 | 4,021,333 | 3,064,436 | 2,691,736 | 2,173,969 |
| **Total deposits** | 15,468,174 | 12,598,203 | 10,001,175 | 8,456,138 | 7,154,425 |
| Fed.funds purch'd & securities sold under agreemts to repurchase | 1,967,516 | 2,245,659 | 1,542,339 | | 484,807 |
| Other borrowings | 457,403 | 618,406 | | 515,345 | 172,646 |
| Acceptances outstanding | 272,013 | 86,445 | 116,216 | 251,468 | 204,159 |
| Other liabilities | 544,029 | 386,557 | 301,758 | 147,717 | 137,771 |
| Long-term debt | 180,000 | 100,000 | 100,000 | -- | -- |
| **Total liabilities** | 18,889,135 | 16,035,270 | 12,061,488 | 9,370,668 | 8,153,808 |
| **Stockholders' Equity** | | | | | |
| Preferred stock | 186 | 186 | 186 | 186 | -- |
| Common stock | 173,663 | 173,095 | 172,539 | 171,359 | 168,643 |
| Capital surplus | 425,291 | 421,170 | 393,800 | 317,227 | 314,357 |
| Retained earnings | 152,472 | 97,509 | 71,928 | 95,667 | 51,890 |
| Accumulated translation adjustment | -- | -- | -- | -- | -- |
| Total | 751,612 | 691,960 | 638,453 | 584,439 | 534,890 |
| Less - Treasury stock at cost | -- | -- | -- | -- | -- |
| **Total Stockholders' Equity** | 751,612 | 691,960 | 638,453 | 584,439 | 534,890 |
| **Total Liabilities & Stockholders' Equity** | 19,640,747 | 16,727,230 | 12,699,941 | 9,955,107 | 8,688,698 |

[2] For Continental Illinois National Bank and Trust Company of Chicago and Subsidiaries only.

[3] Due to lack of information in years 1974 to 1970, the unearned income line item was netted against the Loans (Domestic & Foreign) and Lease receivables line items. Lack of available information prevented a further breakdown of Lease receivables for the periods 1973 througn 1970.

* Due to the availability of information, certain line items have been rounded or reasonably approximated. Also, inadequate information has prevented certain line items from being stated individually. In some cases, totals were used to maintain consistency for comparative purposes.



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**CONSOLIDATED STATEMENT OF CONDITION**
Continental Illinois Corporation and Subsidiaries
**(as percent of total assets)**

| December 31 | 1984[1] | 1983 | 1982 | 1981 | 1980 | 1979 | 1978 | 1977 |
|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | |
| Cash and due from banks | 4.9 | 6.1 | 5.1 | 5.4 | 10.4 | 9.4 | 12.5 | 11.2 |
| Interest-bearing deposits | 8.2 | 8.5 | 4.4 | 10.8 | 10.2 | 11.3 | 12.6 | 15.2 |
| Fed.funds sold and securities purch'd under agrmts to resell | 1.6 | 1.6 | 1.0 | 1.1 | 1.0 | .9 | 1.2 | .7 |
| Trading account assets | 1.8 | 1.3 | 2.0 | .4 | .3 | .5 | .4 | 1.2 |
| Investment securities | 4.4 | 4.2 | 4.8 | 4.6 | 6.0 | 6.2 | 7.0 | 9.7 |
| Loans: | | | | | | | | |
| Domestic | } 70.8 | 48.0 | 51.4 | 47.1 | 44.0 | 45.7 | 41.2 | 42.2 |
| Foreign | | 24.2 | 25.2 | 21.4 | 19.9 | 19.0 | 1.82 | 15.4 |
| Lease financing receivables | 2.5 | 2.5 | 2.7 | 2.4 | 1.7 | 1.7 | 1.5 | 1.6 |
| Total loans and lease receivables | 73.3 | 74.7 | 79.4 | 70.9 | 65.6 | 66.5 | 60.8 | 59.2 |
| Less: Unearned income | .6 | .6 | .8 | .9 | .6 | .6 | .5 | .5 |
| Reserve for credit losses | 1.0 | .9 | .9 | .6 | .6 | .6 | .6 | .7 |
| **Net loans and lease receivables** | 71.7 | 73.1 | 77.7 | 69.4 | 64.4 | 65.3 | 59.8 | 58.0 |
| Properties and equipment | .8 | .8. | .8 | .6 | .7 | .6 | .6 | .6 |
| Customers' liability on acceptances | 2.1 | 2.0 | 1.6 | 5.3 | 4.5 | 3.1 | 2.9 | 1.0 |
| Other assets | 4.5 | 2.3 | 2.5 | 2.5 | 2.6 | 2.7 | 3.0 | 2.4 |
| **Total assets** | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| **Liabilities** | | | | | | | | |
| Deposits: | | | | | | | | |
| Domestic offices | 24.5 | 32.1 | 29.6 | 31.9 | 32.3 | 35.0 | 39.1 | 39.1 |
| Foreign offices | 43.7 | 37.8 | 36.1 | 31.1 | 32.6 | 32.1 | 29.0 | 33.6 |
| **Total deposits** | 68.2 | 69.9 | 65.7 | 63.0 | 64.9 | 67.1 | 68.1 | 72.7 |
| Fed.funds purch'd & securities sold under agreemts to repurchase | 12.5 | 11.5 | 13.8 | 17.0 | 17.5 | 16.4 | 16.6 | 17.0 |
| Other borrowings | 6.8 | 6.4 | 9.4 | 6.4 | 5.2 | 5.3 | 4.8 | 1.7 |
| Acceptances outstanding | 2.1 | 2.1 | 1.6 | 5.3 | 4.5 | 3.1 | 2.9 | 1.0 |
| Other liabilities | 3.0 | 2.9 | 2.6 | 2.8 | 2.6 | 2.9 | 2.2 | 2.3 |
| Long-term debt | 3.0 | 3.0 | 3.0 | 1.8 | 1.6 | 1.5 | 1.5 | 1.4 |
| **Total liabilities** | 95.6 | 95.7 | 96.9 | 96.4 | 96.4 | 96.2 | 96.1 | 96.1 |
| **Stockholders' Equity** | | | | | | | | |
| Preferred stock | .2 | .2 | - | - | - | - | - | - |
| Common stock | .5 | .5 | .5 | .4 | .5 | .5 | .6 | .7 |
| Capital surplus | 1.3 | 1.3 | 1.2 | 1.1 | 1.2 | 1.4 | 1.6 | 1.7 |
| Retained earnings | 2.5 | 2.4 | 2.3 | 2.1 | 1.9 | 1.8 | 1.7 | 1.6 |
| Accumulated translation adjustment | - | - | - | - | - | - | - | - |
| Total | 4.4 | 4.3 | 4.0 | 3.6 | 3.6 | 3.8 | 3.9 | 3.9 |
| Less - Treasury stock at cost | - | - | - | - | - | - | - | - |
| **Total Stockholders' Equity** | 4.4 | 4.3 | 4.0 | 3.6 | 3.6 | 3.8 | 3.9 | 3.9 |
| **Total Liabilities & Stockholders' Equity** | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

[1] As of March 31, 1984.

* Due to the availability of information, certain line items have been rounded or reasonably approximated. Also, inadequate information has prevented certain line items from being stated individually. In some cases, totals were used to maintain consistency for comparative purposes.



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## CONSOLIDATED STATEMENT OF CONDITION

Continental Illinois Corporation and Subsidiaries
(as percent of total assets)

