

AMERICAN BANK FAILURES

BY

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PREFACE

THE basis for the statistical material contained in this study has been gathered principally from published sources, but the writer is under obligation to the Division of Insolvent Banks of the office of the U. S. Comptroller of the Currency for additional data and interpretations furnished in connection with his review of the liquidation of national banks. Acknowledgment must also be made of the assistance received from a number of State Banking Commissioners, from receivers of failed state banks, and from the Division of Research and Statistics of the Federal Reserve Board. Aid given by Dr. Dudley J. Cowden of Williams College in the presentation of material must be especially acknowledged. The author is heavily indebted to Professor A. H. Stockder for his critical review of the entire manuscript, and expresses his appreciation for the suggestions made by Professors James W. Angell and John M. Chapman. For guidance, advice and assistance during the entire period that this study has been in preparation the author is under deep obligation to Professor H. Parker Willis.

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CHAPTER I

INTRODUCTION

THE inability of American banking to provide adequate protection for the resources of the community and the savings of depositors has repeatedly been demonstrated by the recurrence of bank failures. The record of these failures¹

¹ The statistics of failures in the *Annual Reports of the Comptroller of the Currency* refer to all banks for which receivers have been appointed; they do not include banks which suspended business temporarily, and were permitted to resume operations, without the appointment of a receiver. In his discussion of NATIONAL BANK FAILURES in the text of the Annual Report the Comptroller applies the term "actual failures" to all receiverships excluding those instituted "in order to complete unfinished business, or to enforce stock assessments the collection of which was necessary under contracts to succeeding institutions which purchased the assets of the banks under terms by which depositors were paid in full." Furthermore, the number of "actual failures" less the number of banks restored to solvency constitutes the number of banks to be liquidated. [See e. g. *Annual Report of the Comptroller of the Currency*, 1931, p. 29.]

Statistics of the number, etc., of bank failures as reported by the Comptroller are in regard to national banks for years ending October 31, and in regard to banks other than national for years ending June 30.

In the publications of the Federal Reserve Board a "suspension" is noted if a bank is "closed to the public on account of financial difficulties by order of the supervisory authorities or by the directors of the bank." Statistics of suspensions are for calendar years.

In the following discussion the terms "failure" and "suspension" are used interchangeably and refer to banks closed on account of financial difficulties, except that when the term "failure" is used in connection with statistics from the Comptroller's Reports, it refers, in so far as national banks are concerned, to banks for which receivers were appointed; and, in regard to banks other than national, to banks which were reported as failures by the State authorities, without further definition on their part. In the present discussion, all statistics of failures prior to 1921 are the Comptroller's, unless otherwise noted. See ch. ii, note 4, and Table 3.

since the establishment of the national banking system is truly an imposing one, over 19,000 banks having been placed in receivership or forced to restrict or suspend operations between 1865 and December 30, 1933, on account of inability to meet the demands of depositors. Of this number more than 3,000 failures involving resources amounting to nearly one billion dollars occurred prior to 1921.² The 16,000 odd banks which suspended operations during 1921-1933 had deposits of more than nine billion dollars.³ Following is a summary of these failures.

1865-1920	3,108—Resources	\$ 988,900,000
1921-March 15, 1933	11,278—Deposits	5,102,861,000
March 16, 1933	4,507— “	4,105,265,000 ^a
March 16-Dec. 30, 1933 ...	221— “	152,538,000

^a Banks which at the termination of the banking holiday were not permitted to reopen.

A review of the recent failure epidemic discloses that 5,714 banks with deposits of \$1,625,468,000 suspended operations during 1921-1929. Although the persistence of these failures after 1922 and their accumulation at the rate of over 600 annually had afforded conclusive evidence of the existence of a major banking problem, they were for many years practically disregarded, the prevailing opinion being that the situation would correct itself automatically, and that, since only the smaller and weaker banks were involved, their elimination would eventually result in a stronger banking system. It was not until after the collapse in 1929 of the stock market that the political authorities became sufficiently interested in the banking situation to decide upon an investigation, the House of Representatives passing a resolution on February 10, 1930 authorizing its Banking and Cur-

² *Annual Report of the Comptroller of the Currency*, 1931, pp. 6-8.

³ *Annual Report of the Federal Reserve Board*, 1933, pp. 206, 223.

rency Committee "to make a study and investigate group, chain, and branch banking, for the purpose of obtaining information necessary as a basis for legislation".⁴ At the hearings held before this Committee between February 25 and July 11, 1930, various aspects of the failure problem were thoroughly discussed. Similarly, the Senate passed in July 1930 a resolution introduced by Senator Glass authorizing its Banking Committee "to make a complete survey of the National and Federal Reserve Banking systems. . . ." ⁵ Pursuant to this resolution hearings were held before a Subcommittee between January 19 and March 3, 1931, while also enquiries were made by means of questionnaires, and special investigations were made by a staff of assistants attached to the Committee.

In the meantime, while our financial soothsayers continued to deliver themselves of their Delphic oracles, failures were rapidly increasing. During 1930 a total of 1,352 banks with deposits of \$853,363,000 had been suspended by the authorities, of which number as many as 608 were during November and December alone. After the suspension of 198 banks during January 1931, there had been a perceptible decline, although the total from February to July was still as high as 578. Partly as a result of the German collapse in July, and the abandonment of the gold standard by England, but fundamentally as a consequence of the general distrust engendered among the public by the continued hands-off policy of the federal government and the complaisant attitude of the banking fraternity, the last five months witnessed a tremendous increase in suspensions, not less than 1,518 banks being closed, of which as many as 522 during October. The year closed with a total of 2,294 failures, or nearly four times the yearly average before

⁴ House Res. 141 [71st Congress, 2nd Session].

⁵ Senate Res. 71 [71st Congress, 3rd Session].

1930, and representing 10 per cent of the number of banks reported on June 30. Deposits of these suspensions amounted to \$1,690,669,000, an amount larger than that of all failures during 1921-1929.

Events during October 1931 had served as an unequivocal warning that the time had come for our financial leaders to discard their therapeutic bank failure theory, and to realize that further inaction would spell disaster for all. They had for some time been engaged in devising a plan of self-help, but the situation called for more serious efforts than were embodied in the organization of the National Credit Corporation [October 1931]. After a decline to 175 failures during November, there was a new relapse, 357 banks being closed during December, and 342 during the succeeding January [1932]. Not until after Congress had intervened by enacting the Reconstruction Finance Act, which was signed by President Hoover on January 22, did the situation ease. Failures dropped to 121 during February, and to 46 during March.

The Congressional hearings had helped to bring before the entire country the seriousness of the situation, and to crystallize sentiment regarding new legislation. A proposal for such legislation made its appearance on January 21, 1932, in the form of a bill [S. 3215] introduced by Senator Glass.⁶ This bill was the result of exhaustive studies made by the Banking Subcommittee, under the direction of H. Parker Willis, of the evidence presented at the hearings held in 1931, and of the information collected by the Committee's investigators. Among its many provisions [relating to security operations by member banks, the power of bank holding corporations to vote the stock of their banks in Fed-

⁶ The bill [S. 3215] introduced on January 21, 1932, was revised four times. The revised bills were S. 4115 [March 14, 1932], S. 4412 [April 18, 1932], S. 243 [March 9, 1933] and S. 1631 [May 1, 1933].

eral Reserve elections, the reorganization of the Federal Reserve Board, the creation of a Federal Open Market Committee, the reserves to be carried against deposits, the investment of time deposits, the establishment of branches by national banks, etc.] was the proposal to establish a Federal Liquidation Corporation for the purpose of speeding up the liquidation of closed banks, and thus effect the prompt release of "suspended" deposits.

Although the bill was therefore purely a corrective measure, it immediately evoked strong protests among the banking and business fraternities, very conveniently supplementing the opposition of the Hoover régime. In order to divert attention from the Glass bill, the administration sought refuge in "emergency" measures, such as the Reconstruction Finance and the Glass-Steagall⁷ bills, but it was again reported, in a revised form, on March 14 [S. 4115]. The "interests" which had hitherto been convinced that the bill would die a legislative death were suddenly struck with fear by the prospect of its being brought to a vote in the Senate. Their clamor for public hearings became loud and insistent, but even while these were being held [during March and April] it was apparent that they would yield little of constructive value, since those who had asked to be permitted to appear before the Committee had already made up their minds, individually as well as collectively, that nothing good, and only bad could result from the proposed measure, or, for that matter, from any legislation.

The result of these hearings was that certain changes suggested by the Governor of the Federal Reserve Board, and others which had originated within the Committee, were embodied in the bill, which now as S. 4412 was reintro-

⁷ Passed on February 27, 1932. Sections 1 and 2 enabled member banks with less than \$5,000,000 capital, or groups of banks, to borrow from the Reserve Banks on assets previously held ineligible.

duced on April 18. Again organized banking and business interests rose in unison, and, although they had been unable to prove their contentions before the Committee, resolutions condemning the bill in its entirety and announced as expressing the "considered and unanimous opinion of the entire body of members" [although study of the bill had been restricted to a few members of these organizations] converged upon Washington. Although Senator Glass succeeded in obtaining a preferred position for the bill, the prospects for success were very small, if only because the administration had been successful in preventing the introduction of a similar measure in the House. Upon the do-nothing majority in the Senate these protests were far from welcome, and when Congress adjourned in July, it had been successful in preventing the bill from reaching a vote.

All this had been of little aid to the failure situation. As a result of the liberal aid given by the Federal Reconstruction Finance Corporation, failures had temporarily declined, but after the middle of the year there was a distinct tendency of failures to increase, although there were wide fluctuations from month to month. The year closed with 1,456 failures with deposits amounting to \$715,626,000. This was a smaller number than that experienced during 1931, but other factors indicated that conditions were indeed worse.⁸ In several states banks had temporarily been closed by the declaration of "holidays" by the civil authorities. In Nevada a state-wide banking moratorium had been declared in November, while in several states many banks, without actually ceasing operations, had obtained agreements from their depositors for the waiver or deferment of their claims.

⁸ The fact was that the Reconstruction Finance Corporation was giving aid to many banks which could not possibly be saved, because there was not the least possibility that the market value of the assets of these banks would ever again approach the inflated values at which they had originally been acquired.

Early in 1933 it became evident that the situation had been allowed to get beyond control. The post-holiday return flow of currency was considerably less than usual, indicating that much hoarding was taking place. Failures had increased from 161 in December 1932 to 242 in January 1933. The breakdown commenced with the declaration of a four-day holiday in Louisiana in February. Michigan followed on February 14, and Maryland on February 25, while at about the same time restrictions were placed on the withdrawal of funds in Indiana, Arkansas and Ohio. In a number of states laws were passed enabling banks to adjust their liabilities without going into receivership. Since these and similar laws did not affect the national banks, it was necessary for Congress to pass a joint resolution enabling the Comptroller to deal with the new situation in so far as national banks were concerned. These events and preparations, the increase of money in circulation—amounting eventually to \$1,800,000,000 between early February and March 4—, the decline in the reserve ratio, and the increase in money rates were unequivocal indications that the crisis was imminent, and that the faith which the American people for twelve years had continued to have in their banks while the system was crumbling under their very eyes, was approaching the zero-mark. Officially, as appeared later, only 154 banks were “suspended” during February on account of financial difficulties, but actually the number ran into thousands. Four more states declared holidays on March 3. Banks in New York, Pennsylvania, New Jersey, Massachusetts and Illinois failed to open on March 4, while six states followed suit between Saturday [March 4] and March 6. At the time of President Roosevelt’s proclamation of a national bank-holiday, the cessation of all banking operations, including those of the Reserve banks, was an accomplished fact.⁹

⁹ *Annual Report of the Federal Reserve Board, 1933, pp. 8-10.*

The emergency created by the closing of all banks called for immediate attention. Foremost among the problems requiring solution was that of enabling solvent banks to reopen in order to provide the community with a circulating medium. The hoarding of gold also required attention. Provision had also to be made for the numerous banks which it was expected would not be able to reopen. Accordingly, at the special session of Congress called for March 9, an emergency banking bill was introduced. This bill was passed with only 7 dissenting votes [in the Senate], and was signed by President Roosevelt on the same day.¹⁰ Its provisions may be summarized as follows.

1. Title I, Section 1, approved the actions, etc. taken by the President and the Secretary of the Treasury concerning the declaration of the holiday, the conditions under which certain essential banking functions could be carried on, and the reopening of banks. Section 2 provided for control by the Executive of all dealings in gold [hoarding, export, etc.]. By Section 3 provision was made for the delivery of all gold, gold notes, etc. to the United States Treasury. Section 4 referred to certain restrictions placed on the members of the Reserve system during the emergency period.

2. Title II ["Bank Conservation Act"] provided for the appointment of "conservators" for those national banks which would not be in a sufficiently sound condition to permit the issue to them of a license for operation on an unrestricted basis, as soon as the banking holiday would be declared terminated, and prescribed the course to be followed to enable these banks to reorganize, or to be liquidated. [Sections 201-211].

3. Title III, Sections 301-304, conferred authority upon national banks to issue preferred stock, and upon the Reconstruction Finance Corporation to subscribe for, make collateral loans

¹⁰ Public—No. 1—[73rd Congress, 1st Session] "An Act to provide relief in the existing national emergency in banking, and for other purposes" [H. R. 1491].

on, and sell, this preferred stock. [The purpose of these sections was to enable insolvent banks to refinance themselves by government aid].

4. Title IV authorized the issue of federal reserve bank notes secured by direct obligations of the United States, or by notes, drafts, bills of exchange, and bankers' acceptances. It liberalized the loaning powers of the Reserve banks, and authorized them to make advances to individuals on their promissory notes when secured by obligations of the United States.

5. Title V made the necessary appropriation, and contained the customary validating clause.

Since at the time the Act was passed no definite plan for reopening the banks had been formulated, it was necessary to extend the moratorium. However, after by Presidential order of March 10 power had been conferred upon the Secretary of the Treasury to license member banks of the Federal Reserve System found to be solvent, and like power had been granted to the state banking authorities with respect to non-member banks, it was possible to announce on March 11 that the Reserve banks as well as member banks in the twelve reserve cities would reopen on March 13, while banking operations in 250 cities having recognized clearing houses were to be resumed on March 14, and in all other places on March 15.

The immediate effect of the termination of the holiday was the reopening of about 14,000 banks, and a continuation of the suspension of about 4,500 banks which were found to be insolvent or in a condition necessitating placing restrictions on withdrawals by depositors, and limiting the bank's operations to certain specific functions, pending the formation of a plan of reorganization.

After Congress had dealt with the emergency, it became possible once more to direct attention to more permanent legislation. The Glass Bill had passed the Senate on January 10, 1933, but the change of Administration enabled the

reintroduction of certain provisions which it had been necessary to eliminate under the pressure of the Hoover régime. At the short session in March it had been necessary to postpone action on the bill, but it was reintroduced as Senate No. 1631 on May 1. This time the bill contained a section providing for the establishment of a deposit insurance corporation whose duty it would be to assist in the liquidation of failed banks [as had been provided for in earlier bills] and to protect depositors against losses. This section corresponded to the measure introduced by Representative Steagall in the spring of 1932, and again in May 1933.

The Steagall bill (H. R. 5598) was passed by the House on May 23, and two days later the Senate passed the revised Glass bill. The deposit-guaranty section, however, had been the cause of difficulties which it remained necessary to smooth out. Senator Vandenberg had introduced an amendment providing for the temporary guaranty of deposits for one year from July 1, 1933 [the insurance plan of Senate No. 1631 was not to become effective until July 1934], but the Administration was opposed to providing for immediate protection, because this would leave no time to make the necessary investigation of the financial condition of the country's banks. By June 12, however, the agreement had been reached that the temporary plan would start on January 1, 1934, "unless the President shall by proclamation fix an earlier date". The bill passed the House on June 13 by a vote of 191 to 6, while it was approved by the Senate without a record vote. President Roosevelt affixed his signature on June 16.

Following is a summary of the more important provisions of the Banking Act of 1933:¹¹

¹¹ Public—No. 66—[73rd Congress, 1st Session], "An Act to provide for the safer and more effective use of the assets of banks, to regulate interbank control, to prevent undue diversion of funds into speculative operations, and for other purposes" [H. R. 5661].

1. Creation of a Federal Deposit Insurance Corporation whose purpose it is to assist in the liquidation of failed banks, and to insure the deposits of banks admitted to membership in the Corporation. This section is more fully discussed in chapter viii.

2. Divorce of commercial from investment banking. The Act attempts to accomplish this by 1. the separation of security affiliates from commercial banks; 2. restricting the security operations of member banks; 3. prohibiting interlocking directorates between banks and investment organizations. See chapter vii.

3. Restrictions on the use of bank credit for speculation. See chapter vii.

4. Private Banking. Section 21 parallels the sections relating to the divorce of commercial from investment banking, and provides that private banks wishing to do a deposit business must give up their securities business. Firms engaged in the securities business are prohibited from accepting deposits. Provision is made for their examination by the authorities. See chapter vii.

5. New charters for national banks call for a minimum capital of \$100,000, except that banks with not less than \$50,000 may be organized in places the population of which does not exceed 6,000 inhabitants [section 17a]. Double liability no longer attaches to national bank shares issued after June 16, 1933 [section 22].

6. Section 11b prohibits member banks from paying interest on demand deposits. Exceptions are made for deposits payable abroad, for deposits in mutual savings banks, and for those made by the civil authorities. This section also authorizes the Federal Reserve Board "to limit by regulation" the rate of interest which may be paid on time deposits.

7. Morris Plan banks and Mutual Savings banks are now admitted to membership in the Federal Reserve System [sections 5a and 5c].

8. Removal of bank directors and officers. The Federal Reserve Board may remove directors and officers who, after having been officially warned, have continued to violate the banking

laws or to engage in unsound and unsafe practices in conducting the business of the bank [section 30].

9. Group banking. In order to prevent bank holding companies from obtaining control of the Federal Reserve Bank it is provided by section 3b that only one of the banks belonging to a group may participate in the nomination or election of officers of the Federal Reserve Bank. Section 19 provides that holding companies must obtain a permit from the Board before they may vote the shares controlled by them, and must agree to submit to examination when applying for this permit. Shareholders are liable "in proportion to the number of shares held by them, in addition to the amounts invested therein, for all statutory liability imposed on such holding company affiliate by reason of its control of shares of banks." The holding company must agree to divorce itself of securities companies within five years after filing its application for the permit referred to above.

10. The establishment and operation by national banks of new headoffice-city branches is, with the approval of the Comptroller of the Currency, permitted in those states which expressly authorize state banks to maintain and operate such branches. The establishment of branches outside the headoffice-city is permitted "if such establishment and operation are at the time authorized to state banks by the statute law of the State in question by language specifically granting such authority affirmatively and not merely by implication or recognition, and subject to the restrictions as to location imposed by the law of the State on state banks." For the establishment of "outside" branches national banks in a state with less than 500,000 inhabitants and which has no city located therein with less than 50,000 population must have at least \$100,000 capital. The minimum is \$250,000 in those states for which the corresponding population figures are 1,000,000 and 100,000; and \$500,000 in all other states. The capital of each national bank having branches must not be less than the aggregate minimum required by law for an equal number of independent national banks in the various places where the headoffice and the branches are situated [sec-

tion 23]. State member banks are permitted to operate domestic [and foreign] branches under the same conditions as national banks [section 5b].

The Banking Act of 1933 is America's most recent "adventure in constructive finance". Several of its provisions affirm in an unequivocal manner that the shameless banking conditions which had developed during the post-war period were symptoms of widespread unsound and unethical methods of banking, and necessitated drastic action on the part of the lawmaker. Many of the abuses committed in the past have been outlawed, while direct protection to depositors has been extended through the establishment of a guaranty-fund under the auspices of the Federal Deposit Insurance Corporation. Nevertheless, it should be realized that even under the existing statutes it will be impossible to provide the country permanently with a sound and safe banking system, if only for the reason that many institutions will be able to stay outside the jurisdiction under which the new measure has been enacted, and that the existing division and multiplication of legislative and supervisory powers make it impossible to pursue a definite and uniform banking policy. It may be wise to bury the past and look hopefully forward to a realization of the beneficial effects which may be expected from the Banking Act, but the lessons provided by the experiences of the last fourteen years will for a considerable part remain unlearned, if we decide to stop at taking care of immediate emergencies only.

Among the numerous symptoms which have testified to the existence since 1921 of a highly unsatisfactory and dangerous banking situation, bank failure takes a prominent place. A study of certain aspects of the recent epidemic should therefore be of considerable aid towards obtaining an understanding of the character of these difficulties. The record may be made complete by including a review of fail-

ures before 1921. Chapter II is reserved for that purpose. Chapter III will contain an analysis of failures during 1921-1933. Attention will be called to the large proportion of small banks among those that failed, to the fact that failure has been more frequent among state than among national banks, to the geographical distribution of failures, and to the consequences of our unit banking policy.

Bank failure has affected the banking public primarily through the losses which liquidation has inflicted. An attempt to analyze the extent of these losses among national bank depositors is made in Chapter IV, while Chapter V is reserved for noting the recovery to depositors of failed state banks. Chapters VI and VII review certain evidence bearing upon the causes of failure. The provisions of the Banking Act designed to protect depositors from future losses are analyzed in Chapter VIII.

CHAPTER II

BANK FAILURES BEFORE 1921

THE introductory paragraphs of the preceding chapter noted that a total of 3,108 banks with resources amounting to \$988,900,000 were placed in receivership between the date of the first failure of a national bank in 1865 and October 1920. Of this number, 1,750 banks with resources of \$445,500,000 failed between 1865 and 1900, and 1,358 banks with resources of \$543,400,000 during 1900-1920. The number of national banks which failed during the entire period was 594, with resources of \$349,900,000, and the number of banks other than national 2,514, with resources of \$639,000,000. (See Table 1).

In a survey of failures prior to 1921 it will suffice to center attention on events since 1890. In order to provide the proper background for a study of these failures and for an understanding of the causes which led to the breakdown of 1921-1933, such a survey should include an outline of the changes which were taking place in the structure of the banking system.

GROWTH OF THE BANKING SYSTEM

From 66 banks on June 30, 1863, the number of national banks jumped to 1,634 in 1866, but there was only a nominal increase during the succeeding years, the year 1879 with 2,048 banks actually showing a decline from the high point of 2,091 banks in 1876. However, the ground thus lost was soon more than regained, and by the middle of 1890 there were 3,484 national banks, or 70 per cent more than in 1879. Resources increased from \$16,800,000 in 1863 to \$1,476,300,000 in 1866, while in 1879 they amounted to \$2,019,800,000, and in 1890 to \$3,061,700,000.

A considerable share of the early gain in the number of banks and the amount of resources had been obtained at the expense of the state banking systems. In 1863 there were 1,466 state commercial banks and loan and trust companies, and in 1864 1,089, but only 247 were reported in 1868. The next decade, however, witnessed a reversal of this trend, 510 state chartered banks being reported in 1878, and 648 in 1879. By 1889 the number had increased to 1,791, while in 1890 there were 2,250 state banks, or four and a half times as many as in 1879. Similarly, resources had declined from \$1,185,400,000 in 1863 to \$178,900,000 in 1873, but in 1879 they amounted to \$427,600,000, and in 1890 to \$1,374,600,000. If these figures for national banks and banks other than national are compared, it appears that in 1878 there were four times as many national as state banks, while resources were five times as large, while in 1890 there were only three national banks to every two state banks, and resources of national banks were only about two and a quarter times as large.¹

In this race for numerical supremacy the national system was eventually the loser, the year 1893, with an equal number of national and state banks, namely 3,807, marking the turning point. National banks declined to 3,770 in 1894, and to 3,583 in 1899, while state-chartered banks increased from 3,810 to 4,451. In terms of resources, however, the national system continued to retain leadership, the amount increasing from \$3,213,200,000 in 1893 to \$4,708,000,000 in 1899, as against resources of \$1,857,400,000 and \$2,707,600,000 for state banks.

¹ Actually the number of active—as well as of failed—banks was larger than is indicated by the records, the Comptroller of the Currency noting in his Report for 1897 that the increase in the number of banks reporting was rather due to legislative action providing for the collection of banking statistics than to an actual increase in the number of existing banks [vol. i, p. 34]. See note 4, *infra*.

