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The Future Development of Bank Examination Data

In a sense, the bank examination records are a compact logbook of the fortunes of a sizable sector of American business and finance. For the economist, they contain many of the missing parts needed to piece together a comprehensive picture of the credit extension process that plays so critical a role in controlling the volume and direction of employment of economic resources. For the student or practitioner in finance, they describe the financial structure and experience of business firms and banks in a wealth of detail probably unmatched by any other source. For the banker and bank examiner, they offer a virtually complete compendium of bank lending practices and risks. For the maker of economic policy, these records, intelligently exploited, may furnish up-to-date guides to the nature and speed of the responses of businesses and banks to changes in economic circumstances and policies, and eventually a means for better understanding and prediction of these responses.

In all these applications, the opportunities for fruitful analysis are as rich and varied as anyone could ask: the same data may be explored simultaneously from the viewpoint of the individual economic units (borrowers or lenders), in cross-sectional aggregates as of a given point in time, or as time series. The preceding chapters have only scratched the surface of these potentialities. They have extracted and assayed a small part of the ore and demonstrated a high probability that other rich veins lie beneath.

A remarkable feature of these records, from the standpoint of the improvement and broadening of our financial statistics, is that only a relatively small additional investment would be needed to collect and

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arrange the data in such a form that statistical aggregates could readily be assembled. Commercial banks have always had credit files and records, but statistical access to them is perforce a cumbersome procedure, beset by problems of assuring confidentiality, lack of respondent cooperation, and expense. Interview and questionnaire methods, employed in the effort to circumvent these difficulties, have not proved notably more productive. In the bank examination records, the problems of obtaining access to the data, casting them in a fairly standard form, and gathering them in a few central files have already been surmounted. Indeed, many of the examining agencies already calculate aggregate criticism rates on an annual basis, or have the data in such form that their calculation would be a trivial matter. While there are of course some differences in the scope of the data collected by the various examination agencies, these variations appear marginal in relation to the over-all body of information. At the risk of some exaggeration, it is probably fair to state that all that is needed to make the data amenable to machine processing is a somewhat greater degree of standardization in the *form* in which they are transcribed and collected.

A brief survey of the major types of statistics that might be assembled from these records will give a more concrete idea of their potentialities:

1. Detailed data describing the volume of loans outstanding at various classes of banks to various groups of borrowers (classified by industry, size, and other characteristics), as well as the attributes of such loans (including maturity, collateral, interest rates, and other contract terms), are at present available only from three large-scale Federal Reserve Commercial Loan Surveys (each referring to a single day in late 1946, 1955, and 1957). Such surveys, quite apart from their expense, impose a tremendous clerical burden on both the Federal Reserve and the respondent banks, which accounts for the infrequency and reluctance with which they are undertaken. The same data, for the most part in even greater detail, could be obtained regularly from the bank examination reports (perhaps even quarterly, with appropriate scheduling of the dates on which particular banks are to receive their annual examinations). Even if the quality of the bank examination data failed to match that of the loan survey data in all respects (because of problems of examination cut-offs, season-to-season variation

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in the sample, and similar difficulties), the greater frequency of the data and the smaller expense would compensate for any such drawbacks. In all probability, however, the over-all quality of bank examination data would actually be superior to that of special surveys. This would be partly because of the obviously smaller sampling and non-response errors, but mainly because the job is likely to be done much more uniformly and accurately by a relatively small group of skilled examiners and their assistants than by the often untrained employees of the respondent banks, to whom a loan survey report represents an unwelcome addition to the regular workload.

2. Another valuable contribution examination records could make is to statistics of business balance sheets and income statements. The importance of these data is evident from the widespread use (despite their sometimes important technical deficiencies) of such compilations now prepared by various public and private agencies. Interrelations among accounting variables of individual firms are also receiving growing emphasis in recent business cycle literature. The bank examination records can probably yield data similar to those found in the basic source in this area—the Internal Revenue Service's annual *Statistics of Income*. While the bank examination version of *Statistics of Income* would necessarily be a much abbreviated one in certain respects, it could probably be produced within a month or two after the close of the year in contrast with a publication lag of about two years for *Statistics of Income*. Moreover, despite the fact that some of the balance sheets and income statements in banks' credit files at examination time may refer to relatively remote dates, some useful intrayear data might also be developed. At a minimum, balance sheet and other attributes of *new* borrowers could be tabulated at more frequent intervals. The interest in financial ratio data is attested by the compilation by Robert Morris Associates of the financial data of current borrowers from commercial banks and their use by bank credit officers.¹

3. Another major area in which important new statistics should be developed is that of examiner criticism rates. Evidence has been presented that these rates may be an advance indicator of business fluctuations. But the usefulness of regular data on these rates does not

¹There would be the problem, however, of avoiding duplication in these statistics, resulting from the fact that some borrowers borrow at more than one bank. See p. 73, n. 4, for the treatment used in the present study.

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rest on this feature (which, in any event, requires further confirmation from a larger sample). If detailed data on loan volume and attributes and on financial statements of business firms are significant, then this information is even more significant when coupled with evaluations of the quality of the various loan segments and financial statements by expert appraisers; for these appraisers have access to supplementary information of a sort that is not readily recordable statistically or, indeed, may not be recorded anywhere except in the memory of a loan officer of a commercial bank.

4. Finally, systematic processing and analysis of bank examination data are likely to develop information helpful to the examination process itself. Attention could be directed continuously to divergences in criticism rates among particular regions or classes of banks which might indicate unusual developments in lending practices or the business environment. Changes in the credit standards of banks (and, for that matter, of the examiners) could be more readily brought to light. Self-regulation by the commercial banks might become more general and effective if more information could be published on lending practices and experience, although individual bank or borrower transactions must, of course, be kept confidential. There is also the prospect that, on the basis of intensive case history and statistical studies, certain loan attributes or patterns might ultimately be identified as symptomatic of above-normal risk, so that the identification of those loans in need of closer scrutiny might be standardized to some extent, thereby freeing examiner time now spent in "thumbing through" loans that are routine.

The National Bureau's interest in the statistical exploitation of bank examination records has been guided from the beginning by the belief that here was information of the widest relevance that could be assembled and published at relatively small cost. The present paper has illustrated only a few of the possible uses of the data. The results justify, it is believed, not merely an occasional repetition (even if on a much larger scale) of the survey approach used in this pilot study, but an intensive program to exploit regularly the full potentialities of these records—to produce on a current basis the information, so relevant to private as well as government financial decisions, that these records uniquely can provide.