| December 31 | 1976 | 1975 | 1974 | 1973 | 1972 | 1971 | 1970 [2] |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and due from banks | 6.9 | 8.7 | 9.7 | 9.3 | 14.0 | 13.5 | 20.8 |
| Interest-bearing deposits | | | | | | | |
| Fed.funds sold and securities | | | | | | | |
| purch'd under agrmts to resell | 17.9 | 16.0 | 11.0 | 13.4 | 12.5 | 9.1 | 10.6 |
| Trading account assets | 1.7 | 1.0 | 1.8 | 2.0 | 1.4 | 1.8 | 4.8 |
| Investment securities | 10.8 | 11.3 | 9.0 | 12.4 | 14.2 | 17.2 | 17.5 |
| Loans: | | | | | | | |
| Domestic | 43.7 | 46.2 | 51.2 | 49.1 | 46.8 | 40.3 | |
| Foreign | 15.3 | 13.6 | 13.3 | 10.6 | 9.2 | 8.8 | 40.0 |
| Lease financing receivables | 1.5 | 1.4 | .5 | - | - | - | - |
| Total loans and lease receivables | 60.4 | 61.2 | 65.0 | 59.7 | 56.1 | 49.2 | 40.0 |
| Less: Unearned income [3] | .5 | .5 | - | - | - | - | - |
| Reserve for credit losses | .7 | .8 | .8 | .9 | 1.0 | 1.3 | 1.4 |
| Net loans and lease receivables | 59.2 | 59.9 | 64.2 | 58.9 | 55.0 | 47.9 | 38.6 |
| Properties and equipment | .5 | .4 | .3 | .3 | .4 | .4 | .4 |
| Customers' liability on acceptances | .6 | .9 | 1.4 | .5 | .9 | 2.5 | 2.3 |
| Other assets | 2.3 | 1.8 | 2.7 | 3.2 | 1.5 | 7.7 | 5.1 |
| Total assets | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| **Liabilities** | | | | | | | |
| Deposits: | | | | | | | |
| Domestic offices | 39.6 | 46.3 | 49.7 | 51.3 | 54.6 | 57.9 | 57.3 |
| Foreign offices | 32.3 | 29.4 | 29.1 | 24.0 | 24.1 | 27.0 | 25.0 |
| Total deposits | 71.9 | 75.6 | 78.8 | 75.3 | 78.7 | 84.9 | 82.3 |
| Fed.funds purch'd & securities | | | | | | | |
| sold under agreemts to repurchase | 18.1 | 14.5 | 10.0 | 13.4 | | | 5.6 |
| Other borrowings | 1.5 | 1.5 | 2.3 | 3.7 | 12.1 | 5.2 | 2.0 |
| Acceptances outstanding | .6 | .9 | 1.4 | .5 | .9 | 2.5 | 2.3 |
| Other liabilities | 2.5 | 2.4 | 2.8 | 2.3 | 2.4 | 1.5 | 1.6 |
| Long-term debt | 1.2 | .9 | .9 | .6 | .8 | - | - |
| Total liabilities | 95.9 | 95.9 | 96.2 | 95.9 | 95.0 | 94.1 | 93.8 |
| **Stockholders' Equity** | | | | | | | |
| Preferred stock | - | - | - | - | - | - | - |
| Common stock | .8 | .9 | .9 | 1.0 | 1.4 | 1.7 | 1.9 |
| Capital surplus | 1.9 | 2.1 | 2.2 | 2.5 | 3.1 | 3.2 | 3.6 |
| Retained earnings | 1.4 | 1.1 | .8 | .6 | .6 | 1.0 | .6 |
| Accumulated translation adjustment | - | - | - | - | - | - | - |
| Total | 4.1 | 4.1 | 3.8 | 4.1 | 5.0 | 5.9 | 6.2 |
| Less - Treasury stock at cost | - | - | - | - | - | - | - |
| Total Stockholders' Equity | 4.1 | 4.1 | 3.8 | 4.1 | 5.0 | 5.9 | 6.2 |
| **Total Liabilities & Stockholders' Equity** | 100.0 | 100.0 | * 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

2 For Continental Illinois National Bank and Trust Company of Chicago and Subsidiaries only.

3 Due to lack of information in years 1974 to 1970, the unearned income line item was netted against the Loans (Domestic & Foreign) and Lease receivables line items. Lack of available information prevented a further breakdown of Lease receivables for the periods 1973 through 1970.

* Due to the availability of information, certain line items have been rounded or reasonably approximated. Also, inadequate information has prevented certain line items from being stated individually. In some cases, totals were used to maintain consistency for comparative purposes.

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# SECTION 2

Analysis of the Financial Condition of
Continental Illinois Corporation
as Compared with Other Multinational Banks
from 1976 to 1983

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## INTRODUCTION

In the last decade, the banking industry has been subjected to severe recessions, inflation market shifts, increased interest rate volatility, development of new types of assets and liabilities, and encroachment by other businesses. Furthermore, banking has become less protected by regulation and has become more competitive at home and abroad.

During this same period, the number of problem banks increased dramatically (from 183 at year end 1974 to 745 as of September, 1984). As described by the Federal Deposit Insurance Corporation (FDIC), a problem institution is one that has unsafe or unsound conditions and a relatively high possibility of failure. In most instances an increase in problem institutions is followed by an increase in failed institutions. Such was the case for this period. The number of failed institutions, those institutions receiving financial assistance from FDIC, increased dramatically from 4 at year end 1974 to 42, 48, and 55 in 1982, 1983, and 1984, respectively.

But what causes an institution such as Continental Illinois National Bank to become a problem or even a failed bank? The remaining sections of this report will attempt to answer this question by reviewing the objectives and components of the federal regulatory agencies' surveillance system and analyzing the financial condition/performance of Continental Illinois Corporation from 1976 to 1983. More specifically, these sections will focus on how well Continental has performed in comparison with other multinational banks and what factors led to its current situation.

## OBJECTIVES AND COMPONENTS OF A SUREVEILLANCE SYSTEM

Each of the three bank regulators, the Office of the Comptroller of the Currency (OCC), Federal Reserve System (FRS), and FDIC maintain a surveillance system. A surveillance system is designed to identify financial institutions that have or are likely to have financial conditions that warrant special supervisory action. Prior to 1975, the regulators determined the financial condition of a financial institution solely through on-site examinations. However, in the mid to late 1970's, each regulator designed and implemented a surveillance screening system.

The surveillance screening systems are not intended as substitutes for bank examinations nor are they intended to replace the skills and judgements needed to monitor banks or resolve their problems. The primary objective of the systems is to aid the examination process by identifying changes in the financial condition of banks and bank holding companies between examinations. Detection of such changes enables the regulators to focus on a select number of banks as opposed to focusing on the total universe. In turn, the regulators can allocate examination resources efficiently by giving the most attention to those banks that warrant the closest scrutiny. Essentially, the early warning system is made up of three components: (1) a computer screening program to identify financial institutions that fail certain ratios, (2) a detailed financial performance analysis of the institution to its peers, and (3) a notification of corrective action and follow up of problems identified from components (1) and (2).



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Although the regulators consider the present surveillance screening systems extremely useful, they do have several limitations. The results of a computer screen are only as good as the data and ratios used in the screen. A screen will not normally identify those banks subjected to fraud, embezzlement, or other theft nor will it readily identify understated amounts on the financial statements. Also, screens are based on predetermined ratios, thus they will not necessarily identify problems from an emerging industry trend, such as problems caused by bad energy loans, unless such information has been programmed into the computer. None of the systems are designed to predict bank failures nor will they identify all unsound banks. The systems simply tell the regulator that the financial condition of a financial institution has changed since the last bank examination.

## FINANCIAL RATIOS

As mentioned in the previous section, the screening of specific ratios is basically the technique or tool used by the regulators to monitor/analyze the financial condition of an organization. The basic component of ratio analysis is a single ratio, constructed by dividing one balance-sheet and/or income-expense item by another. The denominator of such ratios may be conceived as a "base" or scale factor. For example, a profitability ratio would relate a firm's profits to its asset or equity-capital base to provide a return-on-assets or return-on-equity measure of a firm's overall performance.

It is important to recognize that ratios by themselves do not tell us much about the financial condition of the organization. To provide a meaningful basis for evaluating an organization's financial condition, comparisons with other organizations and/or with its own performance at other times are required. Also, ratio analysis focuses only on symptoms not on causes of financial difficulty. The driving force behind an organization's performance is its management: financial planning, policies, and internal controls ultimately determine an organization's performance.

## FINANCIAL ANALYSIS

In our analysis of Continental's financial condition from 1976 to 1983, we have basically taken the approach used by the regulators and relied upon ratio analysis. We have selected 13 financial ratios under 5 major categories that are used to measure an institution's financial condition. For each ratio we have compared Continental's financial condition with two peer groups. The first peer group includes 16 multinational banking organizations, while the second peer group includes 4 of Chicago's largest banking organizations. The ratios used in the analysis were determined from financial information as filed by bank holding compnies with the Federal Reserve. The data obtained is based on year-end financial data which has not been adjusted for prior year restatements. To supplement the Federal Reserve data, we obtained comparative ratios from an outside consulting firm and reviewed data from the Office of the Comptroller of the Currency, including bank examination reports of Continental Bank from 1976 to date.



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Listed below are the 5 major categories used to measure an institution's financial condition. Included in these categories are the 13 selected financial ratios.

Profitability/Earnings

| | |
|---|---|
| Ratio 1 | Return on Equity |
| Ratio 2 | Return on Assets |

Asset Quality

| | |
|---|---|
| Ratio 3 | Net Charge-offs to Total Loans, Net of Unearned Income |
| Ratio 4 | Allowance for Possible Loan Losses to Total Loans, Net of Unearned Income |
| Ratio 5 | Nonperforming Assets to Total Assets |

Capital Adequacy

| | |
|---|---|
| Ratio 6 | Equity Capital + Allowance for Possible Loan Losses to Total Assets + Allowance for Possible Loan Losses |
| Ratio 7 | Equity Capital + Allowance for Possible Loan Losses + Subordinated Notes and Debentures to Total Assets + Allowance for Possible Loan Losses |
| Ratio 8 | Equity Capital + Allowance for Possible Loan Losses to Total Loans, Net of Unearned Income |

Liquidity

| | |
|---|---|
| Ratio 9 | Total Loans, Net of Unearned Income to Total Assets |
| Ratio 10 | Liquid Assets - Volatile Liabilities to Total Assets |

Growth

| | |
|---|---|
| Ratio 11 | Growth in Loans |
| Ratio 12 | Growth in Assets |
| Ratio 13 | Growth in Earnings |

The remainder of this section analyzes each performance category and provides specific information about Continental's financial condition as it relates to other multinational organizations. Additional information related to the components of the above ratios and the multinational and regional peer group data discussed below may be obtained from the Committee upon request.



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## PROFITABILITY

Profitability ratios are designed for the evaluation of an organization's operational performance. The ratios yield an indicator of an organization's efficiency in using capital committed by stockholders and lenders. The ratios analyzed are return on equity capital and return on assets.