TABLE 1

NUMBER AND RESOURCES OF NATIONAL AND OTHER BANK FAILURES
1865-1920

[Resources in millions of dollars]

Year	Number			Resources		
	All banks	National banks	All other	All banks	National banks	All other
1865	6	1	5	.3	.1	.2
1866	7	2	5	3.0	1.8	1.2
1867	10	7	3	5.1	4.9	.2
1868	10	3	7	.7	.5	.2
1869	8	2	6	.8	.7	.1
1870	1	0	1	.0	.0	.0
1871	7	0	7	2.3	.0	2.3
1872	16	6	10	7.3	5.2	2.1
1873	44	11	33	13.4	8.8	4.6
1874	43	3	40	4.7	.6	4.1
1875	19	5	14	12.4	3.2	9.2
1876	46	9	37	9.5	2.2	7.3
1877	73	10	63	20.4	7.3	13.1
1878	84	14	70	32.9	6.9	26.0
1879	28	8	20	7.7	2.6	5.1
1880	13	3	10	2.6	1.0	1.6
1881	9	0	9	.6	.0	.6
1882	22	3	19	8.8	6.0	2.8
1883	29	2	27	3.7	.9	2.8
1884	65	11	54	20.8	7.9	12.9
1885	36	4	32	7.7	4.7	3.0
1886	21	8	13	2.9	1.6	1.3
1887	27	8	19	9.8	6.9	2.9
1888	25	8	17	9.7	6.9	2.8
1889	17	2	15	2.1	.8	1.3
1890	39	9	30	12.7	2.0	10.7
1891	69	25	44	16.2	9.0	7.2
1892	44	17	27	17.8	15.1	2.7
1893	326	65	261	82.4	27.6	54.8
1894	92	21	71	15.4	7.4	8.0
1895	151	36	115	23.4	12.1	11.3
1896	105	27	78	22.2	12.0	10.2
1897	160	38	122	47.0	29.1	17.9
1898	60	7	53	9.1	4.6	4.5
1899	38	12	26	10.1	2.3	7.8
1900	38	6	32	19.3	11.6	7.7
1901	67	11	56	14.5	8.1	6.4
1902	45	2	43	7.8	.5	7.3
1903	38	12	26	9.0	6.8	2.2
1904	122	20	102	32.0	7.7	24.3
1905	79	22	57	20.7	13.7	7.0
1906	45	8	37	8.8	2.2	6.6
1907	41	7	34	18.4	5.4	13.0
1908	156	24	132	207.9	30.8	177.1
1909	69	9	60	19.2	3.4	15.8

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1910	34	6	28	17.1	2.6	14.5
1911	59	3	56	15.1	1.1	14.0
1912	63	8	55	12.8	5.0	7.8
1913	46	6	40	13.8	7.6	6.2
1914	117	21	96	30.7	10.1	20.6
1915	124	14	110	31.5	15.0	16.5
1916	54	13	41	13.9	3.4	10.5
1917	42	7	35	13.1	6.3	6.8
1918	27	2	25	11.2	2.0	9.2
1919	43	1	42	8.4	.4	8.0 ^a
1920	49	5	44	18.2	2.5	15.7 ^a
Total	3108	594	2514	988.9	349.9	639.0

^a estimated amounts.

Source: *Annual Report of the Comptroller of the Currency*, 1931, pp. 6, 8.

While the rebirth of the state banking systems was fundamentally the result of the rise of deposit banking, the immediate cause for their rapid increase was found in the fact that in a number of states minimum capital requirements for a state charter was only \$10,000, as against \$50,000 for national banks. The number of state banks with less than \$50,000 increased from 187 in 1877 to 2,539 in 1899, or from 21 per cent to 62 per cent of the total number of state banks.

The foregoing picture of the growth of the banking system would not be complete without noting that in 1877 there were 2,432 private banks, and in 1900 as many as 5,287; or, excluding the so-called brokers' banks, respectively 1,503 and 2,467. Moreover the Comptroller's figures for state chartered banks are undoubtedly understated. Barnett's and the Comptroller's figures for 1877, 1890, 1895 and 1900 are as follows:

	1877	1890	1895	1900
National banks ^a	2,078	3,484	3,715	3,732
State banks and Trust Co's ^a	631	2,250	4,016	4,659
State banks ^b	794	2,534	3,818	4,405
Trust Companies ^b	44	102	241	492 ^c
Private and brokers' banks ^b	2,432	4,305	3,924	5,287
Private commercial banks ^b	1,303	—	—	2,647

^a *Annual Report of the Comptroller of the Currency*, 1931, p. 3.

^b Barnett, G. F., *State Banks and Trust Companies since the Passage of the National-Bank Act* [Washington, 1911].

^c Probably an overestimate.

The tremendous increase since 1880 in the number of state-chartered banks, and the stationary condition of the national system after 1894 had been watched with considerable uneasiness by those who had hoped or expected that the national-bank act would make the further chartering of state banks unnecessary. Since it was apparent that the increase in state banks was mainly due to their ability to satisfy the demand for banking facilities in the more sparsely inhabited districts, and since it did not appear feasible to legislate the state systems out of existence, Congress decided in 1900 to acknowledge the existing struggle between the two systems, and, by reducing the minimum capital requirements for a national charter from \$50,000 to \$25,000, bade the national system to accept the challenge.

National banks increased from 3,732 on June 30, 1900 to 8,030 in 1920, or by about 120 per cent, while resources increased from \$4,944,100,000 to \$22,196,700,000, or by about 350 per cent. During the same period state commercial banks and loan and trust companies increased by 320 per cent from 4,659 to 19,603, and their resources by 620 per cent from \$3,090,000,000 to \$22,329,800,000. The total number of national, state commercial, savings, private banks, and loan and trust companies was 13,678 in 1900,² 30,139 in 1920, and 30,812 in 1921.

If the increase in the number of banks is compared with the increase in population, it appears that in 1900 there was one bank for every 5,560 inhabitants, and in 1920 one for every 3,515. This calculation is based on the number of "all" banks. The relative increase in the number of commercial banking facilities [national banks, state commercial

² As reported by the Bureau of Internal Revenue. See the *Annual Report of the Comptroller of the Currency* for 1900, 1901 and 1902. Also, Willis, H. P. and Chapman, John M., *The Banking Situation* [New York, 1934], pp. 122-124.

banks, and loan and trust companies] is indicated by the decrease from 9,050 inhabitants per bank in 1900 to 3,830 in 1920. Including private commercial banks, the decline was from 6,890 to 3,700.

It further appears that in 1920, 28.6 per cent of all banks were located in communities with less than 500 population, but these banks accounted for only 3.8 per cent of total loans and investments. For communities with less than 5,000 inhabitants these percentages were respectively 76.5 and 21.1. Banks in cities of 100,000 or more inhabitants constituted only 5.7 per cent of the total, but these banks accounted for 53.4 per cent of total loans and investments.

The increase in banks was not accompanied by a corresponding increase in capital stock. Average capital stock per national bank declined from \$186,000 in 1890 to \$167,000 in 1900, and to \$143,000 in 1910, while during the succeeding decade it remained practically unchanged. These amounts should be compared with averages of \$90,000, \$54,000 and \$36,000 for state commercial banks. A low point of \$34,000 was reached in 1912, and maintained during the next three years, but the average rose to \$50,000 in 1920. Loan and trust companies averaged \$435,000 in 1900, \$336,000 in 1910 and \$287,000 in 1915—a low point—and \$338,000 in 1920. A comparison of the averages for national banks and for state commercial banks shows that in 1890 the average national bank was twice, in 1900 three times, and in 1910 four times as large as the average state commercial bank. By 1920 the ratio had been reduced to three times. Outstanding is the fact that average capital per national bank was at all times a substantial figure, and declined only slightly. In contrast, in the case of state banks there was a 37 per cent decline between 1900 and 1915, and the average in 1900 and 1920 was about equal to the minimum capital required for a national charter

prior to 1900. Seventy-two per cent of the state banks in 1909 had less than \$50,000 capital, as against only 30 per cent of the national banks. In 1920, 22.7 per cent of all banks had loans and investments of less than \$150,000, and 64.5 per cent had less than \$500,000. Among national banks these percentages were respectively 4.3 and 39.1, and among state banks 29.7 and 74.3. Ninety-five per cent of the banks with less than \$150,000, and 83 per cent of those with less than \$500,000 [loans and investments], were state banks.

These figures show that American banking policy before 1920 was characterized by the grant of numerous charters, mostly for small banks. That this charter policy—which engendered extreme competition and gave impetus to the widespread practice of unsound banking methods—together with the vacillating attitude on the part of the legislative and supervisory authorities was to compel sooner or later a reckoning, is evident.

FAILURES 1891-1920

There were 1,045 bank failures during 1891-1899, 1,358 during 1900-1920, 4,945 during 1921-1929, and 4,842 during 1930-1932.³ Relative to the number of active banks, failures were least frequent during 1900-1920, an average of only 3 banks failing annually out of every 1,000 active banks. This compares with an average of 15 banks during 1891-1899, 21 banks during 1921-1929, and 80 banks during 1930-1932. In the decade before 1900 failures were extremely frequent during the five-year period ending October 1897, the number of banks placed into receivership

³ The number of suspensions reported by the Federal Reserve authorities was 5,714 during 1921-1929, and 5,102 during 1930-1932 [*Annual Report of the Federal Reserve Board*, 1933, p. 206].

amounting to 834, or an average of 22 banks annually per 1,000 active banks.⁴

TABLE 2
PERCENTAGE OF ACTIVE BANKS AND OF ACTIVE RESOURCES PLACED
IN RECEIVERSHIP, BY PERIODS, 1891-1932

[Resources in millions of dollars]

Years ending Oct. 31	Number of failures	Per cent of active banks which failed [annually]	Resources of failures	Per cent of active resources involved in failure [annually]
1891-1899	1,045	1.5	243.6	.35
1893-1897	834	2.2	208.2	.54
1900-1920	1,358	.34	543.4	.10
1921-1929	4,945	2.1	1,423.3	.26
1930-1932	4,842 ^a	8.0		

^a Failures [receiverships] during 1930 and 1931 as reported by the Comptroller, suspensions during 1932 as reported by the Federal Reserve Board.

The largest number of failures during any one year of the several periods was 326 during 1893, 156 during 1908, 976 during 1926, and 2,294 during 1932. They represented, respectively, 3.44, .73, 3.10 and 10.40 per cent of the number of active banks during these years. The lowest number of failures was 92 during 1894, 27 during 1918, 395 during 1922 and 1,352 during 1930, or, respectively, .97, 0.09, 1.20 and 5.60 per cent of the number of active banks.⁵ These percentages indicate, among other things, that the high point of 156 failures during 1908 represented a lower rate of insolvency than the low point of 92 failures during 1894, while 326 failures during 1893 represented a higher rate

⁴ It is pertinent to note that other studies [Barnett's, *supra*, and Professor Stockder's chapter "Bank Failures in the United States" in the *Report of an Inquiry into Contemporary Banking in the United States*, otherwise called *Banking Inquiry of 1925*], as well as *Bradstreet's* records indicate that there were 2,999 failures during 1891-1920. This would increase the total during 1865-1920 to 3,704. See Table 3.

⁵ Figures for 1922, 1926, 1930 and 1932 refer to suspensions.

than 976 failures during 1926. It is furthermore noteworthy that the highest yearly rate during 1900-1920 was lower than the lowest rate for any year of the other periods.

Resources involved in failures during 1900-1920 amounted to \$543,400,000, or considerably more than double the amount involved during 1891-1899, namely \$243,600,000, but the proportion of active resources involved in failure was larger during the earlier than the later period, the percentages on an annual basis being respectively .35 and .26. During 1893-1897 the proportion was as high as .54 per cent, indicating the yearly tie-up of 54 cents out of every one hundred dollars, or a total of \$2.70 for the period. An average of only 10 cents was annually involved during 1900-1920, or a total of \$2.10.

Except for major fluctuations during 1904, 1908, 1914 and 1915, yearly failures between 1900 and 1920 remained on a fairly equal, and low, level. These four years accounted for 519 failures, or 38 per cent of the total during the period, while resources amounted to 55 per cent of the total. Resources of failed banks in 1908 alone amounted to 38 per cent of total failed resources during 1900-1920. The small number of failures during the other years, in conjunction with the continuous increase in active banks explains why the rate of insolvency declined. For instance, during the four years ending October 1903, when the number of active banks averaged 14,000, there were 188 failures, or an average of 13 [annually] per 1,000 banks. But 161 failures during 1916-1920 indicated an average of only 6 failures annually, because active banks averaged about 28,000.

NATIONAL AND STATE BANK FAILURES COMPARED

A further analysis of the record of failures discloses that of the 1,084 failures during 1890-1899, 257 were of national banks and 827 of state-chartered banks. These banks had

resources respectively of \$121,200,000 and \$135,100,000. The number of national bank failures represented 7 per cent of the average number of yearly reported active national banks. The corresponding percentage for state banks was 23. They indicate that failure was relatively three times more frequent among state than among national banks. Similarly, during 1900-1920, 257 national bank failures, and 1,086 failures of state banks, constituted 3.20 per cent and 7.98 per cent of the average number of active national banks and of state banks, respectively. The average annual rates of insolvency were .15 and .38 per cent.

TABLE 3
NUMBER OF FAILURES OF NATIONAL, STATE-CHARTERED AND
PRIVATE BANKS
[1865-1920]

	<i>National, State- chartered and Private Banks</i>	<i>National and State-chartered Banks</i>	<i>National Banks</i>	<i>State- chartered Banks</i>	<i>Private Banks</i>
1865-1890 .	705 ^a	705 ^a	139	566 ^b	—
1891	69 ^a	69 ^a	25	44 ^b	—
1892	85	49	17	32	36
1893	487	293	65	228	194
1894	81	60	21	39	21
1895	112	87	36	51	25
1896	134	93	27	66	41
1897	149	102	38	64	47
1898	59	26	7	19	33
1899	34	20	12	6	14
1891-1899 .	1,210	799	248	551	411
1900	36	20	6	14	16
1901	67	26	11	15	41
1902	52	32	2	30	20
1903	51	34	12	22	17
1904	123	73	20	53	50
1905	82	47	22	25	35
1906	55	42	8	34	13
1907	85	65	7	58	20
1908	160	107	24	83	53
1909	79	46	9	37	33
1910	58	46	6	40	12
1911	83	61	3	58	22
1912	80	59	8	51	21
1913	96	81	6	75	15

1914	155	128	21	107	27
1915	156	117	14	93	39
1916	57	45	13	32	12
1917	51	36	7	29	15
1918	47	37	2	35	10
1919	61	60	1	59	1
1920	165	141	5	136	24
1900-1920	1,789	1,293	207	1,086	496
1865-1920	3,704	2,797	594	2,203	907

^a National banks and Banks other than National.

^b Banks other than National. Presumed to include private banks. See Table 1.

National banks for years ending October. State-chartered banks, 1865-1891, for years ending June 30; 1892-1899, partly for years ending June 30, partly August 31; 1900-1920, calendar years. Private banks, 1892 and 1900-1919, for years ending June 30; 1894-1899, years ending August 31; 1893, 14 months ending August 31; 1920, 18 months ending December 31, 1920.

Source: National Banks, 1865-1920, and Banks other than National, 1865-1891, *Annual Reports of the Comptroller of the Currency*. State Banks, 1892-1899, *Bradstreet's*; 1900-1920, *Banking Inquiry of 1925*. Figures of the *Banking Inquiry* refer to "suspensions". They are based on the data for 25 states for the entire period, but 7 more states had been added by 1905, 10 more states by 1910, and 4 more states by 1914. Data for 2 states were lacking for the entire period. Private Banks, *Annual Reports of the Comptroller of the Currency*, as compiled by *Bradstreet's*.

See also the report by the Federal Reserve Committee on Branch, Group and Chain Banking, 1932, entitled *Bank Suspensions in the United States, 1892-1931*.

On account of the rapid increase after 1900 in the number of active banks, a better picture of the relative frequency of failure is obtained by estimating the rates for several sub-periods. Table 4 shows that, except for the period 1900-1905, failure among state-chartered banks was from two and a half to four times more frequent than among national banks. During 1911-1920 the rate was fully four times as high.

Resources of national banks involved in failure during 1900-1920 amounted to \$147,200,000, or 1.35 per cent of average annual active resources of national banks. The corresponding amount for banks other than national was

\$396,200,000, and the percentage 4.27. Relatively, state bank resources involved in failure were therefore more than three times larger than the resources of failed national banks.

TABLE 4
PERCENTAGE OF ACTIVE BANKS WHICH ANNUALLY FAILED, SEPARATELY
FOR NATIONAL BANKS AND STATE BANKS, BY PERIODS, 1891-1920

	<i>National Banks</i>	<i>State Commercial Banks, Loan & Trust Companies and Savings Banks</i>
1891-1899 .....	.70	—
1900-1905 .....	.26	.36
1906-1910 .....	.17	.40
1911-1915 .....	.14	.46
1916-1920 .....	.07	.30
1900-1920 .....	.15	.38

It is further of interest to note that 47 per cent of the total of \$147,200,000 was involved in national bank failures during 1904, 1908, 1914 and 1915, while state bank failures during these years accounted for 60 per cent of the total amount of failed state bank resources during 1900-1920. State bank failures during 1908 alone accounted for 45 per cent of the total.

It has been shown that previous to 1921 bank failure was by no means a rare phenomenon. Failures were extremely frequent during 1877, 1878, 1884, 1893-1897, 1904-1905, 1907-1908, 1914 and 1915. In other words, failure of a substantial number of banks was a chronic malady of the banking system, and uninterrupted failure of a smaller number of banks a permanent ailment. Although the unreliability of the state bank data, especially regarding the number and resources of active and of failed banks before 1900, make it impossible to make a definite estimate of the relative degree of safety enjoyed by the state banking systems, there is no doubt that, on the whole, a greater proportion of state banks has been involved in failure than of national banks. Irrespective of whether the comparison

is made by longer or shorter periods, and irrespective of whether or not we include the failures of savings banks and of private banks with those of state-chartered banks, it is found that the ratio of failed to active banks is without exception in favor of the national system.

From the point of view of safety there is considerable justification for holding that during the period 1900-1920 our banking system operated rather satisfactorily. Whatever its defects—inelasticity of the national bank note, immobility and decentralization of reserves, and lack of cooperation among the individual banks—it is clear that they were not immediately reflected in a high rate of insolvency. Panics, crises and depression years took their toll, but compared with 976 failures in 1926, the 22 failures in 1904 or the 156 failures in 1908 present a sharp contrast. However, it is significant that before as well as after 1900 national banks enjoyed a greater measure of safety than other banks. In "good" as well as "bad" years it was always the state and private banking system which made the worst showing.

To be in the banking business was, during the first two decades after the turn of the century, quite a safe and profitable occupation. Of course, the number of failures was substantial, and the amount of resources involved far from negligible, but generally, this was an era of banking prosperity. The cause of this prosperity is, however, no secret. There was a gradual and steady upward swing of the price level, with the result that the collateral held by the banks, and the net worth of the unsecured borrower constantly increased in value. This made the loan policy of most banks a simple matter. For a good number, especially for those in the country districts, an elementary knowledge of banking technique sufficed to ensure profitable operation. In not a few cases even such knowledge was absent, because liberal

charter policies enabled each and everyone to start a bank. There was, however, no immediate danger in this situation, because the passing of time alone sufficed to obliterate the disadvantages due to lack of banking training or experience. It became, therefore, almost impossible for a bank to fail. Those that failed were primarily the victims of downright dishonesty and grossly injudicious management. At least, of the 594 failures of national banks which occurred between 1865 and 1920, not less than 58 per cent were due to criminal and unlawful acts, while an additional 23 per cent were the result of injudicious acts. Only 14 per cent failed as the result of the depreciation of assets.⁶ A similar condition undoubtedly existed also in the state banking systems.

Since the absence of any great number of failures during these decades of expansion and "prosperity" was rather an accidental occurrence, it cannot properly be cited as evidence of the soundness and adequacy of the banking system as a whole. It is true that depositors enjoyed safety, and that stockholders were paid large dividends. But it is not less true that during these years the foundation was laid for future difficulties. The belief in the permanence of this fortuitous state of affairs predominated, and the majority of bankers, located as they were in more or less isolated communities, paid little attention to what was happening outside their immediate territory, and did not try to ascertain the trend of business and economic conditions in the country as a whole, let alone abroad. When war prosperity came, it was looked upon as a normal acceleration of the natural course of events, and the possibility of a reaction was seldom, if ever, considered. Outward signs probably justified this optimism, but a consideration of the extravagances that were being indulged in—the unlimited granting

⁶ *Annual Report of the Comptroller of the Currency, 1920, vol. i, p. 183.*

of charters to all applicants, resulting in admission to the banking fraternity of thousands of incompetent individuals and the establishment of a bank in practically every village or hamlet, the enactment of banking statutes of the flimsiest substance, and extreme laxity of supervision — would undoubtedly have resulted in the realization that it would be impossible to escape the consequences of such fair-weather banking.

CHAPTER III

BANK FAILURES, 1921-1933

DURING the first or post-war deflation and "prosperity" phase of the recent failure epidemic, i. e. between January 1, 1921 and December 31, 1929, a total of 5,714 banks with deposits of \$1,625,468,000 were closed on account of financial difficulties by the supervisory authorities or by the banks' directors, while between January 1, 1930 and March 6, 1933—the date on which a national bank-holiday was declared—5,522 banks with deposits of \$3,461,851,000 ceased operations. Including 42 banks with deposits of \$15,542,000 closed during the continuance of the holiday from March 6 to March 15, the epidemic involved, therefore, a total of 11,278 banks with deposits of \$5,102,861,000.

The number of banks which were not permitted to resume operations at the termination of the holiday, including banks permitted to operate on a restricted basis, was 4,507, with deposits of \$4,105,265,000. Including 221 licensed banks with deposits amounting to \$152,538,000 which were suspended between March 16 and December 30, 1933, the total number of banks closed on account of financial difficulties between January 1, 1921 and December 30, 1933, was therefore 16,006, with deposits of \$9,360,664,000.

The number of non-licensed banks placed in receivership by December 30, 1933 was 1,100, with deposits of \$1,894,700,000, while of the 11,212 banks suspended prior to March 1, 1933, a total of 9,559 with deposits of \$4,267,-

401,000 had been permanently closed. The total number of permanently closed banks was 10,659, with deposits of \$6,162,101,000.

The foregoing figures for suspended banks do not, obviously, include those banks which had not been suspended prior to their being absorbed by other institutions in order to prevent outright failure. Nor do the figures for banks placed in receivership or liquidation account for the 1,769 banks with deposits of \$1,042,942,000 which remained non-licensed at the end of 1933, or for the 221 banks suspended between March 16 and December 30, 1933¹ and which were put in liquidation. It should be added that neither for the period under consideration nor for any other period data are available regarding the number of banks absorbed by other institutions in order to prevent failure, although it should be noted that the 1,100 non-licensed banks placed in liquidation between March 16 and December 30, 1933, include banks absorbed or succeeded by other banks. There is little doubt that for a substantial portion of the 5,137 banks absorbed by other banks during 1921-1931,² impending insolvency was the immediate reason that prompted directors and stockholders to liquidate their institutions.

The number of national banks closed between January 1, 1921 and March 15, 1933 was 1,678. Including 1,400 banks which upon the termination of the banking holiday were refused a license, and 9 licensed banks suspended between March 16 and December 30, 1933, the total number of national banks suspended during 1921-1933 was, therefore, 3,087. These banks had deposits amounting to \$3,220,338,000.

¹ By the end of 1934 920 of these non-licensed banks with deposits of \$646,729,000 had been placed in liquidation or receivership. Only 190 banks remained non-licensed. See Tables 5 and 6.

² Chapman, John M., *Concentration of Banking* [New York, 1934], p. 56.

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TABLE 5

NUMBER OF SUSPENDED, REOPENED AND NON-LICENSED BANKS, 1921-1934

	All National		Banks other than National			
	Banks	Banks	Total	State Banks and Loan & Trust Co's	Private Banks	Mutual Savings Banks
<i>Suspended Banks</i>						
1921	505	52	453	409	44	—
1922	367	49	318	294	23	1
1923	646	90	556	533	23	—
1924	775	122	653	616	37	—
1925	618	118	500	461	39	—
1926	976	123	853	801	52	—
1927	669	91	578	545	33	—
1928	499	57	442	412	19	1
1929	659	64	595	564	31	—
1930	1,352	161	1,191	1,131	58	2
1931	2,294	409	1,885	1,804	80	1
1932	1,456	276	1,180	1,140	37	3
[sub-total]	10,816	1,612	9,204	8,716	476	8
1933						
January and February	396	64	332			
March 1-4	24	—	24			
March 5-15	42	2	40			
[total]	11,278	1,678	9,600			
March 16-Dec. 30 ^a	221	9	212			
Non-licensed banks ^b	4,507	1,400 ^c	3,107			
Grand Total	16,006	3,087	12,919			
<i>Suspended Banks Reopened</i>						
Jan. 1, 1921-Mar. 1, 1933 ..	1,653	166	1,487			
<i>Non-Licensed Banks Closed^a</i>						
March 16-Dec. 30, 1933 ...	1,100	464 ^e	636			
Jan. 1, 1934-Dec. 31, 1934 .	920	396	524			
<i>Non-Licensed Banks^b</i>						
March 16, 1933 ^a	1,621	1,400 ^c	221			
April 12, 1933	4,215	1,108 ^e	3,107			
Dec. 30, 1933	1,769	452 ^c	1,453			
Dec. 31, 1934	190	6 ^f	184			
<i>Licensed Banks Suspended^a</i>						
Jan. 1-December 31, 1934 ^g	56	1	55			

^a Licensed banks suspended [includes banks placed in liquidation or receivership, and banks placed on a restricted basis; excludes banks reported as having been absorbed, or succeeded by, or consolidated or combined with, other banks].

^b Banks operating on a restricted basis or not in operation, but not placed in liquidation or receivership. National banks as of March 16, State banks as of April 12, 1933.

^c The Comptroller reports that as of March 16, 1933 the affairs of 1,436 national banks had not been disposed of. This number is made up of 1,088 non-licensed banks, 10 State banks in the District of Columbia, 5 national banks for which licenses were granted prior to March 16, but later revoked, 1 national bank for which a license was granted after March 16, but later revoked, 1 national bank which suspended prior to the banking holiday, and 341 non-licensed banks which were either licensed without the appointment of a conservator, or placed in receivership, or went in liquidation. By December 30, 1933, 490 banks with deposits of \$562,806,477 had been licensed; 338 banks with deposits of \$791,014,099 placed in receivership; 445 banks with deposits of \$416,701,701 remained non-licensed; and 163 with deposits of \$226,122,731 went otherwise in liquidation; making a total of 1,436 banks with deposits of \$1,996,645,008. [Deposits for 341 banks as of December 12, 1933, for 1,095 banks as of first report of conservators].

^d Non-licensed banks placed in liquidation or receivership [includes non-licensed banks absorbed or succeeded by other banks].

^e Member banks of the Federal Reserve System.

^f The disposition made of 1,417 national banks with deposits of \$1,971,960,000 [see note c] was as follows: 1,088 banks with deposits of \$1,802,086,000 were reorganized under old or new charter or sold to other national banks; 30 banks with deposits of \$11,204,000 had left the system; 287 banks with deposits of \$148,511,000 had had their reorganization plans disapproved of and been placed in receivership; 7 banks in receivership, with deposits of \$3,537,000, had approved plans, while the disposition of 5 banks with deposits of \$6,622,000 was pending.

^g Insured banks numbered 9 [1 national bank and 8 state banks], with deposits totaling \$1,861,000, of which \$924,000 was insured.

Source: *Annual Report of the Federal Reserve Board, 1933*; *Annual Report of the Comptroller of the Currency, 1933*; *Federal Reserve Bulletins*, and official releases.

AMERICAN BANK FAILURES

TABLE 6
DEPOSITS OF SUSPENDED, REOPENED AND NON-LICENSED BANKS, 1921-1934
[in thousands of dollars]

	All Banks	National Banks	Banks other than National			
			Total	State Banks & Loan & Trust Co's	Private Banks	Mutual Savings Banks
<i>Suspended Banks</i>						
1921	172,188	20,777	151,411	142,522	8,889	—
1922	93,043	20,197	72,846	69,077	1,908	1,861
1923	149,601	34,244	115,357	113,584	1,773	—
1924	210,151	64,890	145,261	137,533	7,728	—
1925	167,555	55,574	111,981	104,430	7,551	—
1926	260,378	43,998	216,380	206,983	9,397	—
1927	199,329	45,547	154,782	149,445	4,337	—
1928	142,580	36,483	104,097	102,957	2,946	194
1929	230,643	41,614	189,029	181,317	7,712	—
1930	853,363	170,446	682,917	651,388	15,262	16,267
1931	1,690,669	439,171	1,251,498	1,229,904	21,157	437
1932	715,626	214,150	501,476	484,232	7,806	9,438
[sub-total]	4,885,126 ^h	1,187,091	3,698,035 ^h	3,573,372	96,466 ^h	28,197
1933						
January and February ...	198,905	71,802	127,103	—	—	—
March 1-4	3,288	—	3,288	—	—	—
March 5-15	15,542	1,381	14,061	—	—	—
[total]	5,102,861	1,260,274	3,842,387	—	—	—
March 16-Dec. 30 ^a	152,538	17,490	135,048	—	—	—
Non-licensed banks ^b	4,105,265	1,942,574 ^c	2,162,691	—	—	—
Grand Total	9,360,664	3,220,338	6,140,326	—	—	—
<i>Suspended Banks Reopened</i>						
Jan. 1, 1921-Mar. 1, 1933 ..	816,630	116,952	699,678	—	—	—
<i>Non-Licensed Banks Closed^a</i>						
Mar. 16-Dec. 30, 1933	1,894,700	966,676 ^c	928,024	—	—	—
Jan. 1, 1934-Dec. 3, 1934 ..	646,729	401,983	244,746	—	—	—
<i>Non-Licensed Banks^b</i>						
March 16, 1933 ^a	2,866,751	1,942,574 ^c	924,177	—	—	—
April 12, 1933	3,981,232	1,818,541 ^c	2,162,691	—	—	—
Dec. 30, 1933	1,024,942	434,078 ^c	589,964	—	—	—
Dec. 31, 1934	96,344	6,815 ^f	89,529	—	—	—
<i>Licensed Banks Suspended^a</i>						
Jan. 1-Dec. 31, 1934 ^g	36,944	40	36,904	—	—	—

Notes: a-g, see Table 5.

h excludes deposits of 112 private banks. See Table 11.

Source: See preceding Table.

State banks, including mutual savings banks and private banks, to the number of 9,600 with deposits of \$3,842,587,000, suspended operations between January 1, 1921 and March 15, 1933. Including 3,107 non-licensed banks [as of April 12, 1933; no figures are available for March 16], and 212 licensed banks suspended between March 16 and December 30, 1933, the total number of banks other than national suspended during 1921-1933 was 12,919, with deposits of \$6,140,326,000.

SUSPENSIONS, 1921-1932

The average number of banks annually suspended during 1921-1929 was 635, or 2.25 per cent of the average number of annually reported banks. This average compares with 1,352 suspensions during 1930, 2,294 suspensions during 1931, and 1,456 during 1932. The total number of suspensions, namely 10,816, represented 40.4 per cent of the average number of banks during the period, and 35.1 per cent of the number reported on June 30, 1921.

Deposits of banks suspended during 1921-1929 constituted 3.5 per cent of average deposits of active banks. During 1930-1932 the average was 6.53 per cent. Deposits of banks suspended during 1931 alone represented 3.25 per cent of active deposits on June 30. Total deposits involved in suspension during 1921-1932 constituted over 10 per cent of average annual deposits.

NATIONAL AND STATE BANK SUSPENSIONS COMPARED

Of the 10,816 banks suspended during 1921-1932, 1,612 were national banks and 9,204 state-chartered and private banks, with deposits of \$1,187,091,000 and \$3,698,035,000, respectively. The number of national bank failures represented 21 per cent of the average number of annually active national banks, while their deposits represented over 6 per

cent of the average amount of annually active deposits. For banks other than national the corresponding percentages were 48.1 and 11.8. They indicate that the proportion of active state banks closed was about two and a half times, and the proportion of active deposits tied up about twice, as large as the similar proportions for national banks. The average number of annual suspensions per 1,000 active banks was 18 for the national system and 40 for the state banking systems [Table 7].

TABLE 7
PERCENTAGE OF ACTIVE BANKS AND ACTIVE DEPOSITS SUSPENDED,
1921-1932

	Suspended Banks per cent of Active Banks			Suspended Deposits per cent of Active Deposits on June 30
	All Banks	Nat'l Banks	State Banks	All Banks
1921	1.6	.6	2.0	.48
1922	1.3	.6	1.4	.25
1923	2.1	1.1	2.5	.37
1924	2.6	1.5	3.1	.49
1925	2.2	1.5	2.4	.35
1926	3.5	1.5	4.2	.52
1927	2.5	1.2	3.0	.38
1928	1.5	.7	2.4	.27
1929	2.6	.8	3.4	.42
1930	5.6	2.2	7.1	1.54
1931	10.4	6.0	12.1	3.25
1932	7.6	4.5	8.7	1.70
total ^a	40.4	21.0	48.1	10.02
average ^a ...	3.4	1.8	4.0	.84

^a weighted.

Constructed from data abstracted from the *Annual Reports of the Comptroller of the Currency* and of the *Federal Reserve Board*.

SIZE OF SUSPENDED BANKS

The banks which suspended during 1921-1932, and especially during 1921-1929, were for the most part relatively small institutions, average deposits per suspended bank amounting respectively to \$639,000 and \$285,000. If the 10,693 national and state-chartered banks which suspended during 1921-1932 are classified according to the size of their

capital stock, it appears that 34.2 per cent had less than \$25,000 capital, while 85.1 per cent had less than \$100,000 capital. The corresponding percentages for suspensions during 1921-1929 were 39 and 88, and during 1930-1932 28 and 79, indicating that after 1930 there was a notable shift toward failure among the larger banks.

The suspended banks with less than \$25,000 capital were all state-chartered banks, and represented 40.2 per cent of all suspended state banks. Seventy-one per cent of the national banks which suspended had less than \$100,000 capital, as against 87.6 per cent of the state banks.

TABLE 8
NUMBER AND PERCENTAGE DISTRIBUTION OF BANKS SUSPENDED, CLASSIFIED ACCORDING TO CAPITAL STOCK, 1921-1932^a

<i>Banks having capital stock of</i>	<i>All banks</i>		<i>National banks</i>		<i>State banks</i>	
	<i>number</i>	<i>per cent</i>	<i>number</i>	<i>per cent</i>	<i>number</i>	<i>per cent</i>
under \$25,000	3,652	34.2	—	—	3,652	40.2
\$25,000	2,436	23.3	493	30.6	1,993	22.0
\$25,001-49,999	999	9.3	141	8.8	858	9.5
\$50,000-99,999	1,960	18.3	511	31.7	1,449	15.9
\$100,000-199,999	968	9.0	284	17.6	684	7.5
\$200,000-999,999	565	5.3	170	10.5	395	4.3
\$1,000,000 and over	63	.6	13	.8	50	.6
total	10,693	100.0	1,612	100.0	9,081	100.0

^a excluding 123 private banks, the capital stock of which was not known.

Source: *Annual Report of the Federal Reserve Board*, 1933, p. 222.

SUSPENSIONS BY SIZE OF COMMUNITY

By far the greater proportion of failures during 1921-1932 occurred in the smaller communities. Again, the situation during 1921-1929 was somewhat different than from that in 1930-1932, 39 per cent of the failed banks during the former period being located in communities with less than 500, and 79 per cent in those with less than 2,500 inhabitants, as against 30 and 67 per cent, respectively, during 1930-1932. However, the fact remains that throughout the entire period the smaller communities were particularly hard

hit, not less than 3,777 failures, or 34.9 per cent, occurring in communities with less than 500 population, and 7,964, or 73.7 per cent, in those with less than 2,500 population. Of the 3,153 banks suspended during 1921-1931 in places with less than 500 inhabitants, 2,982 banks, or 94.6 per cent, were state banks. The corresponding figures for communities with less than 2,500 population were respectively 6,840, 5,806, or 87.4 per cent.

TABLE 9
NUMBER AND PERCENTAGE DISTRIBUTION OF SUSPENDED BANKS,
1921-1932

Places with population of	Number	Per cent
under 500	3,777	34.9
500-1,000	2,092	19.4
1,000-2,500	2,095	19.4
2,500-5,000	932	8.6
5,000-10,000	533	4.9
10,000-25,000	479	4.4
25,000 and over	908	8.4
total	10,816	100.0

Source: Constructed from data abstracted from the *Annual Report of the Federal Reserve Board*, 1933, p. 222.

NUMBER OF SUSPENDED AND ACTIVE BANKS
COMPARED, BY SIZE

Table 10, which lists separately for national and state banks classified according to size of capital stock the percentages of active banks which failed provides an answer to the question whether failure has been more frequent among the smaller than among the larger banks. It shows that the rate of failure during 1930-1932 was identical among the two groups of largest national banks, and was slightly larger among the group of largest state banks than among the next lower-size group, but that for these exceptions the record was decidedly in favor of the larger banks. Failure was especially frequent among [state] banks with less than \$25,000 capital. During 1921-1929 the rate of failure for

these banks was six times larger, and for state banks with \$25,000 capital, four times larger than for the group of largest state banks. Among national banks the average number of banks annually suspended during 1921-1932 was 24 banks per 1,000 active banks in the \$25,000 group, 19 in the \$25,001-\$99,999, 12 in the \$100,000-\$199,999, and 10 in the group of banks with capital of \$200,000 or more. Among state banks the corresponding number were 44, 38, 22, and 19. State banks with less than \$25,000 capital failed at the rate of 50 banks annually per 1000 active banks.

TABLE 10

NUMBER OF BANK SUSPENSIONS AS A PERCENTAGE OF ACTIVE BANKS,
FOR NATIONAL AND STATE BANKS CLASSIFIED ACCORDING
TO SIZE OF CAPITAL STOCK, 1921-1932

Bank with capital stock of	1921-1929		1930-1932		1921-1932	
	Nat'l banks	State banks	Nat'l banks	State banks	Nat'l banks	State banks
less than \$25,000	—	3.7	—	10.8	—	5.0
\$25,000	1.5	2.8	4.8	10.1	2.4	4.4
\$25,001-\$99,999	1.4	2.5	4.4	9.5	1.9	3.8
\$100,000-\$199,999 . . . . .	.6	1.4	3.4	6.8	1.2	2.2
\$200,000 and over . . . . .	.37	.6	3.4	7.2	1.0	1.9
less than \$100,000	1.45	3.07	4.6	10.1	2.2	4.6
\$100,000 and over . . . . .	.50	1.37	3.4	7.0	1.1	2.1

Source: Compiled from data abstracted from the *Annual Reports of the Comptroller of the Currency* and of the *Federal Reserve Board*, from *Individual Statements of Condition of National Banks*, and from *House Banking and Currency Committee Hearings on H. Res. 141*, pp. 1031-1032.

A comparison of the rate of failure among banks with less than \$100,000 capital, and with \$100,000 or more, shows that the rate among national banks during 1921-1929 was nearly three times larger for the former than for the latter group, and among state banks about two and a half times larger. During 1930-1932 the differences were less pronounced, but the averages for the twelve-year period indicate that for both systems failure was relatively twice as frequent among the smaller than among the larger banks.

The table further reveals that the higher rate of insolvency among state banks generally, as compared with national banks, is not entirely accounted for by the high rate among state banks with less than \$25,000 capital. Even for groups of banks of identical size, failure has been far more frequent among state than among national banks. During 1921-1929 state banks in the \$100,000-\$199,999 group failed at approximately the same rate as national banks in the \$25,000 and in the \$25,001-\$99,999 groups, while during 1930-1932 they failed at a far more rapid rate. A twelve-year average of 19 failures per 1000 active banks was recorded by state banks with capital of \$200,000 or more, as well as by national banks in the \$25,001-\$99,999 class, while the average of 22 failures among national banks with less than \$100,000 capital was only slightly larger than for state banks with capital of \$100,000 or more, which recorded an average of 21 failures.

GEOGRAPHICAL DISTRIBUTION OF SUSPENSIONS

The four regions of the country which had the largest number of failures were the Western Grain, North Central, Southeastern and Southwestern, with 39.1, 16.6, 15.0 and 10.6 per cent of the total number of suspensions, respectively. However, from the point of view of deposits, conditions were worst in the Middle Atlantic, Western Grain, North Central and Southeastern states, suspensions in these states accounting respectively for 23.5, 21.2, 18.2 and 12.2 of all suspended deposits during 1921-1932. The distribution of the number of suspensions and of suspended deposits for the several regions is shown in Table II.³

³ For a classification of states by regions, see Table 13. This classification is adapted from Professor Stockder's study of Bank Failures in the *Banking Inquiry of 1925*.

	Number	Deposits
New England .....	.7	5.2
Middle Atlantic	4.0	23.5
North Central	16.6	18.2
South Mountain	4.7	5.2
Southeastern	15.0	12.2
Southwestern	10.6	6.5
Western Grain	39.1	21.2
Rocky Mountain	6.0	3.6
Great Basin .....	.6	.9
Pacific Coast	2.6	3.5
total	100.0	100.0

If account is taken of the number of active banks in these regions, it is found that for each of the following regions, namely the Southeastern, Western Grain, Rocky Mountain, and Great Basin regions, the proportion of all banks

TABLE 11
NUMBER AND DEPOSITS OF SUSPENDED BANKS, 1921-1932, BY GEOGRAPHIC REGIONS
(Amounts in thousands of dollars)

REGION	NUMBER					DEPOSITS				
	Total	National banks	State banks	Private banks	Mutual sav-ings banks	Total	National banks	State banks	Private banks	Mutual sav-ings banks
New England...	72	12	46	2	5	254,488	47,967	173,900	5,215 ^a	27,406
Middle Atlantic...	431	149	228	53	1	1,146,378	224,473	900,175	21,538 ^b	194
North Central...	1,797	232	1,415	149	1	887,016	215,947	646,507	24,125 ^c	437
South Mountain...	510	74	434	2	—	253,802	102,271	151,501	30 ^d	—
Southeastern....	1,626	177	1,413	36	—	597,304	140,110	455,654	1,560 ^e	—
Southwestern...	1,148	214	850	84	—	317,421	106,696	199,415	11,310 ^f	—
Western Grain...	4,230	492	3,601	156	1	1,034,093	206,081	798,037	29,815 ^g	160
Rocky Mountain	653	173	475	7	—	178,658	71,070	104,715	2,875	—
Great Basin	66	6	60	—	—	45,457	7,530 ^h	37,927	—	—
Pacific Coast....	283	83	200	—	—	170,509	64,946	105,563	—	—
United States...	10,816	1,612	8,720	476	8	4,885,126	1,187,091	3,573,372	96,456 ^h	28,197

Notes a-h: Deposit figures not available, and therefore not included in the amounts listed for the following number of banks: a] 2, b] 16, c] 19, d] 1, e] 14, f] 31, g] 19, and h] 102, total.

Source: *Annual Report of the Federal Reserve Board, 1933, pp. 207-221.*

suspended during 1921-1932 was larger than the proportion of active banks reported on June 30, 1921. As a group, these states accounted for 6,575 suspensions, or 60.7 per cent of the country's total of 10,816, and for 13,500 active banks, or 43.9 per cent of the 30,746 banks in the Continental United States in 1921.

The percentage of active banks which failed was largest in the Rocky Mountain and the Southeastern States, the total number of suspensions in these two regions representing respectively 68.4 and 68 per cent of the average number of yearly active banks. The Western Grain States followed closely with a rate of 56.9 per cent, the Great Basin States with 44.4 per cent, and the Southwestern States with 41 per cent. Failure was mildest in the New England and Middle Atlantic States with rates of 6.7 and 12.2 per cent, respectively. [Table 12, col. 1].

TABLE 12
PERCENTAGE OF ACTIVE BANKS SUSPENDED, 1921-1932,
BY GEOGRAPHIC REGIONS

	<i>Suspensions during 1921-1932 in per cent of average number of yearly active banks</i>	<i>Average number of yearly suspended banks in per cent of average number of yearly active banks</i>	
		<i>1921-1929</i>	<i>1930-1932</i>
New England	6.7	.16	1.8
Middle Atlantic	12.2	.25	3.5
North Central	32.4	.86	9.2
South Mountain	26.5	1.0	6.4
Southeastern	68.0	4.1	13.2
Southwestern	41.0	2.6	6.7
Western Grain	56.9	3.7	9.4
Rocky Mountain	68.4	5.6	6.3
Great Basin	44.4	1.6	11.2
Pacific Coast	23.8	1.7	5.3
United States	39.8	2.2	7.6

A comparison of the situation during 1921-1929 and 1930-1932 is afforded by the percentages in columns 2 and 3 of this table. These percentages have been calculated on an

annual basis, i. e. they represent the average number of annual failures per 100 active banks. It appears that the increase in failures was largest in the New England, Middle Atlantic and North Central States, but only in the latter region did the epidemic after 1929 assume proportions approaching those of the worst affected states.

TABLE 13
AVERAGE PERCENTAGE OF ACTIVE BANKS ANNUALLY SUSPENDED
DURING 1921-1932, BY STATES

<i>Region</i>	<i>Region</i>	<i>Region</i>
New England ... .56	South Mountain . 2.21	Western Grain .. 4.71
Maine ..... .29	Virginia 1.87	Minnesota 3.99
N. Hampshire . .27	West Virginia 2.77	North Dakota . 8.25
Vermont ..... .15	Kentucky 1.96	South Dakota . 9.31
Massachusetts . .59	Tennessee 2.46	Iowa 5.49
Rhode Island .. .63		Nebraska 4.66
Connecticut ... .93	Southeastern 5.67	Missouri 3.50
	N. Carolina ... 5.12	Kansas 2.61
	S. Carolina ... 8.22	
Middle Atlantic . 1.02	Georgia 6.43	Rocky Mountain 5.70
New York .... .74	Florida 7.80	Montana 7.73
New Jersey ... .84	Alabama 2.90	Idaho 5.61
Pennsylvania .. 1.24	Mississippi ... 4.06	Wyoming 5.47
Delaware ..... .45		Colorado 3.61
Maryland ..... .96	Southwestern ... 3.42	New Mexico .. 7.09
D. of Columbia .29	Louisiana 2.21	Arizona 6.67
	Texas 2.66	
North Central ... 2.70	Arkansas 5.75	Pacific Coast ... 1.98
Michigan 3.19	Oklahoma 3.90	Washington ... 2.48
Wisconsin 1.85		Oregon 2.78
Illinois 3.30	Great Basin 3.70	California 1.29
Indiana 3.00	Utah 3.33	
Ohio 1.75	Nevada 5.07	United States ... 3.32

No analysis of the geographic distribution of bank suspensions should fail to point out that there were also wide differences in the rates of insolvency as between the several states of the same region. For instance, during 1921-1929 rates of 7.1, 1.1, and 1.0 per cent were recorded respectively for South Carolina, Mississippi, and Alabama in the Southeastern region, of 8.1, 2.2, and 2.0 per cent respectively for South Dakota, Missouri, and Kansas in the Western Grain region, and 8.0 and 3.0 per cent respectively for Montana

and Idaho in the Rocky Mountain region. During 1930-1932 New Mexico and Wyoming in the Rocky Mountain region recorded the annual failure respectively of 1.3 and 2.0 per cent of their active banks, but the percentage for Arizona was 14.3. Among the North Central States the percentage of 12.3 for Illinois may be contrasted with that of 5.1 for Wisconsin. The avalanche of failures during 1930-1932 caused in several instances the disappearance of the differences noted in connection with failures during 1921-1929, but a perusal of Table 13, which lists for each state the percentage of active banks which annually failed during the twelve-year period, shows that the leveling process had by no means been universal.

OVERBANKING AND BANK FAILURE

In conclusion, it should be noted that these failures largely reflect the weakening effect upon the banking structure of the establishment prior to 1921 of the establishment of an excessive number of banks. An idea of the relationship between the overbanked condition and bank failure is afforded by noting for each state the number of inhabitants per bank and the rate of bank insolvency. (Table 14).

From the accompanying graph it appears that the proportion of active banks which suspended during 1921-1929 was generally lowest in those states which, relative to number of inhabitants, had, in 1920, the lowest number of banks, and was highest in those states which had abundant banking facilities.