### Return on equity capital

Return on equity capital (ratio 1) is the most important measure of profitability for shareholders because it relates net income to the book value of their claims. An analysis of the multinational and regional data reveals that Continental's return on equity capital for the period 1976 to 1981 was high and very stable, averaging 14.31 percent, almost 2 percentage points above its multinational peer group. This high return on equity capital is a result of continued improvement in net income due primarily to a significant increase in interest and fee income from an increasing volume of loans.

In 1982 and 1983, Continental's return was 4.56 and 5.95 percent, respectively. This was 7 and 5 percentage points below the average of the multinational and 4 and 2 percentage points below the regional peer groups, respectively. In both analyses, Continental ranked last and next to last. The extremely low return was due primarily to a significant increase in the provision for loan loss expenses, a direct result of Penn Square's failure and the bankruptcy and near bankruptcy of several of the Bank's large midwest and manufacturing corporate borrowers.

### Return on assets

Return on Assets (ratio 2), which measures the average profitability of the institution's assets, is designed to indicate the effectiveness of management in employing its available resources. An analysis of both the multinational and regional data reveals that Continental's return on assets for the period 1976 to 1981 was high and very stable, averaging .55 percent, approximately .06 percentage points above its multinational peer group. This high return on assets is due primarily to the continued increase in the dollar level of domestic and foreign earning assets. Also, the Bank channeled a large amount of funds traditionally held in the form of short term money market investments into loans offering higher yields but less liquidity.

In 1982 and 1983, Continental's return was .18 and .26 percent, respectively. This was .31 and .26 percentage points below the average of its multinational and regional peer groups, respectively. The low return was due primarily to an increase in loans designated as nonperforming. Continental's loan loss reserve to total loans and net charge-offs to total loans increased significantly from .89 and .29 percent in 1981 to 1.24 and 1.37 percent by the end of 1983, respectively. Also, Continental's net interest margin, the total cost of all its funds contributing to earning assets subtracted from the yield of all its assets, was as much as three-quarters of a percentage point below the average for its multinational peers.

Our financial analysis coupled with a review of bank examination reports from 1977 to 1983 showed increased earning assets in the period leading up to 1981. These higher levels of earning assets were the result of a substantially increased loan volume which increased interest and fee income. Also, non-interest income was increased with the



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expansion of the credit card operation in 1978. However, in mid-1982, poor asset quality, as evidenced by an unprecendented volume of nonperforming loans, dominated Continental's condition. Continental's earnings became severely depressed resulting in a significantly reduced return on assets.

## ASSET QUALITY

An analysis of asset quality is of particular importance to institutions which assume both a credit and an interest rate risk on their assets. Asset quality is mainly concerned with the level, distribution, and severity of nonperforming assets; the level and distribution of non-accrual and reduced rated assets; the adequacy of valuation reserves; and management's ability to administer and collect problem credits. The asset quality ratios analyzed are: net charge-offs to total loans, allowances for possible loan losses to total loans, and nonperforming assets to total assets. These asset quality ratios (3, 4, and 5) focus on indicating areas of concern in the loan portfolio, since assets of a financial institution are represented primarily by loans.

During the period 1978 to 1981, the asset quality ratios of the multinational and regional peer groups revealed the following. Continental's ratio of allowance for possible loan losses to total loans was as much as .09 and .25 percentage points below the average for the peer groups. Continental's ratio of net charge-offs to total loans was consistently below its peers, averaging .29 percent as compared to the peer group's average of .43 and .46 percent. Finally, the Bank's ratio of nonperforming assets averaged 1.30, just slightly above the multinational peer group.

During 1982 and 1983, Continental experienced a severe deterioration in its asset quality ratios as compared to the multinational peer group. The Bank's allowance for possible loan losses to total loans increased significantly from .89 percent in 1981, to 1.15 and 1.24 percent in 1982 and 1983, respectively. The Bank's net charge-offs to total loans increased dramatically from a low of .29 percent in 1981 to 1.28 and 1.37 percent in 1982 and 1983, respectively (.73 percentage points above its peer group average of .55 and .64 for those years). Finally, Continental's ratio of nonperforming assets to total assets also increased dramatically from an average of 1.30 in 1979 to 1981, to 4.6 percent in 1982 and 1983 (2.4 percentage points above the peer group average of 2.2 percent).

## CAPITAL ADEQUACY

The primary function of bank capital is to demonstrate the ability to absorb unanticipated losses. Capital ratios represent the primary technique of analyzing capital adequacy. The capital ratios analyzed are: equity capital to total assets and equity capital to total loans.

### Equity capital to total assets

Equity capital to total assets (ratios 6 & 7) indicates the percentage decline in total assets that could be covered with equity capital and, where applicable, subordinated notes and debt. The ratios are inversely related to the size of the bank. This reflects the more



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conservative stance of small banks and the ability of larger banks to reduce their need for capital because it is believed they can reduce the adverse effects of the default risk and market risk through the law of large numbers. An analysis of the multinational peer group data reveals that Continental's equity capital to total assets ratios were relatively constant for the period 1976 to 1983, averaging 4.6 and 4.7 percent, approximately .15 and .69 percentage points below the peer average. On the other hand, an analysis of the regional data ranked Continental last, at least .67 and .90 percentage points below the peer averages.

### Equity capital to total loans

Equity Capital to total loans (ratio 8) also indicates the percentage decline in assets that could be covered with equity capital. However, this ratio uses total loans in the denominator based on the belief that the majority of the risk in total assets is in the loan portfolio.

An analysis of the multinational peer group data reveals a steady decline in Continental's ratio from 7.13 percent in 1976 to 5.26 percent in 1982. During this period, its rank fell from sixth to last within the peer group. Regional data also placed Continental last during the period, averaging 2.43 percentage points below the peer group average.

Our financial analysis and a review of the bank examination reports from 1976 to 1982 reveals that Continental's level of equity capital over the period did not keep pace in relation to the extremely high volume of loan and asset growth. As a result, the below average base that existed in 1976 continued to erode. Continental was able to assume the additional risk and maintain a strained capital base, whereas others with the same capital ratios could not, because of its continued increase in earnings performance. However, in 1982 and 1983, when the quality of Continental's assets was determined to be poor and the earnings on those assets were depressed, the risk of insolvency significantly increased.

## LIQUIDITY

An individual bank's liquidity is its ability to meet deposit withdrawals, maturing liabilities, and credit demands and commitments over two time periods: (1) the short-run, a period of less than 1 year and (2) the long-run, a period influenced from cycles in economic and financial activity and the growth in deposits and loans. Liquidity ratios provide the primary means of judging a bank's liquidity position. The two liquidity ratios analyzed are loans to assets, and liquid assets minus volatile liabilities to total assets.

### Loans to assets

Total loans net of unearned income to total assets (ratio 9) is a measure of an institution's liquidity. An analysis of the multinational and regional data reveals that Continental's loans continued to increase, becoming far and away its major source of assets. During the period 1976 to 1983, the Bank's ratio rose significantly from an



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average of 58 percent for 1976 to 1978, to 62.8 percent for 1979 and 1980, and to 71.6 percent for 1981 to 1983, approximately 1.5, 5.85, and 10.3 percentage points above its peers. In general, this ratio reveals the existence of a poor liquidity position which dictates the need to further evaluate other liquidity ratios.

Liquid assets minus volatile liabilities to total assets

Liquid assets minus volatile liablilities to total assets (ratio 10) measures the net liquidity of a bank's total asset portfolio after making deductions for volatile liabilities. The numerator is reduced because a significant portion of the liquid assets are pledged against Treasury and other public debt.

An analysis of both the multinational and regional data reveals that Continental's ratio was extremely poor during 1976 to 1983, averaging -45.97 percent, or at least 21 percentage points below its peers. Not only did Continental rank last during the entire period, but its ratio also increased significantly (from an average of -37.7 percent for 1976 to 78 to -46 percent for 1979 to 1980 to -54.2 percent for 1981 to 1983).

Our analysis of the period from 1977 to 1983 revealed that Continental was increasing its assets with heavy loan volume and had to finance them with more volatile, more expensive money. Continental was not adjusting its maturities and asset and liability composition in order to achieve a relative balance between interest sensitive assets and liabilities. For example, to support its aggressive loan policy, Continental maintained a high degree of rate sensitivity through the heavy use of overnight funds and shortened CD and Eurodollar maturities. In addition, Continental began attracting deposits of other commercial banks, particularly foreign banks, by in some cases paying them more interest than domestic banks. At the same time, core deposits from individuals, partnerships, and corporations remained constant during the period, lagging behind the 8 percent growth rate reported by Continental's peer group.

GROWTH

Steady and controlled growth is a desirable characteristic for an institution. The examination of growth ratios reveals useful information about an institution's overall performance. The three ratios analyzed are growth in loans, growth in assets, and growth in earnings.

A high correlation exists among all three ratios, growth in loans, assets, and earnings (ratios 11, 12, and 13). Assets which represent Continental's use of funds have been primarily driven by a growth in loans whose interest income has stimulated a growth in earnings.

An analysis of these ratios from 1977 to 1981 reveals a steady growth in earnings averaging 14.8 percent. This consistent earnings growth, mandated by Continental's management, was driven by a 16.4 percent steady growth average in assets which was maintained by a significant growth in loans averaging 19.9 percent. During this period, Continental outperformed its multinational peers in both asset and loan growth by 3.4 and 5.2 percentage points, resepectively. However, the growth in earnings considered strong by management was as much as 3.6 percentage points below its peer group.



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In 1982 and 1983, the strong and stable growth trends were eliminated. By mid to late 1982 significant concern centered on the quality of Continental's assets. This caused management to take an extremely cautious approach in acquiring additional loans. Also, a number of loans were classified as nonperforming and were written off. As a result, earnings from interest and fees on loans were serverly depressed.

Our analysis confirmed an increase in the growth of loans, assets, and earnings for Continental during the period 1976 to 1981. As mentioned earlier, growth in loans was a major reason for the growth in assets and earnings. An example of the growth in loans was shown by Continental's loan portfolio increases in overseas loans, energy loans, and loans to lesser-developed countries. Our analysis revealed that from 1976 to early 1982, the Bank's loans grew from 60.4 to about 79 percent of total assets. Particularly, growth was shown in energy, specifically oil and gas loans.



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# SECTION 3

Financial History of
Continental Illinois Corporation
from 1970-1984

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## INTRODUCTION

In an attempt to protect the safety and soundness of the banking industry, the Federal Deposit Insurance Corporation (FDIC), the Comptroller of the Currency (OCC), and the Federal Reserve (FRS) on May 17, 1984, arranged an interim emergency financial assistance program and guaranteed all depositors and creditors of Continental Illinois National Bank and Trust Company (the Bank). At the time, the Bank had more than $40 billion in assets and had huge amounts of funds either loaned to or borrowed from many U.S. banks. Regulators were concerned that if the Bank failed it could have had a domino effect on the banking industry resulting in many other bank failures. The assistance program was designed to alleviate the cash shortages facing the Bank so that it would have time to recover in an orderly and permanent manner.

After an evaluation of various alternatives, the regulatory agencies on July 26, 1984, provided the Bank a permanent financial assistance program intended to restore it, over time, to a profitable business entity. The major components of the plan, which is subject to stockholders' approval, include (1) installing a proven internationally recognized management team, (2) moving $4.5 billion in problem loans to FDIC, (3) infusing $1 billion in new capital from FDIC in exchange for preferred stock convertible to 80 percent of the equity of Continental Illinois Corporation (the Corporation) which is the holding company for the Bank, and (4) ensuring an ongoing line of credit from the regulators and participating banks.[1]

But what caused the financial condition of the Bank to deteriorate? This section of the report presents information on the Corporation's and Bank's organizational structure and financial history along with a discussion of relevant events from 1970 to 1984 to help understand how the problems developed.

## CONTINENTAL ILLINOIS CORPORATION

Continental Illinois Corporation was incorporated in Delaware in November 1968 and commenced operations on April 1, 1969, after it acquired all of the outstanding stock, except for directors' qualifying shares, of Continental Illinois National Bank and Trust Company of Chicago. The Corporation directly or through wholly-owned subsidiaries engages in lease and debt financing, mortgage lending and banking, financing of energy development and exploration, asset-based financing, reinsurance of credit life and credit health insurance directly related to extensions of credit by the Bank, fiduciary and investment services, and merchant banking overseas. The Corporation also owns two banks in the suburbs of Chicago, Illinois, a small business investment company, and an equity investment company.



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Through a worldwide network of branches, representative offices, subsidiaries, and affiliates staffed by more than 12,000 people, Continental provides commercial, personal, trust, and money market services to individuals, businesses, and governmental entities. Its business units are organized according to market areas.

## SUBSIDIARY ACQUISITIONS

The Corporation's significant subsidiaries as of 1984 were as follows:

| Name[2] | Jurisdiction of incorporation | Percent of voting securities owned |
|---|---|---|
| Continental Illinois National Bank & Trust Co. of Chicago | Illinois | 100(2) |
| Continental Bank International | Illinois | 100 |
| Continental International Finance Corporation | Illinois | 100 |
| Continental Illinois Bank (Canada) | Canada | 100 |
| Republic Realty Mortgage Corporation | Delaware | 100 |
| Continental Illinois Leasing Corporation | Delaware | 100 |
| Continental Illinois (Delaware) Limited | Delaware | 100 |
| Continental Illinois Equity Corporation | Delaware | 100 |
| Continental Illinois Service Corporation | Delaware | 100 |
| Continental Illinois Venture Corporation | Delaware | 100 |
| Continental Illinois International Investment Corporation | Cayman Islands | 100 |
| Great Lakes Life Insurance Company | Arizona | 100 |
| Continental Illinois Overseas Finance Corporation, N.V. | Netherlands Antilles | 100 |
| Continental Illinois Trust Company of Florida, N.A.[3] | Florida | 100 |
| Continental Illinois Trust Company of Sarasota, N.A.[3] | Florida | 100 |



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| Name | Jurisdiction of incorporation | Percent of voting securities owned |
|---|---|---|
| Continental Illinois Energy Development Corporation | Delaware | 100 |
| Continental Illinois Commercial Corp. | Delaware | 100 |
| Continental Bank of Buffalo Grove, N.A.[3] | Illinois | 100 |
| Continental Bank of Oakbrook Terrace[3] | Illinois | 100 |
| Continental Illinois Corporation Financial Futures | Delaware | 100 |

## CONTINENTAL ILLINOIS NATIONAL BANK

The Bank, which became a subsidiary of the Corporation, has been in business for more than 124 years. At the end of 1983, it was the largest bank in Chicago and was seventh in size in order of both assets and deposits among approximately 15,000 national and state banks in the United States. Operating a full service commercial banking and trust business, the Bank serves individuals, businesses and government in the metropolitan area of Chicago; other major metropolitan areas throughout the Nation; and overseas. It receives deposits; makes and services secured and unsecured loans; distributes U.S. government and municipal securities; and performs a wide variety of personal, corporate, and pension trust and investment advisory services.

Over the past two decades the Bank changed from a conservative institution whose principal functions were providing a safe place for people and businesses to keep their money and lending to good credit risks, to an institution striving for constant growth at home and abroad. During the 1960's, the Bank developed extensive international operations; established groups to render specialized services to the Bank's oil, utility, and finance company customers; established a unified Retail Banking Department to fully serve the consumer and small businessperson; developed a separate Real Estate Department to make commercial and home loans and to service the properties which the Bank holds in a fiduciary capacity; and established a division to provide counseling to companies wishing to relocate in the Chicago metropolitan area. The Bank has a large network of correspondent banking relationships in the United States and throughout the world and provides a wide variety of services for banks.



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## ORGANIZATION OF THE BANK

The organization of the Bank is built around markets it defines as groups of customers who have common needs for the services offered. The activities of each of the five customer-service units are summarized below.

### General Banking Services

General Banking Services provides depository and financial services to corporations and correspondent banks wherever located and to governments and their agencies outside the United States. The responsibilities of the five units which comprise General Banking Services are as follows:

> **U.S. Banking Services** is divided into two areas, that generally provide commercial deposit and loan facilities to corporations, banks, bank holding companies, other financial institutions, and other entities not classified as multinational.[4] The Metro-Midwest Groups, which are organized to provide specialized skills adapted to specific industries, serve customers in the greater Chicago metropolitan area, other parts of Illinois, as well as Indiana, Michigan and Wisconsin. The National Groups, organized on a geographical basis, serve domestic commercial customers not classified as multinational or served by Special Industries Services, including as many as 2,600 domestic correspondent banks[5] at one point.
>
> **Special Industries Services** is organized to (1) supply specialized skills adapted to specific industries and (2) to provide credit and loan facilities to customers worldwide in the oil and gas, mining, construction and engineering, and shipping and marine industries. The Service also provides nationwide credit and loan facilities to public utilities, surface transportation, and equipment leasing industries.
>
> **International Banking Services** is comprised of two Edge Act[6] Corporation subsidiaries and specialized geographic groups. It is headquartered in Chicago and has overseas branches, representative offices, and subsidiaries in 29 foreign countries. It assists foreign correspondent banks, government entities, and corporations not classified as multinational by providing them with international financial services that include short- and medium-term loans, letters of credit, acceptances, collections, remittances, deposit accounts, and foreign exchange services.
>
> Under the Edge Act, the Bank currently operates an Edge Act Corporation subsidiary headquartered in Chicago named Continental Bank International, which has branches in New York, Miami, Houston, and Los Angeles. The branches provide international banking and financial services to corporations and correspondent banks in their respective markets. Another Edge Act Corporation subsidiary, Continental International Finance Corporation, also headquartered in Chicago, has investments (ranging from 100 percent ownership to minority interests) in various foreign financial institutions that serve to supplement the Bank's international services.



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**Multinational Banking Services** provides the special expertise and worldwide capabilities required by major corporate customers that have extensive worldwide operations and are classified as multinational. In addition to Chicago, MultinationalBanking Services has personnel located in New York, London, Tokyo, Brussels, Frankfurt, and other cities where multinational corporations are located.

**Financial Services** provides the other units of General Banking Services with worldwide capability to serve clients by offering a comprehensive variety of trade financing, global cash management, and investment banking functions, including private placements, mergers and acquisitions, and corporate financial advisory services.