TABLE 14

NUMBER OF INHABITANTS PER BANK, AND BANK FAILURE, BY STATES

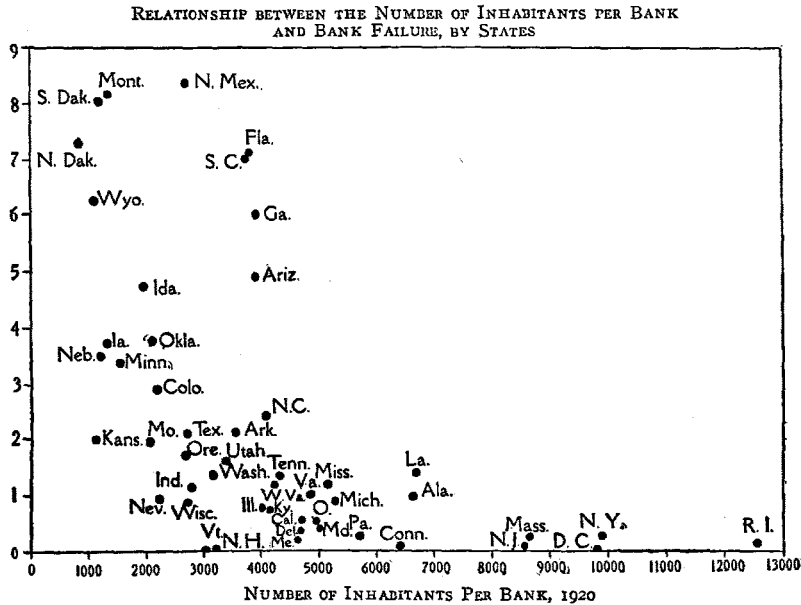
State	Number of inhabitants per bank [1920]	Average percentage of active banks annually suspended 1921-1929	State	Number of inhabitants per bank 1929	Average percentage of active banks annually suspended 1921-1929
Rhode Island	12,625	.08	Arkansas	3,611	2.25
New York	9,929	.22	New Hampshire	3,552	.09
D. of Columbia	9,778	.0	Washington	3,467	1.63
Massachusetts	8,350	.15	Utah	3,398	1.75
New Jersey	8,242	.07	Vermont	3,259	.0
Louisiana	6,760	1.50	Texas	2,973	2.23
Alabama	6,666	1.00	New Mexico	2,943	8.34
Connecticut	6,336	.14	Oregon	2,845	1.79
Pennsylvania	5,687	.27	Indiana	2,781	1.19
Michigan	5,300	.95	Wisconsin	2,711	.85
Maryland	5,177	.49	Colorado	2,347	2.98
Ohio	5,054	.56	Nevada	2,333	.96
Mississippi	5,053	1.14	Oklahoma	2,132	3.72
California	4,824	.55	Missouri	2,063	2.15
Delaware	4,787	.39	Idaho	1,964	4.76
Maine	4,776	.23	Minnesota	1,585	3.41
Virginia	4,745	.99	Iowa	1,368	3.69
West Virginia	4,332	1.11	Kansas	1,315	1.98
Tennessee	4,293	1.35	Montana	1,288	8.16
Kentucky	4,147	.80	Wyoming	1,225	6.34
N. Carolina	4,135	2.45	Nebraska	1,088	3.58
Illinois	4,058	.82	South Dakota	919	8.11
Georgia	3,942	6.04	North Dakota	722	7.24
Arizona	3,885	4.99			
Florida	3,679	7.09			
South Carolina	3,665	7.05	United States	3,538	2.21

* Number of banks as of June 30, 1920. 1920 Census figures.

Some conclusions which may be drawn from the foregoing analysis are as follows:

1. By far the greater proportion of banks suspended during 1921-1932 were small banks, although after 1929 there was a distinct tendency toward failure among the larger banks.
2. The smaller communities have been particularly affected by bank failure.

VERAGE PERCENTAGE OF ACTIVE BANKS
ANNUALLY SUSPENDED, 1921-1929



3. In proportion to the number of active banks, failure was about two and a half times more frequent among the state banking systems than among the national banking system.

4. The larger institutions have shown a greater immunity to failure than the smaller institutions. Our banking system has been unable to provide adequate and safe banking facilities for the country districts.

5. The higher rate of failure among the state banks is only partly accounted for by the high rate among banks with less than \$25,000 capital.

6. The agricultural and livestock sections of the country have shown a high rate of bank insolvency. After 1929 bank failure became more and more diffused over the entire country.

7. A fundamental weakness of our banking structure has been the establishment of an excessive number of banks.

CHAPTER IV

LIQUIDATION OF NATIONAL BANKS

ONE aspect of bank failures regarding which there has been much misunderstanding in the past is the question of the losses inflicted upon depositors as the result of the liquidation of their banks.¹ It is the purpose of the present chapter to throw some light on this question, particularly as regards national banks.

Considerable information regarding the progress and results of liquidation of failed national banks is found in the *Annual Reports of the Comptroller of the Currency*. The more pertinent data are available for banks individually, as well as in summarized form, for: 1. all banks for which receivers have been appointed since 1865 [includes completely liquidated banks as well as banks still in liquidation]; 2. banks the receiverships of which are still uncompleted; 3. all completed receiverships since 1865; and 4. all receiverships completed during the report year. It is apparent that an analysis of the data under sub 3 and sub 4 suffices for the present enquiry.

To introduce the discussion, the following statement covering the results of liquidation of all receiverships closed between 1865 and October 31, 1928 [above, sub 3] is quoted from the Comptroller's Report for the year ending October, 1928:

¹ See the Hearings before the House Banking and Currency Committee pursuant to H. Res. [10241] 11362, a Resolution to Provide a Guaranty Fund for Depositors in Banks [72nd Congress, 1st Session]. See note 6, *infra*.

712 Receiverships closed 1865-October 31, 1928

Total assets taken charge of by the receiver \$469,551.622

Disposition of Assets:

Collected from assets, including offsets allowed [unsecured creditors], and, for accounting purposes, dividends paid secured creditors for all trusts finally closed October 1, 1924 to October 31, 1928	282,043,340
Loss on assets compounded or sold by court order	171,339,184
Book value of assets returned to stockholders ..	16,169,098
	<u>469,551,622</u>

Collected from assets, etc., as above 282,043,340

Collected from stock assessments 28,082,885

Total collections 310,126,225

Disposition of Collections:

Dividends paid [secured and unsecured creditors] on [their] claims proved aggregating \$249,634,906	180,626,033
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Payments to secured and preferred creditors, including offsets allowed [unsecured creditors], payments for the protection of assets, [and, for accounting purposes, dividends paid secured for all trusts finally closed October 1, 1924 to October 31, 1928].	105,451,360
--	-------------

Receivers' salaries, legal and other expense . . .	20,235,434
--	------------

Cash returned to stockholders	3,813,398
---	-----------

\$310,126,225

"The average percentage of dividends paid [secured and unsecured creditors on their proved claims] against the 782 receiverships that have been finally closed, not including the 70

restored to solvency, which paid creditors 100 per cent," noted the Comptroller, "was 72.36 per cent. If offsets allowed [unsecured creditors], loans paid, and other disbursements were included in the calculation the disbursements to creditors would show an average of 80.57 per cent."²

The percentage of 80.57 would, on first consideration, seem to indicate that the average return to depositors had been about 80 cents on the dollar. Indeed, this percentage in connection with a statement made by the Comptroller in 1929 that between July 1, 1920 and June 30, 1929 about 5000 banks with deposits of about \$1,500,000,000 had gone into receivership, and that these figures do not include 500 suspended banks which reopened after reorganization, often resulting in depositors and shareholders voluntarily suffering some loss,³ elicited from one writer the emphatic statement:

The impression of losses to *depositors* which the figure of the Comptroller *suggests* runs away with the facts. American *depositors* have not lost a billion and a half dollars. Nor are they likely to lose a billion and a half dollars. The figure represents the deposits of the banks which failed and takes no account of the payments which liquidation will provide. Of the 782 receiverships closed during 1865-1928 70 were restored to

² pp. 14, 15. [Insertions supplied].

Offsets of unsecured deposits are indicated as "offsets," while offsets of secured deposits, if any, are included in Collections from Assets and in Loans Paid. [An "offset" is that part of an obligation to the bank which is cancelled by the debtor's release of a corresponding amount of his claim upon the bank.]

For an explanation of the inclusion in Collections, as well as in Payments to Secured and Preferred Creditors, of Dividends Paid Secured Creditors for all trusts closed October 1, 1924 to October 31, 1928, see note 7, *infra*. Payments to Secured and Preferred Creditors, including Offsets to Unsecured Creditors [corresponding to the amount of \$105,451,360 in the statement quoted], are in the further discussion referred to as "other payments."

³ *Ibid.*, p. 2, and note 1.

solvency and paid their *creditors* in full with no other loss than that of inconvenience. For the remainder the *creditors* received 80.57 cents on the dollar. If this ratio to losses is maintained for the state and national banks now in process of liquidation or reorganization, then the final net loss to our *depositors* on account of bank failures will not exceed ten per cent of the crushing burden *suggested* above . . . ⁴

Likewise, according to the Oklahoma Banking Commissioner, losses to the 7,264,957 depositors of banks suspended during 1921-1929 would amount to only twenty dollars per head, the Commissioner stating in his testimony before the House Banking and Currency Committee during its hearings held in the early part of 1930:

Mr. Pole, the Comptroller of the Currency states that the recovery by depositors of failed national banks equals 80 per cent; in other words, the loss was 20 per cent. Since the average

⁴Lawrence, J. S., *Banking Concentration in the United States* [New York, 1929], pp. 102, 103. [Italics supplied.]

See further an article by the same writer entitled "What is the Average Recovery of Depositors?" [*American Bankers Association Journal*, February, 1931] in which it was remarked: "It is high time that a few rays of truth be focused upon this confused stage. The bankers seem prey for a host of facile thinkers seeking some scapegoat upon whom to unload that sense of personal inadequacy and fault which always accompany misfortune. . . . To those who know nothing of the liquidation of failed banks the deposits involved in bank failure convey the impression of losses to depositors. A study of national bank failures and subsequent liquidation since the Civil War reveals the fact that *depositors* on the average recovered about 90 cents on the dollar" [pp. 655, 722]. [Italics supplied.]

On the basis of \$1,271,263,000 deposits of suspended banks which went into liquidation, and of \$215,878,000 deposits of suspended banks which were reopened [figures for the period 1921-1928, *Annual Report of the Federal Reserve Board*, 1929, p. 123] a simple calculation will show that if 80 per cent were recovered on the former amount, and 100 per cent on the latter, total losses would still amount to 17.1 per cent of all deposits involved in suspension, and not to only 10 per cent.

deposit per customer in these failed banks was \$234, of which 80 per cent was recovered, the average loss per depositor had been only \$46.80. The fact that seven and one quarter millions of people or 15 [sic] per cent of the population—and I am just approximating these figures—incur a loss of twenty dollars per head by reason of their deposits in failed banks is not so alarming as we might think, and creates no banking situation demanding a change.^{5 6}

⁵ Hearings pursuant to H. Res. 141, pp. 1572 *et seq.*

The final estimate of \$20 per head [or 8 cents on the dollar] was probably intended to reflect the effect of full recovery by depositors of reopened banks.

It is apparent that the Oklahoma Commissioner fell considerably short of the stated purpose of his appearance before the Committee "... I desire the Committee to understand that the references I make are for the sole purpose of throwing light on the merits of the subject under investigation..." Is it not pertinent to ask why the Commissioner from a State in which over 200 state banks had failed during 1921-1929, should impute to the Comptroller the statement that "depositors of national banks had recovered 80 cents on the dollar," and use this figure as the basis for his estimate, instead of presenting some information regarding the liquidation results of the banks under his immediate supervision? "Of course," remarked the witness further, "my source of information comes solely from my knowledge of State banks in Oklahoma..." From the testimony it is apparent that the Commissioner succeeded very well in keeping this knowledge to himself. There was just one fleeting moment during which it seemed as if some of this knowledge might be prised loose. This occurred when Committee member Brand undertook to question the witness, part of the colloquy being as follows:

Mr. Brand: Where were you born?

Mr. Shull [Oklahoma Banking Commissioner]: In Missouri.

Mr. Brand: I thought you made a good showing this morning in regard to the small amount of losses sustained by individual depositors.

Mr. Shull: I just took the figures themselves and analyzed them.

Mr. Brand: And I am not questioning them, but in our State [Georgia] the losses were much heavier. What do your agricultural people grow in your county? [*Ibid.*, p. 1597.]

But the opportunity was lost, none of the Committee members realizing that Mr. Shull had not been talking at all about the losses to depositors in *his* State. So the presentation of irrelevant testimony merrily con-

Unfortunately, the percentage of 80.57 refers neither to the recovery made by *depositors*, nor to the yield of receiverships completed since 1920, but to the "average recov-

tinued, the Committee members being regaled with the Commissioner's observation that "branch banking is alright for the people who are accustomed more or less to a monarchical form of government," and the suggestion that the Committee investigate whether or not a branch bank had failed in California. [*Ibid.*, p. 1601.]

The fact is that 46 Oklahoma State banks (during 1921-1930) paid depositors 43.0 per cent on their claims (incl. offsets, 47.4 per cent). See ch. v, *infra*.

* Similar references to, and interpretations of, the data in the Comptroller's Reports were made at the Hearings on H. Res. 141 [1930]. One estimate was that the maximum losses to depositors from the foundation of the national banking system to 1930 was around \$80,000,000 [*ibid.*, pp. 73-79, 567, 568], and although a more correct interpretation by Governor Young indicated that receiverships closed during 1865-1929 alone had already caused losses of about \$120,000,000, and that receiverships pending at the end of 1929 would result in the loss of an additional \$90,000,000 [*ibid.*, pp. 568, 591-593], it was again held at the Hearings on H. Res. [10241] 11362 [1932] that the Comptroller had testified that total losses to national bank depositors during 1865-1929 had amounted to only \$82,000,000 [*ibid.*, pp. 5, 67]. Former Senator Owen quoted the Comptroller's Report for 1931 [p. 31] in support of his estimate that national bank depositors had lost only \$55,000,000 during 1865-1931. One witness arrived at a total of about \$67,000,000 by deducting the amount of dividends paid by pending as well as closed receiverships as of October 1930 from the deposits of these receiverships [*ibid.*, p. 67], while another estimated the total loss at \$50,000,000 [*ibid.*, p. 207]. Representative Hastings of Oklahoma quoted the dividend percentage of 74.71 and the total payment percentage of 80.95 in connection with receiverships closed during 1865-1927 in support of his estimate that a 25 per cent deposit guarantee would cover the losses to depositors [*ibid.*, p. 136]. A similar estimate was put forward by the head of a contracting and flooring firm [A. Mehrbach], who also stated that according to the Comptroller's Report for 1931 the recovery to depositors during the last 65 years had amounted to 88.4 per cent, and losses therefore to 11.6 per cent, and in support quoted the estimate of 88.4 per cent made in the *Bankers Monthly* for February 1932, and of 90 per cent in the article in the *American Bankers Association Journal* for February 1931, referred to in note 4, *passim* [*ibid.*, pp. 156-167].

Likewise, F. H. Sisson, vice-president of the Guaranty Trust Co. of N. Y., and president of the American Bankers Association, stated at a

ery by all types and classes of creditors of all receiverships completed during 1865-1928."

MEANING OF LIQUIDATING PERCENTAGES

From the liquidation statement quoted from the Comptroller's Report it appears that for the purpose of expressing the results of liquidation in a comprehensive form, two percentages are employed. One of them indicates the "average per cent dividend paid secured and unsecured creditors on secured or unsecured claims," while the other refers to the "average per cent dividend plus other payments [offsets to unsecured creditors, loans paid, etc.] paid to secured, preferred and unsecured creditors." The statement referred to covers all receiverships completed during 1865-1928, but the results of currently closed receiverships are similarly measured by such a "pair" of percentages.

What is the meaning of these percentages? An answer to this question is provided by the following examples, which illustrate the methods employed in their calculation. It should be noted that these methods differ, depending upon whether or not preferred and secured creditors were paid in full.

meeting of the Bond Club in Philadelphia in January 1933 that the *depositors* of banks closed during 1865-1929 had recovered 84 per cent of their deposits, and during 1930-1932 more than 80 per cent.

The fact is that there is no mention in the Comptroller's Report for 1931 of an average recovery by depositors of 88.4 per cent. The source of this percentage is the *Bankers Monthly* for February 1932, in which it was stated "It is estimated that bank closings are eventually liquidating 88.4 per cent. This estimate is based upon figures supplied in the 1931 Annual Report of the Comptroller of the Currency in which 1,073 banks are tabulated as having been completely liquidated in the past 65 years. Eighty-four of these were liquidated 100 per cent or more. The average recovery was 88.4 per cent."

The 989 receiverships closed during 1865-1931 averaged dividend payments of 66.97 per cent, and total payment of 77.04 per cent. The percentage of 88.4 was arbitrarily arrived at by taking into consideration that 84 banks liquidated 100 per cent, and that repayments of \$3,826,716 were made to stockholders.

Example I. Composite Liquidation Statement. Preferred and Secured Creditors paid in full.

<i>Payments</i>		<i>Liabilities</i>	
Dividends [Cash]		Creditors	
Unsecured creditors	\$150,000	Secured ^a	\$100,000
Secured creditors	25,000	Preferred ^b ...	5,000
		Unsecured	
total dividends	175,000	depositors ..	300,000
		borrowers ..	30,000
Other Payments			
Preferred creditors	5,000		
Secured creditors [loans paid] ..	75,000		
Unsecured creditors [offsets] ...	30,000		
total other payments	110,000		
All payments	<u>\$285,000</u>		<u>\$435,000</u>

^a Bills Payable, Rediscounts.

^b Generally trust funds.

Secured creditors realized \$75,000 on the collateral held, and \$25,000 in dividends, or full payment on their claim of \$100,000. Full recovery was also made by preferred creditors. Depositors' claims amounting to \$30,000 were offset against borrowings. "*Proved Claims*" amounted therefore to only \$300,000. Dividends to secured and unsecured creditors amounted to \$175,000, or 58.3 per cent of Proved Claims. Secured, preferred and unsecured creditors received in dividends and "other payments" a total of \$285,000, or 62.6 per cent of Proved Claims and such "Other Payments," amounting to \$435,000. These percentages correspond to those of 72.36 and 80.57 noted in connection with receiverships closed during 1865-1928. *It should be noted in regard to the dividend percentage of 58 that dividend payments include the amount paid secured creditors, although this amount is not included in proved claims, on the basis of which the percentage is calculated.*

Example II. Composite Liquidation Statement. Secured creditors not paid in full.

<i>Payments</i>		<i>Liabilities</i>	
Dividends [Cash]		Creditors	
Unsecured creditors	\$150,000	Secured ^a	\$100,000
Secured creditors	50,000	Preferred ^b ...	5,000
		Unsecured	
total dividends	200,000	depositors ..	300,000
		borrowers ..	30,000

Other Payments		
Preferred creditors	5,000	
Secured creditors [loans paid] ..	25,000	
Unsecured creditors [offsets] ...	30,000	
	<hr/>	
total other payments	60,000	
	<hr/>	
All payments	\$260,000	\$435,000
	<hr/>	<hr/>

^a Bills Payable, Rediscounts.

^b Generally trust funds.

Secured creditors realized only \$25,000 on their collateral, and shared in the general assets up to \$50,000, receiving therefore a total of \$75,000. Total dividends to secured and unsecured creditors amounted to \$200,000, or 50 per cent of "Claims Proved" amounting to \$400,000, *the secured claims of \$100,000 in this case not being eliminated because secured creditors were not paid in full.* Dividends and "other payments" amounted to \$260,000, or 60 per cent of "Claims Proved" and "Other Payments."

Bearing in mind that in the published data dividends paid, other payments, and claims proved are not segregated as to secured, preferred, or unsecured, it is evident that the published data do not permit the calculation of the exact dividend percentages paid to unsecured creditors on their claims, nor the percentages paid in the form of dividends plus offsets, although this would be possible from the two examples given.

The elimination in Example I of secured claims from the total amount of Claims Proved [because the claims were paid in full], and inclusion of the amount in the case of Example II, are the result of certain accounting methods in the Division of Insolvent Banks of the Comptroller's Office, which need not be commented upon here. It will suffice to note that in connection with the methods of calculation employed the Comptroller specifically states: "In making the calculations of percentages of payments to secured and preferred creditors no consideration has been given to those liabilities to creditors not claimed, as well as secured claims which were proved and upon which dividends were paid but which were subsequently eliminated from the total of claims proved by reason of having been paid

in full out of the proceeds of collateral collections. The consideration of such unclaimed items, together with secured claims proved but not included in the total of Proved Claims, would very materially reduce the percentages of payments to creditors as given."⁷

It should now be clear why the percentage of 80.57 noted in connection with receiverships completed during 1865-1928 [or the corresponding percentage for receiverships closed during any other period] does not measure the recovery to depositors. The percentage which approximately measures the recovery is that of 72.36 [for receiverships closed during 1865-1928], which expresses the relationship between dividends paid to secured and unsecured creditors and the aggregate of unsecured claims proved and an undetermined amount of secured claims proved. It is, apparently, overstated, and not based on liabilities at time of failure.⁸

RESULTS OF LIQUIDATION, 1865-1934

Before pursuing our enquiry regarding the results of liquidation of banks closed since 1920, it will be of interest to note the results for earlier years. For each year of the period 1865-1906 they are presented in Table 15 in the form of the recovery percentages to all creditors. Table 16 lists,

⁷ See e. g. *Annual Report*, 1930, pp. 30, 32.

The inclusion in "other payments" and also, therefore, in the total of "proved liabilities", of dividends paid secured creditors would increase "all payments" and "proved liabilities" of Example I respectively to \$310,000 and \$460,000, and of Example II to \$310,000 and \$485,000, and would slightly increase the percentages of 62.6 and 60. This method of calculation was employed, for accounting purposes, for receiverships closed between October 1, 1924 and October 31, 1929.

⁸ "The percentage of 80.57," the Comptroller emphatically stated in a letter to the present writer, "does not, obviously, represent the net recovery to depositors of all failed banks. This percentage cannot be applied to the total of deposits either at date of failure or at date of final closing in a determination of the net losses or recoveries therefrom."

by periods, from 1865 up to and including each year of the period 1906 to 1934, the dividend percentages as well as the total payment percentages. The percentages in Table 16 [which will in the further discussion be referred to as "periodical percentages"] cover, therefore, all receiverships closed during 1865-1906, 1865-1907, etc.

TABLE 15

AVERAGE PERCENTAGE OF RECOVERY TO ALL CREDITORS OF NATIONAL BANK RECEIVERSHIPS CLOSED DURING 1865-1906, BY YEARS

<i>Year ending October 31,</i>	<i>Number of Closed Receiverships</i>	<i>Per cent Dividend and Other Payments</i>	<i>Year ending October 31,</i>	<i>Number of Closed Receiverships</i>	<i>Per cent Dividend and Other Payments</i>
1865	1	63.57	1887	7	77.47
1866	2	28.70	1888	8	84.36
1867	7	75.13	1889	2	100.0
1868	3	81.0	1890	9	78.37
1869	2	91.76	1891	22	45.77
1870	—	—	1892	17	84.75
1871	—	—	1893	51	75.70
1872	6	92.42	1894	18	60.87
1873	11	78.45	1895	32	75.50
1874	3	60.26	1896	24	63.47
1875	5	40.79	1897	35	95.13
1876	9	76.49	1898	6	95.55
1877	10	98.73	1899	11	79.53
1878	13	88.49	1900	4	100.0
1879	8	86.27	1901	5	87.44
1880	3	94.26	1902	2	99.71
1881	0	0	1903	7	99.26
1882	3	66.62	1904	11	99.12
1883	2	75.0	1905	3	99.64
1884	11	80.91	1906	2	100.0
1885	4	79.54			
1886	8	96.14	1865-1906..	387	80.83 ^a

Data for 1870 and 1871 are not available.

^a Aggregate liabilities [claims proved, offsets, loans paid] \$172,281,026.

Total payments [dividends, offsets, loans paid] \$139,249,361.

Constructed from data abstracted from the *Annual Report of the Comptroller of the Currency*, 1907, page 28.

It appears that the year-to-year fluctuations were considerable. The average for the entire period was 80.83 per cent. It should be noted that during the depression years

of the nineties, when the number of failures and closed receiverships was quite substantial, the recovery to creditors was very moderate.