## Trust and Investment Services

Trust and Investment Services provides a variety of services to a large number of individuals, associations, businesses, government entities, and institutions. Through it, the Bank acts as trustee, executor, administrator, guardian, conservator, depository, transfer agent, and registrar. In addition to the separate investment of trust assets, it maintains collective funds for trust investment, including Continental Illinois Investment Trust for employee benefit plans. It also offers custodian and investment counseling services, as well as portfolio management, and financial planning and advisory services for both domestic and international clients.

## Real Estate Services

Real Estate Services makes a wide variety of residential, industrial, and commercial real estate loans, including secured and unsecured credits, to the real estate industry. The Bank's activities include extensions of credit to home builders and developers, mortgage bankers, and real estate investment trusts, and the origination, sales, and servicing of residential mortgages as well as other activities.

## Bond and Treasury Services

Through Bond and Treasury Services, the Bank is a primary dealer in government and federal agency securities as one of approximately 35 primary government bond dealers authorized to deal directly with the Federal Reserve trading desk. It underwrites and distributes state and local government and public housing securities, provides short-term investment facilities to many corporations, supplies correspondent banks with services ranging from periodic pricing of portfolios to complete portfolio management, serves the primary banking needs of public bodies, funds the Corporation and its subsidiaries, manages the Corporation's interest rate sensitivity program and capital account, and controls the non-credit risk of the Corporation.

## Personal Banking Services

The banking needs of individuals and households are the responsibility of Personal Banking Services. It administers savings accounts, time deposits, checking accounts, and



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a broad spectrum of consumer lending activities which includes personal loans, real estate loans, and the MasterCard/Visa bank card programs until their sale in 1984. The Executive Financial Center has been established in an effort to meet the complete banking, borrowing, and short-term investment counseling needs of a select group of Bank customers.

## SUBSIDIARY ACQUISITIONS

The Bank has established a number of subsidiaries since 1970. Under the Edge Act, it owns and operates Continental Bank International and Continental International Finance Corporation. Headquartered in New York, Continental Bank International is an international banking organization, receiving deposits, making loans, and handling all forms of international banking transactions. It maintains direct correspondent banking relationships in most major countries, and its services are available to domestic and foreign banks, corporations, and individuals. The Continental International Finance Corporation, headquartered in Chicago, provides long-term equity and debt financing for businesses operating abroad. The Bank also has equity interests (ranging from 100 percent ownership to minority interests) in various foreign financial institutions located in various countries worldwide.[7] These institutions supplement the Bank's international operations. The statute limits Edge Act subsidiaries to serving foreign trade-related and other international banking needs as opposed to U.S. banking needs.

## CHRONOLOGY OF EVENTS AND FINANCIAL HISTORY

The purpose of this section is to recount the events that took place and financial performance of the bank during the period from 1970 to the present. It is not intended to explain why these events occurred. Early events and financial information is grouped into two time periods --1970-74 and 1975-79. More recent events and financial information related to the period from 1980 to 1984 is presented on a year by year basis.

## 1970-1974

### INDUSTRY ECONOMIC CONDITIONS

During the period 1970-74, the U.S. economy was in the midst of the most prolonged recession since 1933. Spending cutbacks by business, which reduced inventories and shifted borrowings into the bond and commercial paper markets, caused a decline in the volume of bank loans. In addition, the banking system was also affected by impending industrywide problems throughout 1974 resulting from the unusual failures of two large banks and the relatively high level of uncollectible loans.



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## BUSINESS SERVICES

In spite of the economic conditions during this period, the Bank emerged in a position of strength and stability by expanding in many areas. As of December 31, 1974, the Corporation and its subsidiaries had approximately 9,880 officers and employees, an increase of 1,600, or 19 percent, from 1970. All but 220 of the officers and employees were employed by the Bank.

The commercial banking department, which provided commercial deposit and loan facilities to individuals and corporations, was reorganized in 1973 around industry, customer size, and geographic markets in order to develop new markets. Represented among the approximately 33,000 accounts in the commercial banking department were 94 of the 100 largest American corporations and 318 of the Fortune 500 list.

The international and overseas operations grew rapidly and placed greater emphasis on regionalizing business development efforts and penetrating growth markets in each of the countries where the Bank operated. By the end of 1974, the Bank's international network included 122 facilities in 37 nations on six continents, making it the largest of such networks operated by a U.S. financial institution.

Several other Bank operations grew rapidly during this period. The real estate function expanded particularly as to lines-of-credit to home builders and developers, mortgage bankers, real estate investment trusts, and interim construction lending; bond operations enlarged its services to include underwriting and distributing state and local government and public housing securities, providing short-term investment facilities to many corporations and portfolio advisory services for correspondent banks, managing the Bank's investment portfolios, and procuring a large share of the funds required by the Bank; and Personal banking increased consumer credit services by implementing the Master Charge International Charge Credit system.

## SUBSIDIARY ACTIVITY

The early 1970s was a period of rapid growth in the Corporation's subsidiary operations as evidenced by its activities. The Corporation

- -- participated in organizing a venture capital firm which operated under the name of Continental Illinois Venture Corporation, in which the Corporation held 29 percent of the voting stock.

- -- acquired the business and properties of Republic Realty Mortgage Corporation in June 1970 and continued to operate it as a mortgage banking firm doing business in Illinois, Missouri, Wisconsin, and Georgia.

- -- acquired Group Counselors, Inc. by merger into Continental Illinois Realty Advisors, Inc. in March 1971.



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-- entered into a joint venture with The Royal Trust Company in October 1971. The Corporation and The Royal Trust Company then organized Builders Financial Co. Limited and its wholly-owned subsidiaries, Builders Capital Limited and Western Builders Capital Limited, to engage in construction and development lending and other interim financing of Canadian real estate. The Corporation held 50 percent of the common stock and 49.9 percent of the preferred stock (voting) of Builders Financial Co. Limited. The balance of the Builders Financial Co. Limited stock was held by the Royal Trust Company.

-- formed Continental Illinois Leasing Corporation to engage in lease and debt financing in March 1972.

-- formed Continental Illinois (Delaware) Limited in July 1972 to engage in merchant banking overseas through subsidiaries chartered under the laws of Hong Kong and the United Kingdom.

-- formed Continental Illinois Leasing and Financial Ltd. in April 1974, a Canadian corporation, to engage in medium-term lease and debt financing in Canada.

## MANAGEMENT

On March 26, 1973, Roger E. Anderson and John H. Perkins were elected by the Board of Directors to succeed Donald M. Graham and Tilden Cummings as Chairman of the Board and President, respectively. No other major changes occurred.

## FINANCES

The financial position of the Corporation continued to improve for the fifth consecutive year since the bank holding company was formed. The increasing demand for loans over the previous 5 years was satisfied largely through an increased reliance on time deposits and interest-sensitive funds of all kinds. Total deposits had increased from $8.1 billion in 1972 to $15.5 billion in 1974. Particularly noticeable was the growth in overseas branches and subsidiaries where time deposits increased $2.5 billion from 1972 to $5.7 billion in 1974.

Dividends on common stock continued to increase in accordance with the Corporation's policy to increase dividends as earnings increased. Dividends declared in 1974 were $2.20 per share, as compared to $1.93 per share in 1973.

### Earnings

Earnings for 1974 increased 11 percent from 1973 to $95.9 million, with a 5-year annual growth rate reaching 11.7 percent. The Bank's return on shareholders' equity in 1974 was 13.5 percent and had exceeded 12 percent annually for the fifth consecutive year. These accomplishments for 1974 were due in part to a 33 percent increase in net interest income, resulting from a sharp decline in interest rates during the fourth quarter.

Total operating income increased dramatically in 1974 to $1.7 billion, as compared with $1.1 billion in 1973 and $478 million in 1972. The 1974 increase was due primarily to interest fees on loans of $1.3 billion (representing 72 percent of total operating income) which nearly doubled the $720 million recorded in 1973 and quadrupled the $369 million in 1972.



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The growth in income was offset somewhat by the growth in expenses. Total operating expenses also increased dramatically in 1974 to $1.6 billion, as compared with $967 million in 1973 and $422 million in 1972. The 1974 increase was due primarily to interest expenses of $1.3 billion (representing 83 percent of total operating expenses) which nearly doubled the $767 million and quadrupled the $346 million in 1972. Other expenses such as salaries, wages, and compensation increased from $110 million in 1973 to $130 million in 1974.

### Assets

Total assets grew at a record rate from $10.7 billion at the end of 1972 to $19.8 billion in 1974, with a 5-year annual growth rate of 20 percent. This growth in assets was due largely to an increased demand for loans. At year-end 1973, loans were $9.9 billion, an increase of 40.4 percent over 1972. By year-end 1974, loans increased another $2.8 billion to $12.7 billion, representing 64 percent of total assets. Domestic loans in 1974 rose to $10.1 billion, an increase of $1.9 billion from 1973, while overseas loans reached $2.6 billion, an increase of $.8 billion.

### Nonperforming Loans and Losses

The loan loss reserve for 1974 was increased to $213 million, or 23 percent, from 1973 in recognition of possible future losses in a number of areas, including the real estate field. This increase represented 1.2 percent of gross year-end loans.