TABLE 16

AVERAGE DIVIDEND PERCENTAGE AND PERCENTAGE OF TOTAL PAYMENTS TO ALL CREDITORS OF NATIONAL BANK RECEIVERSHIPS CLOSED BETWEEN 1906 AND 1934, BY PERIODS SINCE 1865

<i>From 1865 to October 31,</i>	<i>Per cent Dividend</i>	<i>Per cent Dividend and Other Payments</i>	<i>From 1865 to October 31,</i>	<i>Per cent Dividend</i>	<i>Per cent Dividend and Other Payments</i>
1906	74.42	80.88	1921	77.25	83.79
1907	74.37	80.83	1922	77.21	83.72
1908	75.71	82.22	1923	77.66	84.03
1909	75.71	82.29	1924	74.38	81.72
1910	76.20	82.64	1925	77.84	84.24 ^a
1911	76.19	82.61	1926	76.91	83.55 ^a
1912	76.19	82.61	1927	74.74	80.95 ^a
1913	76.52	82.87	1928	72.36	80.57 ^a
1914	76.46	82.81	1929	70.19	79.13 ^a
1915	76.66	82.95	1930	68.33	77.99 ^a
1916	76.22	83.06	1931	66.97	77.04
1917	77.07	83.63	1932	67.19	77.06
1918	76.98	83.57	1933	66.76	76.79
1919	77.03	83.64	1934	66.51	76.91
1920	77.14	83.71			

^a In the calculation of these percentages, dividend payments to secured creditors from October 1, 1924 to October 31, 1929 were, for accounting purposes, also included in "other payments." There is therefore a break in the series from 1925 to 1929. If in the calculation of the percentages for 1930-1934 a similar procedure is followed, it is found that the percentage for 1930 would be 78.08, for 1931 77.16, for 1932 77.21, for 1933 76.96, and for 1934 77.0. This would make the series continuous from 1924 to 1934. See note 7, *supra*.

Source: *Annual Reports of the Comptroller of the Currency*.

A different picture is presented by the periodical percentages of Table 16. They show that between 1906 and 1924 average dividend, as well as total payments of all receiverships closed since 1865, and indicate that the yearly results of liquidation during 1906-1923 were larger than the average for the preceding period. After 1923, however, the periodical averages underwent a substantial decline. Evidently receiverships closed since 1923 have yielded less

than 77.66 per cent in dividends, and less than 84.03 per cent in total payments.⁹ In other words, these periodical percentages, or rather those recorded as of later years [such as 1928, 1929, etc.], do not measure the liquidation results of receiverships closed after 1924.

RESULTS OF LIQUIDATION, 1924-1934

The yearly liquidation results may be determined without difficulty from the statistics covering the periodical results. Since 1928, moreover, a summarized statement of these yearly results have been included in the Comptroller's reports. In the 1928 report,¹⁰ for instance, the following statement appears immediately after the one for receiverships closed during 1865-1928, which was reproduced in the beginning of this chapter:

During the year ending October 31, 1928, 76 receiverships were closed, including 2 banks restored to solvency. From the assets the receivers collected, including offsets and collections from stock assessments, a total of \$18,113,847,

which was distributed as follows:

Dividends Paid to Secured and Unsecured Creditors on Claims Proved aggregating \$18,385,062	7,792,770
Payments to Secured and Preferred Creditors, including Offsets allowed and Payments for the protection of assets ¹¹	8,884,635
Payments of receivers' salaries, legal, and other expenses	1,433,149
Cash returned to shareholders	3,293

The average percentage of dividends paid on claims proved against the 76 receiverships . . . , not including the 2 banks restored to solvency which paid creditors 100 per cent, was 42.38

⁹ As regards the percentages for 1865-1925, see note 12.

¹⁰ P. 15.

¹¹ Including dividends paid secured creditors. See note 7.

per cent. If offsets, loans paid and other disbursements were included in this calculation the payments to creditors would show an average of 61.16 per cent.

It appears, therefore, that while all receiverships closed during 1865-1928 showed an average recovery to all creditors of 80.57 per cent, those closed during 1928 showed an average of only 61.16 per cent.

The record of 677 receiverships completed during 1924-1934 is given in Table 17. It appears that secured and unsecured creditors of these receiverships received dividends averaging 57.01 per cent of their proved claims. Including offsets, loans paid, and other disbursements, the average recovery was 71.25 per cent. In this calculation no consid-

TABLE 17
AVERAGE DIVIDEND PERCENTAGE AND PERCENTAGE OF TOTAL PAYMENTS
TO ALL CREDITORS OF NATIONAL BANK RECEIVERSHIPS
COMPLETED DURING 1922-1934, BY YEARS

<i>Year ending Oct. 31,</i>	<i>Per cent Dividend</i>	<i>Per cent Dividend and Other Payments</i>	<i>Number of Completed Receiverships ^a</i>
1924	64.04	77.39	12
1925	104.72 ^b	102.85 ^b	13
1926	58.55	69.61	29
1927	44.53	65.56	42
1928	42.38	61.16	74
1929	49.20	65.86	103
1930	48.39	66.84	83
1931	52.40	66.82	91
1932	68.76	77.24	97
1933	60.18	73.15	69
1934	64.05	78.98	64
1924-1934	57.01	71.25	677
1926-1928	46.95	64.52	145

^a Of banks which failed after June 30, 1920, except 2 receiverships each during 1924, 1925 and 1927, 5 during 1926, and 1 during 1931, of banks which failed prior to that date.

^b These percentages are not correct. See note 12.

Compiled from data abstracted from the *Annual Reports of the Comptroller of the Currency*.

eration has been given to the fact that the data for receiverships closed during 1925 are in error.¹²

It is interesting to note that at the time when depositors of banks which had failed since 1920 were held to be recovering about 80 cents on the dollar, the liquidation results of these banks indicated that dividend payments to secured and unsecured creditors had averaged only 46.95 per cent, and total payments only 64.52 per cent [Table 17. The percentages for the period 1926-1928 cover 145 receiverships, of which 138 are of banks which failed after June 30, 1920, and 7 of banks which failed prior to that date] Receiverships closed during 1928, all of which were of banks which had failed after June 30, 1921, had paid dividends of only 42.38 per cent.

Table 17 further shows that recent liquidation results have tended to increase. It should be noted, however, that in the case of receiverships completed during 1932 the high yields of 68.76 and 77.24 per cent were the result of the fact that the 97 receiverships include four large banks which paid creditors in full. These four banks accounted for 40 per cent of the total dividend payments of the 97 banks, and over 25 per cent of the total amount of other payments. If these four banks are excluded, it appears that the 93 remaining receiverships averaged dividends of only 56.65 per cent, and total payments of 60.72 per cent.¹³

¹² Writes the Comptroller: "In connection with your determination of an average of 104.72 per cent from actual liquidation statements of dividends paid, and of 102.85 per cent of all payments, for receiverships closed during 1925, it appears some discrepancy must exist in the liquidation statements as published for that year." It was found that the total amount of Claims Proved did not include the claims proved of at least one receivership, although the dividends paid this receivership were included in the total of Dividends Paid of all receiverships completed during that year. [See *Annual Report*, 1925, p. 251].

¹³ *Ibid.*, 1932, pp. 18, 19, 208-271. [Trusts Nos. 112, 554, 1446, 1503.]

RECOVERY IN TERMS OF LIABILITIES AT
TIME OF FAILURE

Throughout the foregoing discussion the analysis of the liquidation results has been made on the basis of claims and other proved liabilities as shown by the final receivers' reports. Commencing with the annual report for 1930, the segregation of dividend payments as to secured and unsecured, of "other payments" into its constituents "payments to secured and preferred creditors," "offsets allowed and settled" [to unsecured creditors], and "disbursements for the protection of assets," and, for the years 1930, 1931 and 1932, of liabilities as to secured and unsecured, makes it possible to approximate the recovery in terms of liabilities at time of failure, and also to determine more closely the recovery to unsecured creditors in terms of proved liabilities.

During 1930, 1931, and 1932 payments and dividends to secured and preferred creditors amounted respectively to 93.49, 101.34, and 91.09 per cent of secured liabilities at time of failure.¹⁴ The corresponding percentages to all creditors during 1930-1934 were 75.92, 69.29, 80.15, 75.95, and 83.38 per cent. Dividends to unsecured creditors amounted to 52.89, 48.83, 66.40, 53.41, and 48.14 per cent of unsecured liabilities at time of failure, while dividends including offsets amounted to 63.27, 58.48, 76.86, 64.34, and 59.06 per cent. It should be borne in mind that in the calculation of these percentages to secured and preferred creditors and to all creditors, it has not been possible to include in the amount of liabilities at time of failure those secured liabilities which were established after failure. It is evident that the participation of these "additional" lia-

¹⁴ The excess over 100 per cent is accounted for by interest payments upon secured and preferred liabilities established after failure [*ibid.*, 1931, p. 34].

bilities in both dividend and other payments to secured and preferred creditors distorts the "true" percentages. In other words, the percentages as given are more or less considerably overstated.

A further approximation to the extent of the recovery made by unsecured creditors may be reached by a comparison of the recovery in terms of proved liabilities and of liabilities at time of failure. The percentages are listed in Table 18.

TABLE 18
PAYMENTS TO UNSECURED CREDITORS IN PER CENT OF LIABILITIES AT
TIME OF FAILURE, AND OF PROVED LIABILITIES, BY RECEIVER-
SHIPS CLOSED DURING YEARS ENDING OCTOBER 31,
BY YEARS, 1930-1934

Description of Percentage	1930	1931	1932	1933	1934	1930-34
1. Dividends Paid Unsecured Creditors on Proved Secured & Unsecured Claims	41.79	49.69	66.43	58.06	54.50	55.69
2. Dividends & Offsets Paid Unsecured Creditors on Proved Secured and Unsecured Claims plus Offsets	46.19	54.18	69.06	62.47	60.00	60.02
3. Dividends Paid Unsecured Creditors on Unsecured Liabilities at time of failure	52.89	48.83	66.40	53.41 ^a	48.14 ^a	55.57
4. Dividends & Offsets Paid Unsecured Creditors on Unsecured Liabilities at time of failure	63.27	58.48	76.86	64.34 ^a	59.06 ^a	66.04
5. Dividends Paid Secured & Unsecured Creditors on Proved Secured and Unsecured Claims	48.39	52.40	68.76	60.18	64.05	60.08

^a These percentages are in terms of deposits at time of failure.

Constructed from data abstracted from the *Annual Reports of the Comptroller of the Currency*.

Inasmuch as claims proved cannot be segregated as to secured and unsecured, it is not possible to determine with exactness the average recovery during 1930-1934 to deposi-

tors alone. Dividend payments to unsecured creditors averaged 55.69 per cent of proved secured and unsecured claims, while, including offsets, the return averaged 60.02 per cent. In terms of liabilities at time of failure dividends averaged 55.57 per cent, and dividends plus offsets 66.04 per cent. In determining the average recovery to unsecured creditors of banks which have failed since 1920, it should be remembered that receiverships closed prior to 1929 have yielded considerably less than those closed afterwards, while, as explained, the average for the period 1930-1934 has been highly influenced by the inclusion of four receiverships of banks which were taken over, and paid creditors in full. A conservative estimate would be, therefore, that depositors of national banks which failed during the recent epidemic have recovered about 50 per cent on their unsecured claims, while including offsets the yield has probably averaged about 55 per cent. This estimate closely corresponds to one made by the Federal Reserve Committee previously referred to in its study of *Bank Suspensions*, in which it was shown that 267 national bank receiverships completed during 1921-1930 paid unsecured creditors \$34,034,000, or 49.7 per cent of unsecured claims amounting to \$68,489,000. Including offsets, depositors recovered 55.7 per cent. Receiverships closed during 1930-1934 have probably raised these percentages somewhat, but on the whole an estimate of a dividend percentage of 55 per cent of liabilities at time of failure, and of dividends plus offsets of 60 per cent, is undoubtedly fairly accurate.

RECOVERY BY DEPOSITORS OF REOPENED BANKS

Among the 635 national bank receiverships closed between October 1923 and October 1933 [all of banks which had failed after June 30, 1920] 48 were of banks which had been restored to solvency. The available data do not permit mak-

ing an estimate of the average recovery to creditors of these 635 receiverships. However, according to the Division of Research and Statistics of the Federal Reserve Board, the average recovery to unsecured depositors of 1,197 suspended national and state banks which had been permitted to resume operations was 89 per cent. Following is a classification of these banks.

TABLE 19
REOPENED BANKS AND BANKS TAKEN OVER, CLASSIFIED ACCORDING TO
PERCENTAGE OF CLAIMS REALIZED BY UNSECURED
DEPOSITORS, 1921-1930

<i>Per cent of claims realized</i>	<i>National Banks</i>	<i>State Banks</i>	<i>All Banks</i>
0-19	—	6	6
20-39	1	30	31
40-59	7	87	94
60-79	17	97	114
80-99	9	39	48
100	119	785	904
Total	153	1,044	1,197

LOSSES TO DEPOSITORS

The liquidation situation is wrought with so many uncertainties, and so little is known regarding the effect upon depositors of the reorganization, absorption and liquidation during the past two years of those banks which had remained unlicensed at the termination of the holiday, and of the licensed banks suspended subsequently, that it is very difficult to make an accurate estimate. According to a recent announcement by the Chairman of the Reconstruction Finance Corporation, "the ultimate loss to the public of banks closed during 1931 and 1932 and of those unlicensed on March 16, 1933, may be held to \$2,000,000,000 on deposits of \$6,511,560,000."¹⁵ This estimate was based on

¹⁵ November 5, 1934. Deposits of banks suspended January 1, to March 15, 1933, and of licensed banks suspended March 16 to December 30, 1933, totalling \$370,273,000, are not included in this total.

figures gathered by the Federal Reserve. If we add to this figure losses amounting to \$1,154,958,560 for banks closed during 1921-1930 [estimated on the basis of the known liquidation results of national banks closed since 1921, and of national and state banks reopened during 1921-1931], then total losses of failure during 1921-1933 will amount to over \$3,150,000,000. This amount is more than twice as large as that emphatically held by the writer quoted earlier in this chapter ". . . American depositors are not likely to lose," and more than twenty times as large as the amount of \$150,000,000 which this writer held to be "the final net loss to our depositors on account of bank failure." Actually, the known liquidation results would indicate that losses of banks closed during 1921-1929 will finally amount to about \$600,000,000, and to as much as \$2,010,159,750 for all banks closed between January 1, 1921 and March 1, 1933. This latter amount represents 41.5 per cent of deposits at time of failure, amounting to \$5,084,031,000, and consists of losses to national bank depositors of \$526,738,170, and to depositors of banks other than national of \$1,483,421,580.

RECOVERY BY SIZE OF BANKS

A comparison by size of bank of the dividend percentages paid secured and unsecured creditors on their proved claims by 587 receiverships, completed during 1921-1933, of national banks which failed after June 30, 1920, discloses that of the 419 banks with \$50,000 capital or less, 220 banks paid less than 50 per cent, while 199 paid 50 per cent or more. On the other hand, only 58 of the 168 banks with more than \$50,000 capital paid less than 50 per cent, while 110 paid 50 per cent or more. Including banks restored to solvency, the numbers for the group of smaller banks were respectively 220 and 215, and for the group of larger banks 58 and 123. These figures go far toward proving that the

TABLE 20

DISTRIBUTION OF PERCENTAGES OF DIVIDENDS PAID SECURED AND UNSECURED CREDITORS ON THEIR SECURED AND UNSECURED PROVED CLAIMS BY 635 CLOSED RECEIVERSHIPS DURING 1923-1933 OF NATIONAL BANKS CLOSED AFTER JUNE 30, 1921

Dividend Percentage	Number of Banks with Capital Stock of							Total
	\$25,000 to \$49,999	\$25,001 to \$49,999	\$50,000- \$99,999	\$50,001- \$99,999	\$100,000	\$101,000- \$200,000	\$200,000 over	
1-9.9	21	3	15	1	2	1	1	44
10-19.9	29	7	14	3	4	2	—	59
20-29.9	18	4	11	7	6	3	—	49
30-39.9	28	6	17	5	3	4	—	63
40-49.9	23	5	19	6	6	3	1	63
50-59.9	30	4	19	7	9	3	1	73
60-69.9	21	4	15	8	6	4	—	58
70-79.9	10	6	15	6	10	4	1	52
80-89.9	10	1	12	3	6	5	1	38
90-99.9	12	5	2	3	2	2	—	26
100 and over ^a ..	26	10	23	12	23	5	11	111
total	228	55	162	61	77	36	16	635
less than 50	119	25	76	22	21	13	2	278
50 or more ^a	109	30	86	39	56	23	14	357
50 or more ^b	99	27	73	35	49	19	7	309

^a Including banks restored to solvency.

^b Excluding banks restored to solvency.

Compiled from data abstracted from the *Annual Reports of the Comptroller of the Currency*.

liquidation results of the smaller banks have been less favorable than those of the larger banks. A similar conclusion, namely that depositors of banks with loans and investments of \$1,000,000 or more had realized a higher percentage of claims than those in smaller banks was arrived at by the Federal Reserve Committee in its study previously referred to. The investigations made by this Committee also disclosed that banks in larger towns have paid a larger percentage than those in the smaller communities.

This chapter has reviewed the liquidation results of failed national banks, the receiverships of which were completed during 1865-1934. Emphasis has been laid on the liquida-

tion results of banks failed during the recent epidemic, and on the recovery made by unsecured creditors or depositors.¹⁸

The conclusions arrived at may be summarized as follows:

1. Liquidation results of banks closed after 1923 have been considerably less favorable than of those closed before that year, and there have been wide fluctuations from year to year.

2. National banks failed since 1921 have paid depositors an average of from 50 to 55 cents on their proved claims. Including offsets, the average has been from 55 to 60 cents. As might have been expected, secured and preferred creditors have made substantial recoveries, so that the average return to all creditors was about 70 cents. It is pertinent to note that this percentage does not measure the recovery to depositors.

3. Depositors of banks reopened during 1921-1930 have recovered about 89 per cent of their claims.

4. The liquidation results of the smaller banks have been less favorable than those of the larger banks.

5. Losses to depositors of national banks which failed between January 1, 1921 and March 1, 1933 will probably amount to over \$500,000,000 and of banks other than national to about \$1,500,000,000. Total losses of the odd 16,000 banks which suspended operations during 1921-1933 will probably amount to more than \$3,000,000,000.

¹⁸ The costs of liquidation [receivers' salaries, legal and other expense] of 1,219 receiverships completed during 1865-1934 was 3.86 per cent of the book value of the assets and stock assessments administered, or 7.39 per cent of collections from assets and stock assessments. In other words, about 93 cents out of every dollar collected by receivers went to creditors. *Annual Report of the Comptroller of the Currency, 1934, p. 37.*

TABLE 20

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Dividend Percentage	Number of Banks with Capital Stock of						Total	
	\$25,000 to \$49,999	\$25,001 to \$49,999	\$50,000- \$99,999	\$50,001- \$99,999	\$100,000	\$101,000- \$200,000		\$200,000 over
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10-19.9	29	7	14	3	4	2	—	59
20-29.9	18	4	11	7	6	3	—	49
30-39.9	28	6	17	5	3	4	—	63
40-49.9	23	5	19	6	6	3	1	63
50-59.9	30	4	19	7	9	3	1	73
60-69.9	21	4	15	8	6	4	—	58
70-79.9	10	6	15	6	10	4	1	52
80-89.9	10	1	12	3	6	5	1	38
90-99.9	12	5	2	3	2	2	—	26
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tion results of banks failed during the recent epidemic, and on the recovery made by unsecured creditors or depositors.¹⁶

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4. The liquidation results of the smaller banks have been less favorable than those of the larger banks.

5. Losses to depositors of national banks which failed between January 1, 1921 and March 1, 1933 will probably amount to over \$500,000,000 and of banks other than national to about \$1,500,000,000. Total losses of the odd 16,000 banks which suspended operations during 1921-1933 will probably amount to more than \$3,000,000,000.

¹⁶ The costs of liquidation [receivers' salaries, legal and other expense] of 1,219 receiverships completed during 1865-1934 was 3.86 per cent of the book value of the assets and stock assessments administered, or 7.39 per cent of collections from assets and stock assessments. In other words, about 93 cents out of every dollar collected by receivers went to creditors. *Annual Report of the Comptroller of the Currency, 1934, p. 37.*

CHAPTER V

LIQUIDATION OF STATE BANKS

IN contrast with the large volume of regularly published data regarding bank failure and liquidation in the Comptroller's reports, the State banking reports present a regrettable situation. From the standpoint of availability, it should be noted that in a number of states, e. g. Pennsylvania and Oklahoma, no reports whatsoever have been published for a considerable number of years,¹ nor have the banking authorities been found to be inclined to furnish information. Among those states which publish reports, it appears that the reports of several of them are devoid of any information regarding failure of banks and their liquidation status, while the reports of many others deal with the subject in such a perfunctory manner as to make the data impracticable for analysis or interpretation. A few reports contain individual statements for those banks which are in process of liquidation, but do not publish final statements. In a subsequent report we find the statement eliminated, without any indication as to whether there were further developments since the last statement and without giving the dollar amounts claimed and recovered, or the percentage of recovery for banks individually, or collectively. Where the final results of liquidation are given in the form of a percent-

¹ Publication by the State of Oklahoma of its banking reports ceased after the issue of the biennial report for 1919/1920. The Department of Banking of the State of Pennsylvania has published no annual reports since 1917, no appropriation for the printing and distribution in book form of the annual reports of the Secretary of Banking having been made since that year.

age, several reports fail to indicate whether it applies to all creditors as one group, or to ordinary depositors only.

It is evident that under the circumstances it is impossible, even in regard to those states the reports of which contain a more or less substantial amount of liquidation data regarding the results of liquidation, to make an estimate of the average recovery to depositors or creditors in general. The only method feasible is to deal with each state separately, and to indicate the average percentage of recovery, or, where possible, to enumerate the percentages for the individual institutions. In the case of those states which operated a Guaranty Fund for the protection of depositors, the extent of the losses incurred may be readily ascertained from the status of the Fund. Among the states covered by the discussion in the following pages, the cases of South Dakota and Mississippi will, in this connection, be found interesting.

ALABAMA

The receiverships of twelve banks failed since January 1, 1920, had been closed by May 11, 1932. The capital of each bank and the percentages of recovery in the case of depositors were as follows: \$10,000: 100, 100, 80, 9.7; \$11,100: 69.4; \$15,000: 57.5, 40, 35.9 and 33; \$25,000: 60 and none; \$100,000: 24.²

CALIFORNIA

Prior to the departmentalization of the banking system in 1910 there had been 9 failures, but 3 banks had reopened. The dividend percentages to depositors of the 6 liquidated institutions were: 100, 62.25, 46.33, 36.9, 28 and 2. These were highly unfavorable results.

² *Annual Reports of the Superintendent of Banks, State of Alabama, 1915-1930, and letters from the Superintendent.*

Of the 16 banks which suspended operations between 1910 and June 30, 1931, 6 were reopened, one was sold with full assumption of the deposit liability by purchaser, and one under a 50 per cent waiver of outstanding liabilities. Of the remaining 8 banks, three were departmentalized institutions, paying commercial and savings depositors in full, except in one case, where the former class of creditors received 93.5 cents on the dollar. Five commercial banks paid depositors respectively 100, 100, 89.66, 77.60 and 52.50 per cent.³

GEORGIA

Although the letters of transmittal from the Superintendent of Banks to the State Governor accompanying the annual reports of the Banking Department state that the reports submitted include information regarding "dividends paid to creditors of failed banks", no such information is found in the published reports. Requests to the Superintendent for information elicited the response: "I am unable to give you definite information as to the percentage of dividends realized by depositors in closed banks. . . . This percentage will approximate between forty and forty-five per cent."

IDAHO

The annual reports of the "State Bureau of Banking" contain, for each liquidated bank, information regarding deposit liabilities at time of failure, payments to common and to preferred creditors, and the dividend percentages paid to common creditors. The deposit liabilities at time of failure of 33 banks the receiverships of which were closed during 1920-1932 amounted to \$5,893,394.95, against which

³ 22nd Annual Report by the Superintendent of Banks, State of California (June 30th, 1931).

common claims were proved amounting to \$4,766,101.07, and dividends were paid of \$2,151,404.10, representing 45.1 per cent of common claims. Assuming that payments of \$464,049.74 on preferred claims represents payment in full, the average recovery to common and preferred creditors was 50 cents on the dollar of proved claims.

The common dividend percentages were distributed among the 33 banks as follows: 0-19 per cent—7 banks; 20-39 per cent—9 banks; 40-59 per cent—7 banks; 60-79 per cent—5 banks; 80-99 per cent—5 banks. Nineteen banks paid less than 46 cents on the dollar. Excluding one bank which paid depositors nothing, the percentages for the individual banks were as follows: 95.5, 90.3, 84, 82.5, 80, 71.5, [2 banks], 65, 62, 60, 57.9, 56.1, 55, 54.6, 46, 45, 43, 36.2, 35.6, 35.3, 35, 33, 32.5, 27.5, 27.2, 21.3, 18.4, 14.7, 12, 5.9, 5.3, 2.6.⁴

IOWA

Of the 293 state banks which suspended operations between March 20, 1923 and July 15, 1929, 42 banks reorganized and 8 reopened, leaving 243 banks to be liquidated. Of the 93 banks the receiverships of which had been completed by the latter date, twelve paid depositors in full. The deposits at time of suspension of the 93 banks amounted to \$16,847,264, while dividends amounted to \$7,836,576 or 52.9 per cent of proved claims of \$14,829,557. Excluding the twelve banks which paid depositors in full the percentage was 49.⁵

An analysis, by size of bank, of the average recovery to common creditors [depositors] shows that 13 banks with

⁴ *Report for the year 1932, Bureau of Banking, State of Idaho*, pp. 21-23.

⁵ These and succeeding data are compiled from an article entitled "Results of Liquidation of Failed Iowa State Banks" in the *Des Moines Sunday Register* of November 3, 1929.

\$10,000 capital paid an average dividend of 34.3 per cent, 9 banks with \$15,000 paid 48.5 per cent, 6 banks with \$20,000 paid 54.2 per cent, 31 banks with \$25,000 paid 53.0 per cent, 7 banks with \$30,000 paid 50.6 per cent, and 14 banks with \$50,000 paid 68 per cent. Excluding the 12 banks which paid depositors in full, there were 44 banks which refunded depositors less than fifty cents on the dollar, and 37 which refunded fifty cents or more.

LOUISIANA

No estimate can be made of the average dividend paid to unsecured creditors of seventeen banks the receiverships of which were closed up to the year 1932. The receivers of four banks supplied the writer with information regarding the amounts of proved claims by the various classes of creditors, and the amounts paid through liquidation. It appeared that unsecured creditors recovered an average of 54.8 cents on the dollar. Including secured claims [which were paid in full] the average recovery to secured and unsecured creditors amounted to 59.6 cents, the individual institutions paying respectively 78, 54, 48 and 4 per cent.

The dividend percentages paid to unsecured creditors by the 17 banks were respectively 100, 77, 73, 70 [2 banks], 67, 65, 55, 54, 50 [2 banks], 40, 35, 29, 16, 15, 4.

MISSISSIPPI

In 1914 the Mississippi legislature passed the Guaranty Bank Act, to take effect May 15, 1915. The law permitted the department to make from one to five assessments of 1/20 per cent of deposits, yearly. Unfortunately, during the first three or four years only one assessment was made, so that there was no reserve when failures commenced to occur in 1920. Although subsequently the full number of assessments was made, the amount of deposits involved in

failure continued to outstrip the assessments, so that when the law was repealed on March 11, 1930, the deficit amounted to about five million dollars. Feeling more or less obligated by reason of the fact that it had forced the law upon the banks, the legislature, after repealing the law, passed a measure authorizing the banking department to issue bonds—these bonds to have the faith and credit of the State behind them—and with the proceeds to pay depositors of banks that had failed prior to appeal, i. e. to retire the certificates issued to depositors in lieu of cash payment. However, by the middle of 1932 it had not yet been possible to sell these bonds at a price satisfactory to the banking department.⁶

Under the Guaranty Law, depositors of failed banks were paid out of the Guaranty Fund, the Fund being replenished by the proceeds from assessments and from the liquidation of the banks' assets. When the Fund commenced to develop a deficit, depositors were unable to collect from it the difference between their claims and the amount realized from the sale of the banks' assets. Of the 63 banks which failed during the period that the Guaranty Law was in force, 44 banks had no more realizable assets. The depositors of 30 of these 44 banks were paid practically in full, 52.4 per cent of their claims being paid from the sale of the banks' assets, and 44.1 per cent by the Fund. The assets of 14 banks, the depositors of which received no cash payment from the Fund, refunded to them 42 cents on the dollar, while they became the holders of certificates for 54.7 per cent of their claims. There was a contingent claim of 3.3 per cent. The average yield from the sale of assets of the 44 banks equalled 48.8 per cent of deposit liabilities.

Nineteen banks still had realizable assets at the end of 1931, these assets representing 6.3 per cent of deposit liabilities at time of failure. Assets realized yielded deposi-

⁶ Letters from the Superintendent of Banks.

tors 52.4 per cent of their claims, payments from the Fund amounting to 2.3 per cent, and outstanding certificates to 44.8 per cent. There was a contingent claim of one-half of 1 per cent. All in all, it therefore appears that the depositors of 33 banks are the owners of outstanding certificates representing from 54.7 to 44.9 per cent of their claims, while from 42 to 52.4 per cent of these claims were paid from the proceeds of the sale of the banks' assets. Assets of the 44 banks which had been fully liquidated paid depositors the following percentages of deposits at time of failure: 100 [4 banks], 97, 93, 92, 82, 83, 75 [2 banks], 73, 70 [3 banks], 67, 66 [2 banks], 59, 58 [2 banks], 55, 54, 50, 49 [2 banks], 46, 44, 43, 37, 31, 30, 29 [2 banks], 27, 25, 24, 15, 14, 13, 12, 11, 9, 1.⁷

After repealing the Guaranty Law, the Mississippi legislature passed the so-called "Depositors' Protective Law", which provided for the creation of a fund for the benefit of depositors by assessing the surplus of active banks at the rate of 3 per cent annually. The money thus collected was to be used to pay depositors of banks which had failed subsequent to the date of repeal of the Guaranty Law, after the assets of these banks had been sold. The Fund operates on an annual basis, i. e. the yearly assessments may be used to pay only the depositors of banks which failed during the year. During 1931 about \$150,000 was collected, but this amount represented only a small percentage of the claims of depositors of failed banks. From the assets of 58 banks which failed between March 11, 1930 and December 31, 1931, depositors had collected by the latter date about 22 per cent on deposits at time of failure. Available realizable assets represented 36 per cent of deposits, but it is doubtful whether the total yields to depositors from the sale of their

banks' assets will amount to more than 50 cents on the dollar.

MISSOURI

Preferred and secured creditors of state banks have a first claim on the banks' assets, the State Circuit determining which claims shall be classed as general and which as preferred. General creditors cannot be paid anything until after preferred claims have been paid in full. This partly accounts for the fact that the depositors of 5 banks out of a total of 47 banks (the receiverships of which were closed during 1929 and 1930) lost the full amount of their claims as approved by the Commissioner of Finance, while in 44 cases preferred creditors were paid in full, and in the remaining three cases received respectively, 80, 72 and 39.83 per cent on their claims.⁸

Including the five banks which paid no dividend to [ordinary] depositors, there were 26 banks which paid less than 50 cents on the dollar, while 17 paid between 50 and 99 cents, and four paid depositors the full amount of their proved claims. A classification of the dividend percentages paid by these 47 receiverships by size of bank shows the following distribution: Banks with capital stock of \$10,000: 100, 81, 74, 65 [2 banks], 44, 40, 34, 28, 21, 16, 0 [2 banks]; \$10,001-24,999: 100, 84, 60, 55, 52, 45, 25, 16, 12; \$25,000: 60, 20, 8, 0; \$25,001-49,999: 100, 33, 30, 22; \$50,000: 100, 92, 86, 66 [2 banks], 62, 49, 10, 8, 0 [2 banks]; \$50,001 - 99,999: 40, 29, .0241; \$100,000: 59; \$150,000: 52, and \$200,000: 98.⁹

⁷ *Biennial Report for 1930 and 1931 of the Banking Department, State of Mississippi*, Exhibit F, pp. 20, 21.

⁸ *Ibid.*, Exhibit G, pp. 22, 23.

⁹ *Eighteenth Biennial Report for 1929 and 1930, Commissioner of Finance, State of Missouri*, pp. 26, 27.

OHIO

The reports of the State Banking Department, while containing considerable data regarding the status and progress of liquidation of failed banks, are decidedly lacking in their information regarding the final results of liquidation. It will not be possible therefore to indicate more than the several percentages of "total dividends" paid. By September 1933 such information was available for eight banks. Two of them had paid dividends of 100 per cent, the remaining six having paid respectively 91.33, 82.125, 80.33, 77.5, 50.5, and 12 per cent. This is undoubtedly a highly favorable record. It is not possible from the available data to indicate the average recovery to depositors of these 8 banks.¹⁰

OREGON

The receiverships of 17 banks failed since January 1, 1921 had been finally closed by December 31, 1932. Commercial and savings depositors recovered 61.9 per cent of their proved claims. Including preferred claims and bills payable which were paid in full, the average return was 69.3 per cent.

Available data do not permit a segregation of the payments to savings and to commercial depositors of ten departmentalized banks, and it is therefore not possible to determine the average percentage of recovery for these two groups of depositors separately. Savings depositors of four banks were paid in full, while those of the remaining six institutions received respectively 99, 94, 89, 87, 84 and 81 per cent on their claims. The dividend percentages paid to commercial depositors were, respectively: 100, 88, 86, 85, 79.5, 76, 65, 57.5, 55.8, 55.7, 51.1, 47.5, 45.7, 41.5, 38.4, 38 and 16.2 per cent.¹¹

¹⁰ *23rd Annual Report (1930) Division of Banks, State of Ohio, p. 34.*

¹¹ *Banking Department, State of Oregon, Annual Reports.*

SOUTH DAKOTA

From the standpoint of the position of creditors of insolvent South Dakota state banks, receiverships may be classified in three distinct groups. This grouping does not include the receiverships of five banks which failed before the enactment of the Guaranty Law on March 15, 1915. These five banks had been fully liquidated by June 30, 1932, creditors [preferred, secured and unsecured] having recovered an average of 73 per cent on total liabilities at time of failure. The percentages for the individual banks were respectively 100, 96.5, 86.8, 76.3 and 57.6.¹²

Subsequent to the enactment of the Guaranty Law, depositors of closed banks became creditors of the Guaranty Fund. After the depositors of 16 banks had been paid in full, the Fund was depleted, the proceeds of liquidation of these banks being insufficient to reimburse it. In five of these banks whose liquidation had been completed by June 30, 1930, the Fund collected about 50 per cent of its claim. Including offsets and certain other payments, depositors received about 54 per cent on their proved claims from the sale of the banks' assets. The individual percentages were 100, 71, 50, 47, 4.

Depositors of banks which closed after the Fund had become exhausted received certificates of indebtedness in lieu of cash payment. These certificates were a liability of the Fund, but did not constitute payment. Technically, their owners have a claim on the Fund, but depositors are entirely dependent upon the proceeds of liquidation of the banks' assets, since the amendment to the Guaranty Law in 1927 cut off all revenue for the Fund. In fact, the amendment repealed the Law. The outstanding certificates in the hands

¹² These and succeeding data are from the *19th and 20th Biennial Reports* [covering the period July 1, 1928 to June 30, 1932] of the *Superintendent of Banks, State of South Dakota*.

of depositors of banks the liquidation of which has been completed (i. e. certificates issued for the total amount of depositors' claims less those retired by payment from the banks' assets), are therefore worthless.¹⁸ The amount of cash in the Fund as of June 30, 1932, would have been sufficient to retire only three quarters of 1 per cent of the amount of the outstanding certificates.

Thirteen banks the liquidation of which had been completed by June 30, 1930, fall in this classification. The liquidation of assets yielded depositors 47 per cent of their deposits at time of failure. The yields by the individual banks were respectively 82, 67, 62, 62, 58, 54, 50, 49, 40, 38, 22, 20 and 12 per cent. The liquidation of an additional 17 banks which had failed before the repeal of the Act, had been fully completed by June 30, 1932. On claims totaling \$2,028,099, depositors received only \$318,643, or less than 16 cents on the dollar. The individual percentages of recovery for these 17 banks were respectively 89, 62, 60, 58, 55, 53, 46, 45, 28, 16, 11, 10 [3 banks], 4, two banks paying no dividends.

The depositors of banks closed after the legislature had passed the amendment cutting off the revenue for the Fund [July 1, 1927] do not benefit in any way from the provisions of the Guaranty Act. From a practical point of view they are in the same position as the depositors of prior failed banks who received certificates after the Fund had become exhausted, since both groups are dependent upon the proceeds of the sale of the banks' assets for the payment of their claims. None of these post-repeal banks had been liquidated by June 30, 1932.

¹⁸ Letters from the Superintendent. See also the Supreme Court Decision, relating to the State Bank Guaranty Fund Law and Disposition of Monies on Hand in the Guaranty Fund [Opinion filed January 30, 1931, by Judge Campbell].

It appears therefore that, with the aid of the Fund, depositors of 16 banks were paid in full, but the assets of 5 of these banks yielded only 54 per cent on the amount of proved claims, including offsets. As shown by the final liquidation statement of 30 banks which received no aid from the Guaranty Fund, the average recovery to depositors, including offsets, was only 28 cents on the dollar of their claims.

VIRGINIA

Insolvent banks are not administered by the Bureau of Insurance and Banking, but by receivers appointed by the Court. The annual reports of this Bureau show the status of those banks which are still in the hands of receivers, but they contain no listing showing the final results of liquidation, the Bureau's procedure being to eliminate the institution's name from the list of pending receiverships after receipt of advice from the receiver that no further payments will be made. For the purpose of ascertaining the final results of liquidation, a comparison between reports is therefore useless, since it cannot be ascertained from them whether or not additional dividends were paid subsequent to the date of the last report showing the bank's liquidation status. It was therefore necessary for the writer to approach the receivers of the failed banks directly.

It appeared that the liquidation of closed Virginia state banks was a slow process. Seven banks had been completely liquidated by January 1, 1933. Six banks had paid depositors a total of respectively 82, 81, 55, 50, 45 and 40 per cent on their proved claims, no dividends having been paid to the depositors of one bank. Information received during the middle of 1932 regarding the status of ten non-completed receiverships was to the effect that depositors could expect little if anything in addition to what had already been received, namely, dividends of 83, 75, 73, 60, 55, 40, 37, 30, 29, 25 per cent of their claims, respectively.

percentages of dividends and of dividends and offsets paid to common creditors by 988 state banks in 35 states, the receiverships of which were completed during 1921-1930.

In the case of several states the percentages are highly misleading on account of the small number of banks included—absolutely, or relative to number of banks that have failed. For this reason, and others which are self-explanatory, it is evident, therefore, that the average for the states included in the table is considerably overestimated.

TABLE 21
RESULTS OF LIQUIDATION OF 988 STATE BANKS, BY STATES, 1921-1930

State	Number of Banks	Per cent Dividend	Per cent Dividend and Offsets	State	Number of Banks	Per cent Dividend	Per cent Dividend and Offsets
Connecticut .	1	100.0	100	Oklahoma ...	46	43.0	47.4
Pennsylvania	2	88.6	89.7	Minnesota ...	49	45.0	48.2
Maryland ...	2	100.0	100	N. Dakota ..	35	27.8	27.8
Michigan ...	2	59.3	72.2	S. Dakota ...	23	61.4	63.9
Wisconsin ...	20	63.9	65.6	Iowa	176	50.7	53.6
Illinois	2	62.5	62.5	Nebraska ^a ..	15	100.0	100.0
Indiana	6	88.2	88.2	Missouri	104	48.9	52.6
Virginia	3	54.7	57.4	Kansas	122	68.2	68.7
Tennessee ...	10	82.7	83.2	Montana	22	35.1	51.9
N. Carolina .	1	100	100	Idaho ^b	28	47.5	49.4
S. Carolina ..	12	63.7	66.1	Wyoming ...	9	52.4	53.7
Georgia	111	37.7	44.3	Colorado	62	66.1	68.1
Florida	4	37.8	38.6	New Mexico	4	66.6	69.9
Alabama	9	53.8	59.4	Arizona	3	91.0	91.0
Mississippi ..	2	100	100	Washington	32	72.9	79.4
Louisiana ...	16	40.7	41.1	Oregon ^b	14	64.4	65.6
Texas	23	84.3	84.8	California ...	4	96.4	96.5
Arkansas	14	32.0	36.4	35 States ..	988	58.3	62.0

^a Out of the Guaranty Fund.

^b In Idaho and Oregon depositors are preferred creditors.

Fragmentary as is the foregoing analysis, it is apparent that the liquidation of failed state banks, like that of national banks, has inflicted considerable losses upon depositors. An evaluation of the personal hardships thus caused, of their disruptive influence upon the confidence of depositors in

general, and upon the course of business as a whole, cannot be undertaken here, but, by noting the extent of losses or recovery in the case of individual banks, it may be concluded that widespread suffering has followed in the wake of failure. If it is required, for purposes of generalization, to have recourse to an "average", it would seem that the evidence indicates that state bank depositors have recovered about 50 cents on the dollar, and completely refutes those "beautiful analyses" which proposed to show that depositors were losing only from 10 to 20 cents.

CHAPTER VI

RESPONSIBILITY FOR FAILURES

THE state of things as revealed by the review of developments prior to 1921 obviously indicate that the structural defects of the banking system were fundamentally an outgrowth of the division of authority between the national and state governments in regard to the chartering of banks. Regulation of the banking business by 49 different legal and administrative bodies—which gave rise to the struggle between the national and state authorities to attract to their respective systems as many banks as possible, causing the establishment in many states of excessive numbers of banks—has in many other ways exercised a destructive influence upon American banking, and has been indirectly responsible for many of the difficulties experienced during the last decade or more.

A dispassionate survey of the evidence does not support the view often advanced in the past that divided jurisdiction has prompted healthy competition between the national and state systems, and has resulted in raising the standards of banking and the practice of management. The fact is that the competition for banks and resources has necessitated repeated relaxations of the banking laws.¹ After the rise of

¹ Typical of the confused thinking which has attended the problem of the effect of dual control is the following statement by a speaker at the American Bankers Convention in 1929: "To maintain the national banking system at its present high standard [*sic*] it will be necessary to enact legislation granting national banks privileges which would make a national

deposit banking had enabled the state banking systems to recover from the setback received in the Sixties, the state authorities bent all their efforts toward increasing the number of their banks. Standards of banking in State laws were, therefore, on the whole below those of the national law, and state-chartered banks enjoyed many privileges not accorded to national banks. In the Nineties it became evident that the national system would be relegated to a minor position, unless national banks were granted similar privileges. Congress finally decided in 1900 to meet the issue in this manner, and by reducing the minimum capital requirements for a national charter from \$50,000 to \$25,000 enabled the national banking system to enter into competition with the state banks in the country districts. The weakening effect upon the banking structure of the fierce competition which thereupon ensued between the national and state systems has already been noted.

In pursuance of this "parity" policy, Congress in 1906 widened the powers of national banks by changing the amount which could be lent to individual borrowers from 10 per cent of the paid-up capital of the bank to 10 per cent of the capital and 10 per cent of the surplus. The amount lent was not to exceed 30 per cent of capital alone. Subsequent amendments added various exceptions to these provisions, so that, for instance, the 10 per cent limitation does not at present apply to obligations in the form of drafts, bills, etc. against actually existing values, or against goods in process of shipment, it being stipulated that larger amounts may be lent if the market value of the goods exceeds the face amount of the obligation.

charter so attractive that not only would desertations from the ranks cease, but new recruits added from every side. *You cannot sell merchandise by offering something almost just as good.*" [Insertions and italics supplied.] [*Commercial and Financial Chronicle*, No. 3356, October 19, 1929, p. 75.]

The Federal Reserve Act permitted national banks for the first time to make loans on real estate. This power was restricted to banks not in central reserve cities. Authority was given to make loans on improved farm land situated within the Reserve district, the amount lent not to exceed 50 per cent of the actual value, and the aggregate of such loans not to exceed 25 per cent of capital and surplus, or one-third of time deposits. Loans were not to run longer than five years. In 1916 national banks were given permission to make loans also on real estate [non-farm land] situated within 100 miles of the bank's domicile, the maturity of such loans not to exceed one year. By the McFadden Act the one-year limitation on non-farm land was extended to five years, the restriction as to location widened to the entire Federal Reserve district, and the stipulation regarding the aggregate that could be lent changed to 50 per cent of savings deposits. National banks in central reserve cities were placed on a parity with other national banks.

In order to enable national banks to meet the competition of the state-chartered loan and trust companies engaged in the banking business, the Federal Reserve Act authorized the Federal Reserve Board to permit national banks to engage on a limited scale, in the trust business, namely that of exercising corporate trust functions. Subsequent amendments [in 1918, 1922 and 1927] clarified and liberalized the original provisions, so that at present national banks are on an equal footing with the state-chartered institutions.

The Federal Reserve Act also enabled national banks to engage more effectively in the business of savings banking [the Comptroller of the Currency had ruled as long ago as 1903 that there was nothing in the national-bank act preventing national banks from operating savings or thrift departments] by giving time deposits preferential treatment as to reserve requirements. Under the national-bank act

demand and time deposits carried identical reserves, namely 25 per cent for banks in central reserve and reserve cities, and 15 per cent for country banks. The Reserve Act imposed a 5 per cent reserve on time deposits. This was reduced to 3 per cent in 1917. However, in contrast with the restrictions thrown around the investment powers of state-chartered savings banks, and, after 1907, of state commercial banks doing a savings business, national banks were left at liberty to invest these deposits as they saw fit.

Other changes in the national-bank act widening the scope of operations of national banks relate to the authority granted them to issue bankers' acceptances; and the power granted banks in towns of less than 5,000 inhabitants to act as insurance agents and as brokers or agents for making or procuring real estate loans. Ostensibly in order to permit the wider distribution of ownership of national bank stock, but actually promoting the employment of such stock for speculative purposes, was the reduction in the par value of shares from \$100 to any [lower] amount that might be provided by the articles of association. The McFadden Act also recognized the right of national banks to engage in operations in the securities markets.²

It is evident that these changes in the national statutes—made in order to enable national banks to meet the competition of state institutions—resulted in lowering the level of banking operations generally, and gradually undermined the soundness and safety of the banking system.

It is only natural that national banking authorities in pursuance of their liberal legislation policies should have refrained from strengthening and increasing the powers of the examining and supervisory officials. Moreover, the desire to do nothing that would cause banks to become dissatisfied and leave the system, has served as an effective deterrent to full use by officials of the powers granted

² For a further discussion of this development, see ch. vii, *infra*.

them, and to insistence on their part that the management of banks comply with their recommendations and orders.³

In view of these developments and those noted regarding the changes that had taken place in the banking structure—the abnormal increase in the number of banks, the issue of charters to individuals who had little or no banking experience or training, etc.—it is not surprising to find that incompetence and malpractices on the part of management occupy an important place among the “causes of failure”. For instance, the Comptroller of the Currency reported in 1925 that 50 per cent of the national bank failures during that year were due to inexperience and mismanagement, 10 per cent due to defalcation, and 40 per cent due to unfavorable local conditions.⁴ In other words, management was directly responsible for 60 per cent of these failures. However, in view of the fact that it is the test of good management to overcome the effects of adverse economic conditions, there is considerable justification for holding that management was directly or indirectly responsible for the failure of all of these banks.

In contrast to the apology offered in 1930 by the Oklahoma Commissioner that “better than 95 per cent of the failures since 1921 were caused by, and are really traceable to, the abnormal inflation and deflation caused by our late war conditions”,⁵ the comments made by several commissioners appear to be decidedly more informative. Remarked the Georgia Commissioner in his Report for 1930: “Our bankers and those who have given the matter study realize that the bad banking practices prior to 1920 had sown many of the seeds of trouble we have been reaping for the past

³ Cf. the Federal Reserve Committee's Report previously referred to. Also, *The Banking Situation*, *op. cit.*, pp. 192-203.

⁴ *Annual Report*, 1925, p. 5.

⁵ Hearings pursuant to H. Res. 141 [1930], p. 1573.

ten years".⁶ "These failures", reported the Kansas Commissioner in 1926, "were largely due to incompetence, and in a few instances to dishonesty", while in 1928 it was noted, "Our examiners have also uncovered gross violations of the bank law, such as falsification of records, embezzlement of funds, false statements to the department, misapplication of funds, and other criminal offenses".⁷ According to the Alabama Commissioner, "Failures were due to lack of proper management, neglect of directors, or crookedness. . . . The prices of commodities, real estate and other collateral were high for several years. The management of these banks not having the foresight a banker should have, loaned money with the existing values as securities, thinking that times would always be prosperous. In some cases they had not had the loans margined even with the high values then existing".⁸ While the Wisconsin Commissioner reported in 1923, "In addition to natural causes, bad management, misapplication and embezzlement caused many banks to fail",⁹ and the Louisiana Commissioner noted in the same year, "The proper and necessary conservatism was lacking during the war-period", and in 1925 that "gross and evil management, poor management, promotion of speculative enterprises, loans without security, too large loans, loans to companies in which officers were interested, were the major causes of bank failure".¹⁰

An analysis by the Reserve authorities of the causes of failure of banks suspended during 1921-1927 showed that the principal cause was the accumulation of a large portion of worthless, slow or past-due paper, but in quite a number

⁶ P. iv.

⁷ *Report* for 1926, p. 3; 1928, pp. 4, 5.

⁸ *Report* for 1924, p. iii.

⁹ *Report* for 1923, pp. v, vi.