## 1975-1979

### INDUSTRY ECONOMIC CONDITIONS

The severe recession during the prior period which created financial difficulties for a number of companies began to recede in early 1976. The improvement in the banking industry occurred largely as a result of an increase in business borrowing, which was fueled primarily by a sharp rise in inflation, but also by increases in corporate spending for new plant and equipment and a continuing downturn in corporate liquidity.

As noted above, the economy during this period experienced a sharp rise in inflation. The consumer price index increased 13.3 percent between the beginning and end of 1979, or 11.2 percent on the average during the year, as compared with a 9.1 percent increase on the average for 1978. Also, world oil prices more than doubled in 1979 and were still rising, outracing the rate of inflation and fueling still more inflation.

### BUSINESS SERVICES

During this period, as in the prior period, the Corporation experienced continued growth despite the economic conditions. General Banking Services, which includes commercial, multinational, and international activities, experienced profitable gains in volume and market position. New business development and increased market penetration, together with efforts at more effective comprehensive service for multinational customers worldwide further enhanced the Corporation's position. Results



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in all markets reflected an announcement made on July 7, 1976, by Continental's Chairman, Roger E. Anderson, that the Bank would embark on a strategy to make it one of the three biggest lenders to industrial and commercial companies by 1981.

Commercial Banking exhibited continued growth, especially in domestic commercial and industrial loans. In addition to competing aggressively for large loans, the Bank opened offices in the Midwest to enhance its position among small to mid-sized companies. International Banking increased its services during the period by opening five new branch and representative offices and three new bank subsidiaries. Also, a correspondent banking relationship was established with the Bank of China to conduct business both with its Peking headquarters and its branches.

Real Estate Services' loan portfolio continued to grow, aided primarily by the strength in the commercial construction market. Also, asset swap and repayment programs further improved the Bank's position and accelerated the repayment of real estate credits.

## SUBSIDIARY ACTIVITY

The Corporation, through Continental Illinois Leasing and Financial Corporation, formed Continental Illinois Capital (Canada) Ltd. in 1975, a Canadian subsidiary, to engage in mortgage lending in Canada, acquired all outstanding common stock of Continental Illinois Venture Corporation in 1976; formed Great Lakes Life Insurance Company in 1977 which acts as a reinsurance underwriter of credit, life, accident, and health insurance; and formed Continental Illinois Equity Corporation in 1979 which makes equity type investments in unaffiliated companies.

## MANAGEMENT

Executive management remained unchanged, with the exception of George R. Baker, who was placed in charge of the Commercial and International Banking Services consolidated under General Banking Services.

## FINANCES

Continental's financial position continued developing during this period at a rate consistent with that of the previous 4 years. Stockholders' equity increased by $137 million or 11 percent to $1.4 billion at December 31, 1979. The rate of return on stockholders' equity has held steady over the period at 15 percent. In addition, the capital base has provided a steadily rising dividend to stockholders. The 1979 dividend was increased 11 percent to a new annual rate of $1.60 per share. This rate reflects a two-for-one common stock split which became effective in May, 1977.

### Earnings

Income before security transactions increased 15 percent to a record $194.1 million, for a 5-year compound growth rate of 14.2 percent, the same as in 1978. Net interest income increased by $80 million, or 13.3 percent, to $677.3 million. Other operating income increased by $41 million, or 24.5 percent, to $207.7 million, reflecting emphasis on



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noninterest income. Against the $121 million gain from these two principal income sources, other operating expenses were up $80.5 million, or 20.9 percent, to $464.5 million, reflecting business growth and the impact of inflation.

Assets

Loans and other earning assets averaged 20 percent above the 1978 level, and total assets increased by $4.7 billion, or 15.2 percent, to $35.7 billion.

Nonperforming Loans and Losses

The 1979 provision for credit losses and net charge-offs, which are applicable to both loans and lease financing receivables, were $70 and $49.1 million, respectively, as compared to $62.5 and $41.4 million, espectively in 1978. In each of the prior two years the provision had exceeded the charge-offs by approximately $21 million, thus slightly increasing the reserve to $212.1 million at December 31, 1979. Although the reserve increased during the period, the reserve as a percent of total loans and leased receivables decreased from 1.27 at year end 1976, to .91 at year end 1979.

## 1980

### INDUSTRY ECONOMIC CONDITIONS

During 1980, the banking industry's attention was directed towards the continued concern over accelerating inflation, volatile financial markets and uncertain economic growth. The level of economic activity for 1980 was similar to the prior year. Unlike 1979, however, when the acceleration of prices was heavily concentrated in the energy sector, no single factor accounted for 1980's rise. The inflation rate remained high due to a deterioration in the price situation. For example, labor costs increased due to an acceleration of compensation per hour and a poor performance in productivity. Food prices surged under the influence of rebounding farm prices and rising costs of marketing. Conditions in the mortgage and housing markets deteriorated sharply. Also, inflation produced serious problems for the nonbank thrift institution and other entities that concentrate their holdings in longer-term instruments bearing fixed interest rates.

### BUSINESS SERVICES

The Bank continued to work toward its goal of becoming one of the three top institutions serving American and foreign-based multinational customers by further developing its business services. General Banking Services, building on national presence of 25 offices, opened new offices in the South and West. Four Edge Act subsidiaries based in major cities were reorganized as branches of a single Edge corporation based in Chicago. Selective expansion of the international network continued with the opening of three new branches. In addition, a minority interest was purchased in a Nigerian firm, and



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service to correspondent banks in Europe was enhanced through a newly formed European Banking section headquartered in London.

In other areas, commercial finance activity was augmented by a new Commercial Services unit that specialized in helping businesses, such as smaller oil and gas producers that might not qualify for traditional bank financing, with loans secured by the value of equipment or merchandise.

## SUBSIDIARY ACTIVITY

In February 1980, the Corporation established Continental Illinois Energy Development Corporation to make loans to energy development and exploration companies and to service such loans; formed Continental Illinois of Florida, Inc., to engage primarily in the marketing of trust and investment services provided by the Bank; and funded Continental Illinois Overseas Finance Corporation N.V. in the Netherlands Antilles.

## MANAGEMENT

Donald C. Miller was permanently assigned as Vice Chairman of the Board of Directors; Edwin J. Hlavka was designated as the Vice President and Auditor of the Corporate Financial Services; and Edward S. Bottum was assigned as the Vice President of Trust and Investment Services, replacing Charles R. Hall.

## FINANCES

The Corporation's financial growth continued amid 1980's high rate of inflation and unprecedented interest rate swings. The Multinational Lending Department placed heavy emphasis upon extending commitments to carefully identified targets and increasing these commitments to the full lending limit. International Banking Services and the Financial Institution Division stressed expansion of wholesale banking both nationally and internationally.

Equity capital increased by 11.8 percent to 3.62 percent of total assets. Retained earnings increased by $162 million, bringing the year-end total to $1.5 billion, thus building the capital base for further growth.

### Earnings

Earnings reflected continued, steady earnings on the part of major profit contributors, General Banking Services and the Special Industries Group. The Oil and Gas Division was the Special Industries Group's single largest source of profit for the year. Net income was up $30.1 million, or 76 cents a share, to $225.9 million. The overall return on assets declined by two-hundredths of 1 percent.



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## Assets

Loan volume averaged $4.2 billion and other earning assets $1.3 billion above the 1979 level, increasing net interest income on a taxable equivalent basis from this source by $140 million, or 20.6 percent. Except for April and May, the Corporation recorded increases in average total loans each month. Growth in loans was heavier in the second half of the year and more pronounced in domestic loans, in contrast with the first half, in which foreign loan growth predominated. Average total assets grew by about $6.3 billion. The growth in assets was financed largely through higher balances of interest-bearing liabilities.

## Nonperforming loans and losses

Nonperforming credits were $444 million. Mortgage and real estate loans on a renegotiated basis were up $21 million from the prior year. The reserve for credit losses increased 13.9 percent from 1979. Relatively lower growth of loans in 1980, coupled with a higher net addition (provision for credit losses minus net credit losses) to the reserve, maintained the percentage relationship of the reserve to total credits at the 1979 year-end level.

Net credit losses on consumer installment loans were the highest single loss category in 1980. These losses were 45.9 percent of total net charge-offs in 1980 as opposed to 64 percent in 1979. Net losses on commercial and industrial loans were up $15.2 million in 1980 and represented 39.3 percent of total net losses, compared with 16.5 percent in 1979.

# 1981

## INDUSTRY ECONOMIC CONDITIONS

The year 1981 was a year of extremes for banks in a number of key areas. There were general domestic and worldwide economic weaknesses and wide fluctuations in interest rate levels. Furthermore, the banking industry's capitalization base was eroding causing concern to the bank regulators.

The overall level of economic activity during 1981 accelerated and the rate of price increases slowed, but the burden of high interest rates placed some sectors of the economy under heavy pressure. The housing industry was devastated, many auto dealers closed because of declining sales and the extremely high cost of financing inventories, and many other small firms in other lines went out of business. The thrift industry experienced a severe squeeze on earnings and high interest rates impeded the formation of business capital needed for improving productivity performance.

## BUSINESS SERVICES

The Corporation's performance in 1981 was strong and compared well with the previous strong year, 1980. The Bank moved up in the order of banks ranked by asset size, taking over the sixth position from Chemical Bank. The Corporation's performance stemmed from its concentrating in a number of areas, including significant non-interest



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expense restrain and substantial expansion in the size of its loan portfolio. In 1981 the Bank became the largest domestic corporate and industrial lender in the Nation.