¹⁰ *Report* for 1923, p. 41; 1924/1925, p. 33.

of cases poor management and heavy withdrawals were assigned as largely responsible for the suspension. The causes of suspension listed in order of their importance, i. e. based on the number of times shown as having been a primary or contributing cause, were as follows: Doubtful, slow or past-due paper; heavy withdrawals; poor management; depreciation of securities; loans to officers and directors; defalcation; loans to enterprises in which officers and directors were interested; failure of banking correspondent, and of other large debtors. If, as seems quite proper, "doubtful, slow or past-due paper", and "loans to officers and directors, and to the enterprises in which they are interested" are grouped under the head of "poor management", it appears that this was the principal cause of failure during 1921-1927.¹¹

The results of investigations made on this score by the Federal Reserve Committee previously referred to, by the Senate Banking and Currency Committee of the circumstances surrounding the collapse of the Detroit and Cleveland holding groups, and the revelations in connection with other notorious failures [Bank of the United States, Bank of Kentucky, Harriman Bank] lend further support to the thought that the immediate causes of many failures may directly be traced to grossly injudicious as well as illegal practices. They also testify to the existence of highly inefficient methods of examination and to laxity among the officials of final authority.

That this situation had been general, i. e. that in the case of suspended banks generally the supervisory authorities had been lax in insisting on compliance with their recommendations on the part of the bank's management, was shown by the results of the Reserve Committee's investigations of the

¹¹ Report by the Federal Reserve authorities, April 11, 1928. See Hearings, H. R. 141, pp. 703, 704.

circumstances surrounding the failure of 225 typical banks. Thus, as revealed by the bank examiners' reports, the investigation disclosed that the assets of these banks had been deteriorating over a period of years; that for a considerable number of years prior to failure most of these banks had heavily borrowed; that large loans had been made to officers and directors; that lending policies had been lax, especially in connection with real estate mortgages and general loans to farmers; that loans had constantly been renewed; that the legal limits upon the loan lines of the banks had been evaded; that the policy of continuously borrowing had been subject to criticism by the authorities, and that the banks had refused to pay attention to these, and other criticisms by the examiners of the banks' lax and careless lending policies, and unwise application of funds.

As regards the deterioration of the assets of these banks prior to failure it appeared that the amount of questionable and fixed assets of banks suspended during 1921-1930 had shown an increase of from 30 per cent of capital and surplus in 1920 [first half] to 296 per cent in 1930 [first half], and had averaged considerably over 100 per cent from 1922 onward. If the 225 suspended banks are segregated according to the year of suspension, it is found that in one case questionable and fixed assets amounted at time of suspension to four and a half times the bank's capital and surplus. It also appeared that in all cases, except for suspensions during 1931, the proportion had reached 100 per cent within two years after 1920. In contrast, the proportion in the case of 33 selected active banks was never more than 68 per cent, and averaged around 50 per cent; it was 11 per cent in 1920, and 30 per cent in 1930. Following is a list of these percentages in 1920 and in the year of suspension for suspended banks [classified according to the year of suspension].

Per cent in:	Banks suspending in										
	1921	1922	1923	1924	1925	1926	1927	1928	1929	1930	1931
1920	10	42	51	28	12	51	23	51	9	17	23
Year of suspension..	164	292	280	297	352	218	447	343	257	296	236

As regards loans to officers, directors, etc. it was disclosed that the proportion of capital and surplus thus invested by the 33 active banks hovered around 20 [the range being from 25 to 12], while it declined to 7 per cent in 1931. In contrast, median experience for suspended banks showed an average of not less than 30 per cent. No definite trend was shown by these percentages for all suspended banks as one group, but for banks suspended during 1931 there had been a tendency for the proportion to increase.¹²

The disclosures by the Senate Banking Committee regarding events in the Detroit and Cleveland areas relate to practices which had developed in connection with group banking. They show an astounding variety of illegal and injudicious practices, such as "window dressing" [elimination of bills payable, nondisclosure of hypothecation of securities, inclusion of customers' securities held for safekeeping, inclusion of trust funds and funds for safekeeping, inclusion of resources of banks not affiliated with the group as of the date of report, bolstering of deposits and resources, etc.], making large loans to officers, directors and allied interests, etc. In the case of the Guardian Trust Company, loans to officers and directors amounted at time of failure to over 6 per cent of loans and discounts, and to about 33 per cent of capital and surplus. A few weeks before the bank closed, 71 per cent of the loans to officers and directors were unsecured. In the case of the Union Trust Company (of Cleveland) the situation shortly before failure was as follows: Loans to officers, directors and employees amounted to 9.6 per cent

¹² The Committee's study has been partly reprinted in the chapter on Bank Examinations in *The Banking Situation, op. cit.*

of total loans; to companies in which officers and directors were interested, 21.4 per cent; to officers, directors and employees of other Cleveland and of out-of-town banks, 6.7 per cent; making a total of 37.3 per cent of total loans.¹³

Absence of a uniform banking policy has indirectly contributed to our banking troubles by having prevented the orderly reconstruction of the banking system necessary on account of the changes during the past two decades or more in the country's economic structure. The character of these changes, and their causes, are well known. The development of means of fast transportation and communication has resulted in the transfer by the inhabitants of the smaller communities of a considerable part of their purchasing to the larger population centers. At the same time, it has enabled outside firms, such as chain-store organizations, mail-order houses and public utility corporations to penetrate into these previously isolated communities, and thus make further inroads upon the business of the local bank by the continuous transfer of their business receipts to their head offices, and by doing their financing in the larger financial centers. The increased size of the business unit has also had an adverse effect upon the usefulness of the smaller banks, because of the inability of these banks to extend sufficiently high credit lines. The general result of these and allied changes was that the local banks found it more and more difficult to keep up their deposits and make profitable loans, and that many of them were eventually forced to close.

Although recognizing that the consequences of these and related changes in the country's economic structure have

¹³ Senate Banking and Currency Committee, Report on Stock Exchange Practices [Report No. 1455], pp. 231 *et seq.*

For a review of Detroit banking events see the very commendable article entitled "Michigan Magic—The Detroit Banking Scandal," by John T. Flynn, in *Harpers Magazine* [vol. 168, December 1933].

been more or less unavoidable, doubt may be raised as to whether our banking structure would have fared as badly as is true had branch banking been continuously permitted on a wider scale. Judged from experiences in other countries with economic conditions closely similar to those which have prevailed in this country since 1921, there is considerable justification for the belief that a less individualistic and more coordinated banking system would have been able to weather difficulties far more successfully.

What, then, has been during these years of failure the defense for this unit policy? Judging from the character and the variety of claims advanced, it would appear that the protagonists have been unable to put their finger on any definite advantages. Vague references have been made to the local bank as a "community investment", or to the existence of a typical "community of interest" between the local banker and the community. It has often been specifically maintained that it is the local banker's duty to further the interests of the community and develop "worthy" individuals, and that the local banker alone is able to do so, because he is best acquainted with all those qualities of prospective borrowers which are essential if the bank is to be adequately protected. As stated by a speaker at the American Bankers' Association convention in 1929: "Only the well-posted unit banker thoroughly identified with his community can solve the problem of furnishing proper credit and avoid excessive loans in an agricultural community,—nay more, can assist and develop the worthy individual through an intimate knowledge of his affairs and check the scheme of a rascal".¹⁴ Or, as remarked by a New Jersey banker in a letter to the chairman of the House Banking and Currency Committee during the Committee's investigation in 1930: "The bank, like the church, is a community

¹⁴ *Comm. & Fin. Chronicle, loc. cit., p. 79.*

enterprise, its stock a community investment, its success a community pride. It is a community temple where the saver and the borrower meet in a home they call their own".¹⁵ And as more fully set forth by a recent writer:

The strongest contention of the unit bankers is the identity of interest of the local bank and the community which it serves. . . . Intimacy between the official of final authority in the local bank and the applicant for credit permit appraisal on a character basis. . . . The unit banker is usually one of the leading citizens of the town. Even though he occupies no public office his views are sought on all questions of civic importance. When funds for a new hospital are being raised like as not the local banker is found in the forefront of those who are leading the campaign. When the State legislature is determining the location of a new highway, we find the banker representing the community and pleading its interests. The local church, the seasonal philanthropies, the local school, all make grateful acknowledgement to the local banker who cheerfully contributes of his time and energy and wealth to promote their welfare . . . ¹⁶

We may well ask whether these outside activities were undertaken merely because of the banker's love for the community, or because they promised prominence, power and independence. To contend that the incentive to engage in these civic and social activities sprang from disinterested concern for the community's interests is too grotesque even for the simplest mind to believe. Moreover, it is small wonder that with all these extra-curricular activities—philanthropies, church bazaars, hospital drives and school campaigns, and what not, the local banker had little time to attend to his business, direct the policies of the bank, and supervise its management? Is it surprising that with his attention glued on local events he was unaware of what was

¹⁵ Hearings, H. Res. 141 [1930], p. 2013.

¹⁶ Lawrence, *Banking Concentration*, *op. cit.*, pp. 87 *et seq.*

happening beyond the horizon—events of more importance to the welfare of the community than the laying of a cornerstone—and that he was forced to exclaim that “the deflation struck, out of a clear sky”?¹⁷ It is surprising that the story of bank failure is to a great extent a disconsolate tale of poor management, of diversion of the bank's funds to enterprises in which officers or directors were interested, of bankers who paid no attention to the provisions of the law, pleaded against further regulation, snubbed the supervising officials, and threatened to sue the Banking Commissioner if he should close the bank?¹⁸

Banking theory does not support the claim that the knowledge of local conditions entitles the banker to extend credit on a “character” basis, nor has such procedure in the long run been of advantage to the bank or the community, as experience since 1921 has conclusively shown. It may not always be possible for the bank to insist on the deposit of adequate collateral, or to obtain statements properly setting forth the financial condition of the prospective borrower, but the claim that there is a specific advantage in the unit system, because, at least in so far as the smaller community is concerned, it enables the banker's knowledge to be cited in support of the liberal extension of character loans, is clearly untenable.

The statement that the typical country bank is a community investment has little meaning except in so far as it purposes to contrast the ownership of the local bank with that of a branch operated by “outside” interests. There is, however, little justification for holding that such local ownership is of specific advantage to the inhabitants in general,—that, as is usually stated, there is a specific community

¹⁷ *Comm. & Fin. Chronicle, loc. cit.*, p. 103.

¹⁸ See e. g. *Banking Report*, State of Alabama, 1925, p. 12; Arizona, 1924, pp. 6-13.

or identity of interest between the bank and the community which can adequately be protected only if the bank is locally owned. It is rather in the nature of ownership which has prevailed among our typical country banks that we find the reason for the fact that such protection has not always been forthcoming. The character of such ownership—and control—may be readily ascertained from the following data regarding state banks in South Dakota, which are fairly representative of conditions among country banks generally.

TABLE 22

DISTRIBUTION OF STOCKHOLDERS, AND OF MAJORITY STOCKHOLDINGS BY INDIVIDUALS AND FAMILIES AMONG 277 STATE CHARTERED BANKS IN SOUTH DAKOTA, JUNE 30, 1930

<i>Number of stockholders per bank</i>	<i>Number of banks</i>	<i>Number of individuals holding a majority of stock</i>	<i>Number of banks</i>	<i>Number of families holding a majority of stock</i>	<i>Number of banks</i>
1-10	139	One bank	4 ^a	One bank	4 ^a
11-20	62	One family	3 ^b	One family	46
21-30	31	1 stockholder	64	One stockholder	64
31-40	10	2 "	85	2 families	69
41-50	9	3 "	45	3 "	32
51-60	7	4 "	22	4 "	14
61-70	7	5 "	12	5 "	12
71-80	7	6 "	6	6 "	10
81-100	2	7 "	3	7 "	5
101-200	2	8 "	5	8 "	4
		9 "	5	9 "	8
		11-39 "	16	11-21 "	7
Total	227		277		277

^a Groups banks.

^b Each bank entirely owned by one family.

Compiled from data abstracted from the *19th Biennial Report of the Banking Department, South Dakota*, pp. 331-668, 676-694.

The number of stockholders of 277 South Dakota state-chartered banks on June 30, 1930 was 5,517, or an average of 20 per bank. Two hundred and one banks, or 75 per cent of the total, had from 1 to 20 stockholders each, while 139 banks, or 50 per cent, had from 1 to 10 stockholders. The total number of stockholders of these 139 banks was 988, or 7 per bank, while the total for the remaining 138 banks

[those with more than 10 stockholders] was 4,529, or 33 per bank. The highest number of stockholders per bank was 227, while only two banks had from 101-200 stockholders.

The private character of these banks is more forcefully brought out by noting the distribution of majority stock ownership. Apart from 4 banks which belonged to group systems, there were 231 banks out of the total 277 the majority of stock of each of which was held by five individuals or less. This number includes three banks each completely owned by one family, 64 one-man banks, 85 banks controlled by two, 45 by three, 22 banks by four, and 12 by five, stockholders. An enquiry into the extent of family-control discloses that in addition to the 64 banks controlled by one individual, there were 46 cases in which the majority of stock was owned by one family, 69 cases representing ownership by two families, 32 by three families, 14 by four families, 12 by five families, and 10 by six families. Not less than 110 banks, or 40 per cent of the total number, were therefore controlled by one family, while in 80 per cent of the cases majority stock ownership rested with less than four families.

Under the circumstances there is little justification for the assertion that local ownership has involved, *ipso facto*, the identity of interest between the bank and the community. The fact is rather that the concentration of ownership and control of the typical country bank by a few individuals has permitted them to "manage" the banks for their own interests, in utter disregard of the real interests of the community.

In closing the present chapter, it seems desirable to summarize the discussion as follows:

1. Competition between the national and state banking systems for banks and resources has involved a gradual

deterioration of the banking laws. It has specifically been shown that between 1900 and 1927 the national banking act has several times been relaxed in order to place the powers of national banks more nearly on a par with those enjoyed by state banks.

2. The circumstance that banks can freely shift from one system to the other has acted as a deterrent to strengthening the powers of the supervisory officials, and to making full use of those already possessed.

3. Laxity in control and supervision has promoted the growth of unsound and illegal practices on the part of management. Poor management has been a major cause of bank failure.

4. The failure of many banks may indirectly be ascribed to negligence on the part of the supervisory officials. They have failed to act and insist on compliance with their orders or recommendations on the part of management.

5. Unit banking policy has closely fitted into the scheme of multiple banking control. The doctrine of states' rights has served well as a bulwark against the taking of measures designed to place the banking system on a sounder basis.

6. The character of the ownership and control of the smaller unit banks has not been such as to promote sound banking. From the point of view of ownership, the local bank has generally been the affair of a relatively small number of inhabitants; from the point of view of control, it has been in a substantial number of cases a one-man or one-family bank. The failure of many banks may be directly ascribed to the abuses which grew out of this situation.

CHAPTER VII

COMMERCIAL BANKS AND THE SECURITY MARKETS

No discussion of the causes and circumstances which contributed to the breakdown of the banking system can fail to make mention of the diversion since 1921 of commercial bank credit from the commercial loan market to the security markets. This diversion involved 1. the purchase by commercial banks of securities for their own account, and 2. the making of advances on securities owned by customers, including advances to brokers, or so-called brokers' loans, and was greatly facilitated by the organization of security affiliates,¹ because it enabled the parent institutions to evade even more effectively the existing liberal provisions of the law regarding the investment powers of commercial banks. It is the purpose of the present chapter to note, particularly for the period of bank failures, the transformation which took place in the portfolios of commercial banks as the result of these investment activities, and to indicate the effect of this transformation upon their liquidity.

Permission for national banks to make bond investments dates technically from 1927, in which year Congress passed the so-called McFadden Act,² which contained the provision "that the business of buying and selling investment securities . . . shall hereafter be limited to buying and selling . . . marketable obligations evidencing indebtedness of

¹ On the origin, etc. of security affiliates, see *Senate Banking and Currency Committee Hearings on S. Res. 71*, part VII, pp. 1052-1068, and this Committee's *Report on Stock Exchange Practices pursuant to S. Res. 84, 56 and 97*, pp. 155-185 [Report No. 1455].

² Act of February 25, 1927 [Public No. 639, 69th Congress].

any person, copartnership, association or corporation, in the form of bonds, notes and/or debentures, commonly known as 'investment securities'; such further definition of the term 'investment securities' as may by regulation be prescribed by the Comptroller of the Currency. . . ." However, national banks had long before that time been given these powers as the result of the Comptroller's interpretation of Section 5136 of the Revised Statutes permitting national banks to discount and negotiate promissory notes, drafts, bills of exchange, and other evidences of debt. Accordingly, although the National Banking Act had never contemplated investments in securities by national banks, they had gradually found their way into the banks' portfolios, and increasingly so after 1927, since the only limitation put on the types of bonds which national banks were permitted to buy subsequent to the passage of the McFadden Act was the factor of marketability, and this term was interpreted by the Comptroller very liberally. An identical situation had developed in earlier years among state banks, which in numerous cases had been given permission to invest in stocks as well as bonds. As noted in the preceding chapter, national banks had also been permitted to do a practically unrestricted real estate loan business. It is evident, therefore, that the road to enable commercial banks to make permanent investments was, at least technically, wide open during the entire failure period.

An idea of this diversion is obtained by noting the percentage distribution of the constituent items of loans, discounts and investments for the years 1921 and 1930. It appears that in the case of national banks 'all other loans' decreased from 56.3 to 35.7 per cent, while investments increased from 25.1 to 31.6 per cent, and real estate loans from 1.7 to 6.8 per cent. Security loans increased from 16.9 to 25.9 per cent. In the case of state commercial banks,

'all other loans' declined from 52.6 to 50.7 per cent, but the percentage was 58.9 in 1928. Secured loans, excluding real estate loans, show for both state commercial banks and loans and trust companies a decline between 1921 and 1928,

TABLE 23
PERCENTAGE DISTRIBUTION OF LOANS, DISCOUNTS AND INVESTMENTS
OF NATIONAL BANKS, STATE COMMERCIAL BANKS AND
LOAN AND TRUST COMPANIES
[JUNE 30]

	<i>National Banks</i>		<i>State Commercial Banks</i>		<i>Loan & Trust Companies</i>	
	1921	1930	1921	1930	1921	1930
Investments	25.1	31.6	21.2	24.2	30.8	28.8
Secured Loans * ...	10.9	25.9	13.2	11.8	27.0	34.0
Real Estate Loans .	1.7	6.8	13.0	13.3	9.1	10.0
All Other	56.3	35.7	52.6	50.7	33.1	27.2
total	100.0	100.0	100.0	100.0	100.0	100.0

* 1921: Loans secured by bonds and stocks for national banks, all secured loans for other banks; 1930: Loans secured by bonds and stocks.

but the percentages listed for these years do not indicate the changes which occurred in the proportion of loans secured by bonds and stocks only. The percentages for 'all other loans' indicate a small decline in the case of state commercial banks, but one from 33.1 to 27.2 per cent for loan and trust companies. Actually, however, the decrease for these banks was much larger, since the amount of 'other loans' on which the percentages for 1921 and 1928 are based included an undetermined amount of loans which should have been classified elsewhere.³

A more detailed view of the changes in the portfolios of national banks is presented in Table 24.

Reference has already been made to the huge increase in the amount of real estate holdings of national banks between 1921 and 1930. Further light on the character of this increase is given by the percentages expressing these loans in

³ *Annual Report of the Comptroller of the Currency, 1928, p. 92, n. 1.*

TABLE 24

NATIONAL BANKS, PERCENTAGE DISTRIBUTION OF LOANS, DISCOUNTS AND INVESTMENTS [JUNE 30]

Per cent of Loans, Discounts & Investments

Year	<i>Investments</i>	<i>Security Loans</i>	<i>Real Estate Loans</i>	<i>All Other Loans</i>	<i>Real Estate Loans per cent of Capital & Surplus</i>	<i>Eligible Loans^a per cent of Loans</i>
1915	23.7	20.1	1.8	54.4	8.4	—
1921	25.1	16.9	1.7	56.3	12.2	—
1923	30.0	17.6	2.7	49.7	19.3	30.2
1928	32.1	23.0	5.8	39.1	42.7	21.7
1932	41.2	19.8	9.2	29.8	57.2	16.0
1933	47.5	18.5	8.6	25.4	54.0	16.8
1934	54.9	15.4	7.8	21.9	51.4	17.3

^a Loans eligible for rediscount with Federal Reserve banks, including paper under rediscount.

terms of capital funds. In 1921 real estate loans of national banks represented only 12.2 per cent of capital and surplus, as against 57.2 per cent in 1932.

The decline in commercial paper is adequately shown by the fact that eligible loans declined from 30.2 per cent of all loans in 1923 to 16.0 per cent in 1932.

The proportion of loans, discounts and investments invested in securities has differed widely among differently situated banks. Country banks, on the whole, have shown a preference for purchasing securities outright, while reserve-city banks have preferred making security loans. Thus, in 1921, 17.4 per cent of loans, discounts and investments of national banks in central reserve cities represented securities owned, while among reserve-city banks the proportion was 20.9 per cent, and among country banks 31.4 per cent. In 1930 these percentages were respectively 25.3, 29.2 and 36.4. On the other hand, security loans constituted 22.2 per cent of loans, discounts and investments of central reserve-city banks in 1921, as against 20.5 per cent among reserve-city banks, and 12.3 per cent among country banks; while in 1930 the proportions were respectively 43.4, 27.0 and 16.8 per cent. (Table 25).

TABLE 25

NATIONAL BANKS: PERCENTAGE DISTRIBUTION OF INVESTMENTS AND SECURITY LOANS; BANKS CLASSIFIED ACCORDING TO LOCATION. 1921, 1930, 1934

Location of banks	Per cent of Loans, Discounts & Investments						Per cent of Loans and Discounts		
	Investments			Security Loans			Real Estate Loans		
	1921	1930	1934	1921	1930	1934	1921	1930	1934
Central Res. Cities .	17.4	25.3	57.2	22.2	43.4	23.1	.1	.5	1.7
Reserve Cities	20.9	29.2	55.4	20.5	27.0	14.0	1.0	12.2	21.7
Country	31.4	36.4	53.9	12.3	16.8	12.4	4.4	13.1	21.3

On the whole, real estate loans have figured more prominently among banks in the country districts than among the central reserve or reserve city banks. In reserve city banks, however, they rapidly increased after 1927. Real estate holdings of national banks in central reserve city banks have at all times formed an insignificant part of total loans, in 1921 the proportion being only .1 per cent, in 1930 .5, and in 1934 1.7. The corresponding percentages for reserve city banks were 1.0, 12.2 and 21.7 per cent, and for country banks 4.4, 13.1, and 21.3 per cent. In other words, in 1930 reserve city and country banks had over one tenth of their loans invested in real estate loans, as against less than one per cent for New York City and Chicago banks. In 1934 the proportion was over one fifth for the former, and less than one fiftieth for the latter.

In its bearing upon solvency and liquidity, the character of the securities carried is of course of the utmost importance. The larger the proportion of securities readily marketable without loss in value, the greater is the bank's liquidity, and the smaller the chance that it will have to close on account of insolvency. A diminution of the proportion of stable and liquid securities may be offset by increasing cash balances, but if preference is given to second grade securities on account of their high return, banks will sooner or later find themselves in difficulties. An analysis of the in-

vestment portfolios from this point of view shows that during the first phase of the failure episode an increasing proportion of security holdings consisted of second and third grade investments. In 1921, 39 per cent of all investments of commercial banks were outside the United States government, state, municipal, railroad and public utility groups, as against 49 per cent in 1930. This increase was almost entirely accounted for by the decrease from 35 to 26 per cent in the holdings of United States government securities. The decrease was greatest among loan and trust companies, namely from 23 to 10 per cent, while among national banks the proportion declined from 50 to 40 per cent, and among state commercial banks from 19 to 17 per cent. Among

TABLE 26
ALL COMMERCIAL BANKS, PERCENTAGE DISTRIBUTION OF SECURITIES,
BY TYPES, 1921, 1930

Type of Security	All Banks		Nat'l Banks		State Comm'l Banks		Loan & Trust Companies	
	1921	1930	1921	1930	1921	1930	1921	1930
U. S. gov't bonds	35	26	50	40	19	17	23	10
State, etc.	9	10	10	12	8	10	7	4
Railroad, Public Ut. ..	17	15	17	21	8	5	27	12
Total	61	51	77	73	35	32	57	26
All other	39	49	23	27	65	68	43	74
Total	100	100	100	100	100	100	100	100

Compiled from data abstracted from the *Annual Reports of the Comptroller of the Currency*.

state banks as a group, "other securities" constituted a much larger proportion of total securities investments than among national banks. Among the latter the proportion was about 25 per cent both in 1921 and 1930, while among state commercial banks it was 66 per cent; loan and trust companies increased the proportion from 50 per cent in 1921 to 75 per cent in 1930. The high rate of insolvency among state banks during this period is undoubtedly a reflection of this unsound condition of the investment account. (Table 26).