One of the primary growth areas within the Bank was in the Oil and Gas Division of the Special Industries Group. By mid-year, domestic oil and gas loans totaled $2.9 billion and represented more than 10 percent of the Bank's total loan portfolio. The Bank had developed a presence in most of the active areas in the industry by establishing regional offices in Texas; Colorado; and Alberta, Canada. As with the oil and gas loans, commercial real estate loans also made up about 10 percent of the Bank's total loan portfolio.

SUBSIDIARY ACTIVITY

New regional offices in Atlanta; Detroit; Minneapolis; and White Plains, New York, further expanded the Corporation's U.S. network to 13 locations. Agreements were reached to acquire two small Chicago banks.

The Corporation continued to enhance its position in the international financial marketplace through selective foreign branch office expansion. Growth overseas was principally related to the Multinational Banking Department and the Special Industries Group. Branch offices were opened in Canada, Barcelona, and Puerto Rico, while satellite facilities were closed in Dusseldorf, Edinburgh, Munich, Rotterdam, and Vienna.

FINANCES

As a concrete step toward further enhancing the attractiveness of stock as an investment, long-range targets for two key performance measures were raised in 1981, and new higher goals were set. The return on equity goal was raised from 15 percent to 18 percent, and return on total assets was raised to 0.65 percent, or 6 basis points[8] above the average return of the previous 5 years. The commercial and industrial loan portfolio grew to $12.8 billion at year-end.

Stockholders equity averaged $1.6 billion in 1981, a 12.0 percent increase from 1980, and was 3.6 percent of total assets at year-end. Stockholders received 28.8 percent of 1981 income before security transactions in the form of dividends, while in 1980 the dividend payout ratio was 29.78 percent.

Earnings

Attention to resource allocation, expense control, funding, and liquidity management made an important contribution to record earnings. Income before security transactions of $260.3 million increased 16.1 percent from the $224.1 million recorded in 1980. Net income rose 12.7 percent from the previous year to $254.6 million. Return on total assets increased 3 basis points over 1980. Net interest income was up 8.8 percent over the 1980 level. The increase was made possible by a 17.7 percent increase in average loans and a 27.3 percent increase in average leases.

Assets

Average total loans increased each month, except for February, with heavier growth occurring in the second half of the year. The commercial and industrial loan portfolio



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grew to $12.8 billion from about $9.8 billion in 1980 and real estate loans increased by 12 percent to a total of $3.9 billion. The Bank continued to be the leading lender to domestic energy producers. Although only sixth in assets among American banks, it loaned more money to domestic commercial and industrial companies than any other bank in the Nation.

During the year, Continental moved toward higher yielding earning assets with shorter maturities. This move was in line with the Bank's interest rate sensitivity management policy which involved lengthening and shortening maturity schedules of assets and liabilities in anticipation of interest rate cycles. Foreign operations accounted for 40.7 percent of total assets at year-end and produced 29 percent of total net income for the Corporation.

Average earning assets increased 12.8 percent, due primarily to growth in loans and lease financing. The increase in average earning assets was financed primarily through interest-bearing liabilities. These sources increased 13 percent in 1981 over the 1980 average, while interest-free funds increased 8.7 percent over the same period. The 15.2-percent rate on average foreign time deposits tied the overall rate of average savings and time deposits, and together these deposits increased 13.3 percent in 1981 over the 1980 average. The more expensive money-market liability, short-term borrowed funds, also increased 11.8 percent over the same period.

Nonperforming Loans and Losses

As a result of high interest rate levels and an economic slowdown in 1981, the Bank had nonperforming credits of $653 million; representing 1.9 percent of total loans and lease receivables outstanding at year end, compared wiht $444 million, or 1.6 percent at year end 1980. Before this rise, nonperforming credits had declined steadily from $705 million, or 5.7 percent of the total loan and lease portfolio reported at year end 1975.

Net credit losses increased 15.8 percent from 1980 to $71.1 million. Increased domestic and industrial loans and overseas loan charge-offs contributed to the entire increase amid sluggish economic conditions.

## 1982

### INDUSTRY ECONOMIC CONDITIONS

Persistent weakness in business activity and employment, along with high interest rates, exerted pressure on commercial banks. Profits edged down and returns on assets and on equity reached lows last observed in the recovery from the 1973-75 recession. Potential losses became worrisome as the financial difficulties of some major borrowing countries impaired their ability to maintain payments on debt owed to U.S. banks. Most commercial banks recorded substantial profits, but the proportion of banks with operating losses rose to nearly 8 percent, about equal to the mid-1970's peak and more than double the recent low in 1979.

### BUSINESS SERVICES

The Corporation experienced serious difficulties because of an inordinately high level of problem assets. Significant publicity of its relationship with the defunct Penn Square Bank caused Continental's image in the financial community to fall precipitately. This in turn, caused a significant change in its funding profile. Because domestic



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investors were reluctant to purchase long-term instruments, the Euromarkets were heavily used in order to maintain a relatively stable mix between long- and short-term funding.

Problems were evident in all lending departments with oil and gas and real estate accounting for a large portion of the problem loans. Between 1981 and 1982, outstanding loans in the Oil and Gas Division increased from $2.8 billion to $5.2 billion, more than 15 percent of the Bank's total loan portfolio.

Under market pressure, the Bank removed its name in late July from the list of banks where CDs were eligible for delivery to fill Chicago Board of Trade and Chicago Mercantile Exchange futures contracts. In early September, Standard and Poor's reduced the Bank's credit rating for the second time.

## SUBSIDIARY ACTIVITY

Growth through establishment or acquisition of subsidiaries slowed to almost a standstill. The Corporation completed the acquisition of two smaller banks in Chicago which it initiated in 1981 and established a subsidiary to deal in the financial futures market.

## MANAGEMENT

As a result of Penn Square problem loans, a group of the Bank's senior officers conducted a comprehensive management review of its operation and recommended a number of management changes. A new auditor and Executive Vice President for General Banking Services were appointed, and a new credit risk evaluation division was created. A special litigation committee was also appointed to assess the Bank's officers' and directors' responsibility for the Bank's actions in connection with derivative and class action lawsuits.

In 1983, the Bank entered into a written agreement with OCC agreeing to address certain problems noted in OCC's 1982 examination of the Bank. Under the agreement, the Bank was required to continue implementation and maintenance of new and strengthened plans, policies, and procedures designed to improve overall performance in accordance with the Bank's revised corporate objectives and to report periodically on such matters to OCC. These actions cover such areas as asset and liability management and the Bank's credit approval, evaluation, and collection activities. By May 1984 the Bank was experiencing severe cash flow problems requiring assistance from the FDIC and a consortium of United States banks.

## FINANCES

The Bank began to lose its position as a top money center bank. Total assets of the Corporation declined by 8.5 percent from $46.9 billion in 1981 to $42.9 billion in 1982. Stock prices fell from $36.90 per share to as low as $15 per share. Sources of funds declined in all major categories except other borrowing, foreign deposits, and long-term debt, which increased from the previous year by $1 billion, $800 million, and $400 million, respectively. The greatest decline in source of funds was in domestic demand and time deposits which decreased by $634 million and $1.6 billion, respectively, from 1981.



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Severe market resistance curtailed the issuance of domestic CDs and commercial paper to such a degree that the Bank was able to rollover only about 60 percent of its commercial paper. When sizeable amounts of term money were obtained, the Bank had to pay substantial premiums. By September 1982, the Bank's primary incremental funding sources were overnight Eurodollars and brokered Federal funds.

Total stockholders' equity declined by $797,000 at year-end 1982, over year-end 1981. As a result of reduced 1982 earnings and maintenance of the $0.50 a share quarterly dividend, stockholders received 94.34 percent of income before security transactions as dividends in 1982 compared with 28.88 percent in 1981. Retained earnings were down by $627,000 from 1981's total.

Earnings

Net interest and other operating income was a record $1.2 billion before provision for credit losses. But net income was the lowest in 5 years, primarily due to a sharply increased provision for loan losses of $492 million, compared to $120 million the year before. Both the earnings decline and the increased provision reflected a steep rise in problem credits. Income before security transactions totaled $84.3 million, down substantially from $260.3 million in 1981. Net income for the year was $77.8 million, down from $254.6 million a year earlier. Net interest income accounted for 73.5 percent of total operating revenues before provisions for credit losses, compared with 71.4 percent a year earlier.

Assets

Average total loans increased from 1981 levels in 8 of the first 9 months of 1982 but declined in 2 of the final 3 months for a 15.8 percent overall increase over 1981. Commercial and industrial loans averaged $13.7 billion in 1982 and remained the largest domestic loan category, increasing by 28 percent in 1982. Mortgage and real estate loans rose 9.6 percent, compared with 12.9 percent growth in 1981, while loans to financial institutions were up 11.6 percent in 1982. Average interest earning assets, reflecting higher loan and lease receivable balances, were up 15.8 percent to $33 billion.

Nonperforming Loans and Losses

At the close of 1982, nonperforming loans totaled $1.9 billion or 5.6 percent of total loans and leases receivables, up substantially from $653 million or 1.9 percent of 1981 loan and lease receivables. The provision for loan losses totaled $492 million, which included a $220 million increase in the provision for loan losses during the second quarter due to problem credits as a result of Penn Square loans. Net credit losses were $393.2 million, up substantially from $71.1 million in 1981. Net losses of $191 million on participations purchased from the Penn Square Bank were a major factor in the increase.

## 1983

## INDUSTRY AND ECONOMIC CONDITIONS

The economy in the aggregate proved strong but banks experienced fewer demands for business loans, which in the past had been among the highest yielding assets in banks'



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portfolios. Credit problems intensified in energy and energy related businesses as the recession lingered in that area. Housing and consumer spending provided the main thrust for the economy. Business spending for autos, trucks, and high technology goods accelerated, but investment in structures and heavy machinery remained weak. Federal government spending was stimulative, but part of this effect was offset by declines in state and local government spending. Exports remained weak and the trade deficit ballooned as imports responded to rising domestic demand.

## BUSINESS SERVICES

The Corporation continued to experience losses especially in the oil and gas area which accounted for a high percentage of problem loans. Between nonperforming loans and loss provisions, the Bank was carrying close to $590 million pretax drag on earnings. Although funding had reasosnably stabilized, resistance to the Bank was still apparent, especially in the domestic markets. Reduced premiums on term funds and asset reductions allowed overnight funds to decrease by about $4.6 billion. A shift to offshore funding began in mid-1982, and in mid-1983 over one-half of term funds were obtained in the Euromarkets.

## SUBSIDIARY ACTIVITY

Subsidiaries of the Corporation, excluding the Bank, represented 5 percent of total consolidated assets at December 31, 1983, down slightly from 5.1 percent a year earlier. For the year the subsidiaries contributed $33 million to net income, compared with $43 million for 1982. No new acquisitions were reported by the Corporation.

## MANAGEMENT

The Board and management responded to serious credit problems uncovered in 1982 by conducting an in-depth management review of operations. As a result, management made major changes in lending policies and restructured senior management to better define lines of authority and responsibility and provide for orderly management succession. The "corporate office"[9] concept was dissolved, with most department heads reporting to the Chairman. In August, the Board elected Executive Vice Presidents Taylor and Bottum to the Board. Mr. Taylor became Vice Chairman and retained his position as head of Bond and Treasury Services, with Mr. Bottum shifting duties to become the head of General Banking Services. In November, the Bank realigned the investment responsibilities and restructured the credit review function. A Credit Evaluation Department was created to replace the old rating committee.

## FINANCES

The Corporation turned its attention to overcoming the problem of large amounts of nonperforming loans causing depressed earnings far below that experienced during the past few years. During 1983, the Corporation continued to pay a premium for certain of its liabilities. Funding sources were shifted substantially to offshore markets. Foreign deposits accounted for 38 percent of the Bank's funds, followed by 16 percent from time deposits, and 16 percent from purchased federal funds. Subsequent to year-end 1983, one of the major rating agencies reduced the Corporation's rating on nonredeemable preferred stock and further reduced its rating of the Corporation's long-term debt.



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## Earnings

Earnings continued to be depressed because of heavy loan loss provisions, income reductions due to nonperforming assets, and increased funding costs. In addition, interest expense continued to be higher than normal due to funding premiums of 25 to 50 basis points paid on a portion of the Bank's liabilities.

Net income was $108.3 million in 1983, $30 million greater than 1982 but only about one-third of 1981 net income. The return on average total assets for 1983 was 0.26 percent, compared with 0.17 percent in 1982 and 0.57 percent in 1981. Net interest income on a taxable equivalent basis declined 8.4 percent from 1982 but increased slightly from 1981.

## Assets

Earning assets averaged $36.1 billion in 1983 reflecting a decline of $4.1 billion or 9 percent from 1982. Of the total earning assets, $23.4 billion was domestic and the balance, $12.7 billion, foreign. Domestic and foreign loans made up $30.8 billion of total earning assets and of these loans $20.5 billion was domestic and $10.3 billion was foreign.

## Nonperforming Loans and Losses

Loan quality continued to decline as more loans entered the nonperforming category. Nonperforming loans totaled $1.9 billion, or 6.2 percent, of total loans and lease receivables. This compared with 1.9 percent at year-end 1981. Nonperforming loans included $456 million in participations purchased from Penn Square, down from $595 million at year-end 1982. Loans purchased from Penn Square in the amount of $135 million were written off during the year. The provision for credit losses was $382.5 million or 1.21 percent of total loans compared with 1.11 percent at the end of 1982. Net loan losses for the year totaled $386.5 million compared with $393.2 million in 1982 and $71.1 million in 1981.

# 1984

## INDUSTRY ECONOMIC OUTLOOK

Continuing economic expansion set the stage for improved banking industry performance in 1984. The cash flow of corporations was much improved over earlier periods and business borrowing from banks was increasing because of low current inventory levels. Corporations did some restocking, a process normally financed with bank borrowings. Rising levels of industry capacity utilization and the expressed intention of corporate executives to boost capital spending indicated an increasing demand for funds.

Foreign loans increased in 1984, but banks shifted their emphasis from foreign to domestic consumers. The rate of growth in consumer lending, in the form of personal loans and mortgages, was expected to surpass all other lending categories in 1984, according to Standard and Poor's. Personal income was up, unemployment down, consumer confidence high, and the demand for durables and housing brisk.



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## BUSINESS SERVICES

Beginning in May 1984, the Bank experienced a serious liquidity crisis resulting from the loss of a major portion of its funding base domestically and abroad. Major providers of overnight and term funds failed to renew their holdings and the Bank was forced to prepay time deposits in the Eurodollar and domestic markets and to arrange for the replacement of CD's in the domestic market. Because no other adequate funding sources were available, the Bank resorted to Federal Reserve Bank borrowings which rose to an average daily level of $2.6 billion.

## SUBSIDIARY ACTIVITY

During March 1984, the Bank sold its charge card operations, and during July 1984 the Corporation sold Continental Illinois Limited, its London-based merchant bank. The Corporation announced plans to sell its leasing company and real estate mortgage company.

## MANAGEMENT

In early 1984, Chairman Anderson was replaced by David Taylor. Edward S. Bottum was made President. In August, Messrs. Taylor and Bottum were replaced by John E. Swearingen (Chairman of the Board of Directors and Chief Executive Officer of the Corporation) and William S. Ogden (Chairman of the Board of Directors and Chief Executive Officer of the Bank).

## FINANCES

The Corporation's financial position eroded rapidly in early 1984, resulting primarily from a run-off of deposits and other funding sources starting in May 1984. Business was sluggish because of sharply narrowed margins and the effects of a large amount of Latin American loans classified as nonperforming. At June 30, 1984, interest bearing deposits totaled $14.5 billion, down from $24.9 billion at December 31, 1983.

### Earnings

Earnings were offset by lower net interest income, reflecting the impact of interest earnings reversals from nonperforming credits and increases in the general level of interest rates which raised the cost of funding and narrowed margins. Higher other operating income during the quarter more than offset the declines in net interest income. Net income was $29 million for the first quarter; however, it was dependent upon a nonrecurring revenue item totaling $188 million from the sale of the Bank's credit card operations. The Corporation would have experienced a pretax loss of $140 million without the nonrecurring income. The second quarter net loss was $1.2 billion. Net interest income on a taxable equivalent basis was $166 million for the first quarter of 1984, down from $241.5 million in the prior year's quarter. The net interest margin was 1.83 percent, compared with 2.63 percent during the same period last year.



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## Assets

Earning assets averaged $34.5 billion during the second quarter -- $21.9 billion domestic and $12.6 billion foreign -- down from $36.6 billion a year earlier. A significant portion of this decline was in reduced domestic loan volume including the sale of the charge card portfolio. At period end, earning assets totaled $32.3 billion, including loan balances of $29.6 billion.

## Nonperforming Loans and Losses

Nonperforming loans and lease financing receivables amounted to $2.7 billion at June 30, 1984 and represented 9.2 percent of the loan and lease portfolio. Loans and lease financing receivables to borrowers in the oil and gas industry totaled approximately $4.7 billion of which $1.1 billion were nonperforming. The provision for credit losses was $705 million. Net credit losses totaled $748 million.



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# FOOTNOTES

1 Participants include 28 major American banks.

2 Certain subsidiaries of Continental Illinois National Bank and Trust Company of Chicago and certain subsidiaries of Continental Illinois Corporation are omitted because such subsidiaries, considered in the aggregate, would not constitute a significant subsidiary.

3 Except for directors' qualifying shares.

4 A multinational business is one that serves customers in the U.S. and other countries.

5 U.S. banks that provide service to other domestic banks.

6 A Federal statute which authorizes national banks to form subsidiary corporations for development of overseas business.

7 These countries are Argentina, Australia, Austria, Belgium, Brazil, Canada, the Cayman Islands, Colombia, Ecuador, France, Indonesia, Iran, Jamaica, Japan, Lebanon, Luxembourg, Malaysia, Morocco, Pakistan, Peru, the Philippines, Singapore, Spain, Switzerland, Taiwan, Thailand, and the United Kingdom.

8 100 basis points equals 1 percent.

9 The corporate office included the Chairman, Vice Chairman, and the President. The concept provided for most department heads to report to the corporate office rather than to specific individuals.



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