Conditions just noted as between national banks and state chartered banks appear to have existed also among national banks in reserve cities as compared with those in the country districts. Among the national banks as a group the proportion of "other securities" advanced from 23 per cent in 1921 to 27 per cent in 1930, but this increase was entirely due to the advance from 24 to 33 per cent among country banks, the proportion among reserve-city banks having remained practically unchanged at about 22 per cent. On June 30, 1932 it was about 16 per cent among reserve city banks, but still 24 per cent among country banks, the same as in 1921. (Table 27).

TABLE 27

NATIONAL BANKS, PERCENTAGE DISTRIBUTION OF SECURITIES, BY TYPES, 1921, 1930, 1932. BANKS CLASSIFIED ACCORDING TO LOCATION. [JUNE 30]

Type of Security	Central Reserve-City Banks			Reserve-City Banks			Country Banks		
	1921	1930	1932	1921	1930	1923	1921	1930	1932
U. S. gov't bonds	52	56	60	33	52	56	48	29	35
State, Municipal } Railr., Publ. Util... }	25	21	24	24	27	27	28	39	41
All other	23	23	16	23	21	17	24	33	24
Total	100	100	100	100	100	100	100	100	100

Compiled from data abstracted from the *Annual Reports of the Comptroller of the Currency*.

Summarizing, it appears that banks in reserve cities were on the whole in a more favorable and liquid position than country banks. The former had large amounts of loans secured by collateral, while the proportion of securities owned outright was relatively small. Besides, close to 80 per cent of the volume of securities owned consisted of investments of the more stable types. On the other hand, the portfolios of country banks contained a large volume of permanent investments of which up to one third represented securities other than United States government, state, municipal, railroad and public utility bonds. Moreover, although

the proportion of security loans was small, it would appear that they involved considerable losses because of the difficulty to obtain additional collateral. At least, according to the responses made by the Comptroller of the Currency and the Federal Reserve banks to certain queries submitted by the Senate Banking and Currency Committee during its investigation in 1931, it appears that a larger number of undermargined loans were found in the smaller banks.⁴

It is evident that as a result of this transformation of the portfolios of commercial banks there was a considerable decline in liquidity. Data are not available to permit the making of an estimate of this decline among commercial banks generally, but among national banks the proportion of loans, discounts, investments and cash balances represented by the more liquid assets declined from 39.9 per cent in 1923 to 30.6 in 1930, mainly due to the decrease in the proportion

TABLE 28
LIQUIDITY OF NATIONAL BANKS, 1923-1930
[JUNE 30]

Year	Liquid Assets ^a per cent of	
	Total Assets ^b	Deposits
1923	39.9	48.3
1924	38.3	45.0
1925	35.2	40.5
1926	33.3	38.0
1927	33.8	38.1
1928	29.9	35.4
1929	31.6	36.5
1930	30.6	34.5

^a Cash, Due from Banks, Acceptances, Eligible Paper, United States Securities and Loans secured by U. S. gov't securities.

^b Liquid Assets plus Securities other than U. S. government bonds, Loans secured by other than U. S. gov't bonds, Real Estate Loans and all "Other Loans."

Compiled from data abstracted from the *Annual Reports of the Comptroller of the Currency*.

Cf. Edwards, G. W., "Liquidity and Solvency of National Banks, 1923-1933" [*The Journal of Business of the University of Chicago*, vol. vii, no. 2, April 1934].

⁴ *Ibid.*, *Hearings on S. Res. 71*, p. 1074.

of paper eligible for discount. In terms of deposits, liquid assets declined from 48.3 per cent in 1923 to 34.5 per cent in 1930. (Table 28).

The comparison made in the preceding chapter of the ratio of non-liquidity among active and suspended banks may be supplemented by noting the relationship between net capital funds [i. e. capital and surplus minus banking house and real estate investments] and the total amount of other than United States government securities, and miscellaneous securities, respectively. As regards net capital funds, it

TABLE 29

NET CAPITAL FUNDS AND SECURITIES INVESTMENTS, COMPARED; NATIONAL BANKS, STATE COMMERCIAL BANKS AND LOAN & TRUST COMPANIES, 1921, 1930, 1933

<i>Net capital funds in per cent of:</i>	<i>National Banks</i>	<i>State Comm'l Banks</i>	<i>Loan & Trust Companies</i>
<i>Total Capital Funds</i>			
1921	80.0	76.6	79.6
1930	72.6	68.2	80.9
1932	68.4	65.7	76.2
<i>Other than U. S. Gov't Bonds</i>			
1921	80.0	63.4	56.2
1930	58.6	50.8	62.6
1932	50.1	51.0	74.9
<i>Miscellaneous Securities</i> *			
1921	252.0	78.2	102.0
1930	144.0	63.6	79.4
1932	152.0	77.3	174.0

* Other than U. S. government, state, municipal, railroad and public utility bonds.

Compiled from data abstracted from the *Annual Reports of the Comptroller of the Currency*.

appears that among national banks the decline was from 80 per cent of total capital funds in 1921 to 72.6 per cent in 1930, and among state commercial banks from 76.6 to 68.2 per cent. In 1921 net capital funds of national banks represented 80 per cent of other than United States government securities, but in 1930 58.6 per cent, and in 1933 only 50.1

per cent. The corresponding percentages for state commercial banks were 63.4, 50.8 and 51.0. About two and a half times the amount of miscellaneous securities of national banks in 1921 was covered by net capital funds, but in 1930 less than one and a half times. Among state commercial banks the amount of net capital funds was at all times considerably lower than that of second and third grade securities, and the same condition existed among loan and trust companies during 1922-1930. (Table 29).

Making a similar comparison for national banks classified according to location, it appears that net capital funds of central reserve city banks declined from 89.7 per cent of total capital funds in 1923 to 83.0 per cent in 1932, of reserve city banks from 74 to 65.6 per cent, and of country banks from 71.4 to 62.4 per cent. There were wide fluctuations among central reserve city banks in the ratio of net capital funds and other than United States government securities, but the tendency was towards a decline, the percentage being 154 in 1923 and 107 in 1932. Among reserve city banks the percentages were respectively 102 and 54.7, and among country banks 55.1 and 34.6.

From these figures of the relationship between net capital funds and securities investments it may be concluded that the ability to absorb losses on account of the depreciation in price of these securities has been particularly small among state banks in general, and among country banks in particular. In 1932, the amount of other than United States government securities of country banks was nearly three times as large as net capital funds. This means that a 33 per cent decline in the price of these securities would entirely wipe out capital funds. Although it is impossible to say what this percentage has been for the average bank, or for banks as a group, there is no doubt that in many instances the decline was sufficient to jeopardize seriously the position

of many banks, and to cause the insolvency of those which had large amounts of second and third grade securities.

A general idea of the diversion between 1921 and 1930 of commercial bank credit to the securities markets may be obtained by comparing the percentage increase in resources with the increase in the constituent parts of loans, discounts and investments. Resources of all commercial banks increased by 45 per cent, but investments increased by 63 per cent, secured loans by 51 per cent, and real estate loans by 89 per cent. On the other hand, loans and discounts advanced by 31 per cent only, and all "other loans" by 12 per cent. (Table 30).

TABLE 30
PERCENTAGE INCREASE OF RESOURCES AND OF LOANS, DISCOUNTS AND INVESTMENTS; 1921 TO 1930

Type of Banks	Resources	Invest- ments	Loans & Discounts	Secured loans	Real Estate loans	Other loans ^b
All Banks	45	63	31	51	89	12
National Banks	42	71	22	26	426	4
State Comm'l Banks ...	7	21	2	-6 ^a	9	2
Loan & Trust Companies	116	97	118	166	128	75

^a Decrease.

^b Other than real estate and secured loans.

Compiled from data abstracted from the *Annual Reports of the Comptroller of the Currency*.

The tendency for securities investments to increase at a more rapid rate than resources was strongest among national banks, as indicated by an increase of 71 per cent for investments and 42 per cent for resources. The corresponding percentages for state commercial banks were 7 and 21, and for loan and trust companies 116 and 97. Real estate loans of national banks increased by 428 per cent, of state commercial banks by 9 per cent, and of loan and trust companies by 128 per cent, while loans other than real estate and secured loans increased respectively by 4, 2 and 75 per cent.

It should be clear that the participation by commercial banks in the securities markets was not an event unrelated

to the general industrial and business situation. It is true that the reduction in reserve requirements and the accumulation of gold had made possible the inordinate expansion of credit just noted, but the primary inducements to commercial banks to enter upon this new field undoubtedly originated in the fact that there was a declining demand for commercial bank credit and a constantly rising demand for long-term credit because of the new methods of financing which had been developed in conjunction with alterations in business organization, in merchandising and selling methods, etc. Whatever were the inducements, it is evident that to the extent commercial banks facilitated and aggressively furthered the diversion of their funds to the capital market, and lent to brokers as well as customers on collateral so as to enable the carrying of securities until a rise in the market made it profitable to sell, they were responsible for the severity and consequences of the reaction which set in after the unbridled speculative fever had run its course. To maintain that it was the breakdown of the business structure which caused the banking system to collapse is putting the cart before the horse. It should be recognized that the accumulation of our banking troubles during the Twenties was to no small extent due to the effective way in which the breakdown of the business structure, locally or regionally, was used as a smokescreen for the errors, abuses and malpractices which developed with the entrance of commercial bankers into the securities markets.

Justification for the increase by commercial banks of their long-term investments has often been sought in the fact that there was also an increase in long-term liabilities, i. e. in time deposits, the theory being that the right of the bank to demand from its time depositors a 30 or 60 days' notice of withdrawal will enable it, in the interim that these restrictions upon the withdrawal of funds are in force, to liquidate

some of its slower loans. Experience has shown, however, that such procedure has seldom had the desired effect, but has generally resulted in a general impairment of confidence, and a concerted run by demand as well as time depositors, which necessitated the closing of the bank in order to prevent demand depositors from exhausting the bank's assets.⁵ The difficulties experienced on this account have been accentuated by the fact that it has not been uncommon on the part of banks, because of the lower reserve requirements for time deposits, to transfer to the time-deposit account demand deposits which were considered to be inactive. Moreover, time deposits, especially in city banks, have shown a considerable velocity of turn-over, so that in reality they are more like demand deposits.⁶ It should be apparent that the problem of time deposits versus investments is not one for which a solution can be found in balancing the amounts held, but in prescribing, as in the case of savings-bank deposits, the types of securities which commercial banks are to purchase as investments for these deposits.

The foregoing survey of the changes in the portfolios of commercial banks as a result of their operations in the securities markets may be summarized as follows:

1. During the past twenty years there has been a large increase in the proportion of loans and investments devoted to the purchase of securities and the making of collateral security loans, including real estate loans, and a decrease in the proportion of commercial loans;

2. The proportion applied to the purchase of securities has been largest among the country banks, while city banks have shown a preference for making collateral loans. Real

⁵ *Ibid.*, p. 1050.

⁶ See the Report of the Committee on Bank Reserves of the Federal Reserve System [November 1931] [*Annual Report of the Federal Reserve Board*, 1932, pp. 260-285].

estate loans have figured largely among country banks, and during recent years also among reserve city banks;

3. These and similar changes in the banks' portfolios—the repeated renewal of loans technically marked as liquid, the purchase of acceptances representing merchandise in storage—caused a gradual decline in liquidity, while the convertibility of the greater proportion of their assets came to depend upon quotations in a market supported only by speculation.

4. The circumstance that the portfolio of the smaller and country banks contained a large proportion of second and third grade securities made these banks especially susceptible to price fluctuations in the stock markets, even before 1929, and caused many to fail. Failure on a large scale was inevitable after prices had taken their final downward plunge, and it became necessary on the part of the banks to write off their inflated assets.

The change noted in the character of the portfolios of commercial banks has to some extent been inevitable on account of changes in business organization, but the employment of bank credit in the manner practised since 1922 was entirely outside the legitimate sphere of commercial banking operations. That the combination of investment and commercial banks has been a major cause of bank failure has been fully recognized in the Banking Act of 1933, which contains the following provisions designed to separate these two types of banking, and to prevent the undue use of commercial bank funds for speculative purposes:

1. Divorce of commercial from investment banking:

a. Commercial banks can no longer maintain affiliates which are engaged in the issue, flotation, underwriting, etc. of stocks, bonds, etc. [Sect. 20]. Sect. 18 for national banks, and sect. 15 for state banks provides for separation of ownership, and sect. 32 prohibits the interlocking of directorates.

b. Securities dealings by national banks are limited to the purchasing and selling of securities upon the order of customers. This prohibition does not apply to obligations of the United States government, of States, etc. The purchase of investment securities for own account is subject to the following restrictions: 1. The amount of any one issue may not exceed 10 per cent of the total amount outstanding; 2. It may not exceed 15 per cent of the bank's capital, or 25 per cent of its capital and surplus. These activities are further subject to "such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe" [Sect. 16].

c. Sect. 21[a] provides that firms engaged in the securities business may not engage in the deposit business.

2. Restrictions upon the employment of bank credit for speculation:

a. Sect. 3[a] provides that each Federal Reserve Bank shall keep itself informed of the character and amount of the loans and investments of member banks with a view to ascertaining whether undue use is made of bank credit for the speculative carrying of, or trading in, securities, real estate, . . . or commodities. . . . Any undue use must be reported to the Federal Reserve Board, which may suspend the bank from the use of the credit facilities of the Federal Reserve System.

b. Section 7 empowers the Federal Reserve Board to fix for each reserve district the percentage of individual bank capital and surplus which may be represented by loans secured by bonds or stocks, and to deny the rediscount privilege to banks which increase such loans despite the Board's order to desist.

c. Member banks may now obtain loans against their notes secured by rediscountable paper for periods not exceeding 90 days, but the amount advanced becomes immediately due, if a bank increases its security loans despite an official warning by the Reserve Bank or the Board to the contrary [Sect. 9].

d. Member banks are prohibited from acting as media or agents for non-banking corporations desirous of making brokers' loans [Sect. 11-a].

e. Member banks are prohibited from paying interest on demand deposits [Sect. 11-b].

These are severe restrictions upon the investment and speculative activities of commercial banks, but it is evident that they are a long way from effecting a complete divorce of commercial from investment banking. It may be possible through administrative control to correct the defects of the present statute, or prevent them from taking on dangerous proportions, but it should be pointed out that

1. no limitation has been put on the total amount of bonds which national banks may purchase for their own account;
2. there is no description in the Act of the character or type of investment securities which may be purchased, except that they should be "marketable", and that it is left to the Comptroller of the Currency to further define the term "investment security";
3. the use of bank credit for speculative purposes is still permitted, or, at least possible.

There is no limitation to put on the total amount that may be lent, it being left to the Federal Reserve authorities to determine whether the amount has reached "undue" proportions.

It is not within the scope of the present discussion to deal with the points just raised with a view to determining whether the segregation of commercial and investment banking should be made more complete, or whether the investment activities of commercial banks should be more closely defined. Whatever the decision which it will eventually be necessary to take, it should encompass all commercial banks.

CHAPTER VIII

THE GUARANTY OF DEPOSITS

As finally enacted, the so-called guaranty section of the Glass bill of May 1933, providing for the establishment of a federal deposit insurance corporation whose duty it would be to assist in the speedy liquidation of failed banks and to protect depositors against future losses, contained two insurance plans, namely a "temporary" plan, to be effective from January 1 to July 1, 1934, and a "permanent" plan, which was to become effective on the later date. However, by the Deposit Insurance Act of June 16, 1934,¹ the temporary plan was extended for another year—until July 1, 1935—, and the effective date of the permanent plan postponed for a similar period.

Under the temporary plan, individual deposits are at present insured up to an amount not exceeding \$5,000 [\$2,500 before July 1, 1934]. The Act provides that membership in this plan is compulsory upon all members banks of the Federal Reserve system, but voluntary to non-member banks. However, most of the latter have joined, so that at present about 14,000 of the country's 15,000 banks are insured. In order to obtain the insurance privilege, banks have been required to pay into the Temporary Fund an assessment of one quarter of 1 per cent of their deposits eligible for insurance, i. e. of the aggregate of individual deposits of \$5,000, or less. In addition, one further assessment of one quarter of 1 per cent may be made if, prior to July 1, 1935, funds are required to meet the obli-

¹ S. 3025 [73rd Congress].

gations of the Fund to insured depositors of banks which have been closed. By the Act of 1934 provision was made for establishment of a separate Fund for mutual savings banks ["Fund for Mutuals"], to be effective between August 1, 1934 and July 1, 1935. This Fund enables mutual savings banks to elect either \$2,500 or \$5,000 as the maximum insured amount for individual depositors.

Under the permanent plan, every member bank of the Federal Reserve System must apply for class A stock in the Corporation for an amount equal to one half of 1 per cent of its total deposits. Non-member banks desiring to join the plan must make a similar subscription. In order to make permanent membership effective, applicants must pay one half of their subscription into the Fund, the remainder being subject to call. This stock is entitled to cumulative dividends of 6 per cent, but carries no voting privileges. Assessments payable into the Fund are levied on total deposits, and amount to one quarter of 1 per cent. The number of assessments that may be made is unlimited, and no dividends may be paid by the insured bank to its stockholders unless all assessments have been paid in full. Individual deposits are to be fully guaranteed up to an amount not exceeding \$10,000, with a 75 per cent guaranty for the excess over \$10,000 in the case of deposits not exceeding \$50,000 and of 50 per cent for the excess over \$50,000. Non-member banks of the Federal Reserve system which desire to obtain or retain the guaranty privilege after July 1, 1937, must first join the Reserve system.

The capital to be contributed by the insured banks after July 1, 1935, is in addition to the Corporation's organization capital subscribed for by the Federal Reserve banks and the federal government. Each of the former has been required to subscribe for capital B-stock to an amount equalling one half of 1 per cent of its surplus as of January

1, 1933. The total of this subscription amounts to about \$140,000,000. The subscription by the Secretary of the Treasury was fixed at \$150,000,000.

The affairs of the Corporation are administered by a Board of Directors consisting of three members, including the Comptroller of the Currency. Of the two members appointed by the President of the United States—by and with the advice and consent of the Senate—one is chairman. The appointive members hold office for 6 years.

The Corporation acts as receiver of all closed national banks, and of closed state banks if the Corporation's appointment as receiver is authorized by State laws, and of course, provided the State authorities make the appointment. In order to facilitate payment to insured depositors, a new national bank is formed, which assumes the insured liabilities of the failed bank, and to which the Corporation makes available the amount due depositors. The Corporation is entitled to receive from the closed banks the dividends which would ordinarily have been payable to depositors, until such dividends equal the payment made by the Corporation to depositors. Any further dividends are paid to the depositors.

Initially the new bank will have no stock, nor will it have to subscribe to stock of the Federal Reserve Bank, but it must keep legal reserves. Stock may eventually be offered for sale—in which case the stockholders of the defunct bank are given the first opportunity to purchase it—and if sold, the bank will be entitled to a certificate issued by the Comptroller authorizing it to commence business. If, within two years after the failed bank was closed, it will have been impossible to execute this plan, the new bank will either be placed in voluntary liquidation, and its assets be sold to another institution, or its affairs be liquidated. To facilitate liquidation the Corporation is authorized to purchase the

assets of the closed bank provided it is a member of the Reserve system, and to issue and have outstanding at any one time its notes, debentures, bonds, etc. in an amount aggregating not more than three times its capital stock.

Table 31 shows, by types of banks, the extent of membership of the Temporary Fund as of October 1, 1934, and the proportion of deposits and depositors which are insured. It appears that only 32.69 per cent of the deposits of state

TABLE 31
INSURED BANKS, DEPOSITS AND DEPOSITORS
[October 1, 1934]

[Deposits in millions of dollars]

Type of Bank	Number of Banks	Insured Deposits	Ratio Insured to total Deposits %	Number of Insured Depositors [in thousands]	Ratio Fully-Insured to Total Depositors %
National banks	5,450	\$20,073	42.29	26,378	98.46
State member banks	969	10,965	32.69	9,560	97.92
State non-member banks ...	7,638	4,944	72.43	13,812	99.10
Mutual Savings banks					
maximum \$5,000	44	467	88.41	908	97.86
maximum \$2,500	24	571	67.95	587	87.48
	14,125	37,020	44.44	51,245	98.39

Source: *Federal Reserve bulletin*, February 1935, p. 122.

member banks are protected, as against 42.29 per cent in national banks, and 72.43 per cent in state non-member banks. The average for all banks, including mutual savings banks, is 44.44 per cent. On the other hand, the proportion of depositors fully insured is about the same in all banks, and amounts to about 98 per cent.

If a comparison is made of the ratio of insured to total deposits by size of bank, it appears that the smaller the bank, the larger the ratio, the range being from 91.67 per cent for the smallest banks, those with deposits of \$100,000 or less, to 25.69 per cent for the group of largest banks, those with deposits of more than \$50,000,000. The proportion of

deposits insured in the next-to-largest banks is 49.57 per cent, or about twice as large as in the largest banks. The ratio of fully-insured to total depositors (accounts) ranges from 99.74 per cent in the smallest banks to 97.16 per cent in the largest banks. See Table 32.

TABLE 32

ACCOUNTS AND DEPOSITS IN INSURED COMMERCIAL BANKS AND TRUST COMPANIES, DISTRIBUTED ACCORDING TO SIZE OF BANK

[October 1, 1934]

<i>Banks with Deposits of</i>	<i>Number of Banks</i>	<i>Ratio Fully-Insured Accounts to Total Accounts %</i>	<i>Ratio Fully-Insured Deposits to Total Deposits %</i>	<i>Ratio of Total Deposits of each Group to Deposits of All Banks</i>
\$100,000 or less	1,502	99.74	91.67	.28
100,001-250,000 incl.	3,580	99.56	86.95	1.69
250,001-500,000 incl.	3,109	99.43	83.14	3.08
500,001-750,000 incl.	1,477	99.32	79.78	2.51
750,001-1,000,000 incl.	943	99.26	77.60	2.26
1,000,001-2,000,000 incl. . . .	1,630	99.10	74.62	6.34
2,000,001-5,000,000 incl. . . .	1,060	98.84	69.14	8.88
5,000,001-50,000,000 incl. . . .	631	98.33	49.57	22.31
50,000,001 or more	96	97.16	25.69	52.65
Total	14,028	98.53	43.49	100.00

Source: Federal Deposit Insurance Corporation.

It may further be of interest to note that on October 1, 1934 there were 1,091 non-insured banks, with deposits of \$512,781,000. Of this number 426 banks had deposits of \$100,000 or less, while 1,025 banks had deposits of \$1-000,000 or less.

The number of licensed banks suspended during 1934, including banks placed on a restricted basis, was 56, with deposits of \$36,944,000. This number includes 1 national bank, and 55 state banks, with deposits of \$40,000 and \$36,904,000, respectively.² The total number of insured

² Excludes 920 banks with deposits of \$646,729,000 which received no license at the termination of the banking holiday, and which were placed in liquidation or receivership during 1934. See ch. iii, Tables 5 and 6.

banks which suspended was 8, with total deposits of \$1,864,323, namely 1 national bank, with deposits of \$41,643 and 7 state banks, with deposits of \$1,823,680. Insured deposits amounted respectively to \$37,902 and \$888,878, or a total of \$926,780, representing about 50 per cent of total deposits of these banks. The proportion of insured to total deposits for these eight banks individually was, respectively, 100, 94, 91, 88, 87, 84, 46 and 30 per cent.³

It should be noted that the Banking bill of 1935,⁴ which was recently introduced into Congress, proposes to make some radical changes in the "permanent" insurance scheme as outlined above. The provisions relating to the guaranty are contained in Title I of this bill and may be summarized as follows:

1. The Temporary Fund and the Fund for Mutuals are to be merged into the Permanent Fund immediately upon enactment of the bill. The maximum insured protection of \$5,000 now enjoyed under the "temporary" plan is to be continued. Trust funds will be insured up to \$5,000 for each trust estate.

2. Banks now insured will continue to be insured. Non-member banks of the Reserve system may withdraw voluntarily, upon giving notice to the Corporation and to depositors, and the Board may terminate the insured status of any insured bank if it is engaged in unsound or illegal practices, or has repeatedly violated the law. In either case, deposits [less withdrawals] continue to be insured for two years, and the bank during this period must pay assessments. State member banks of the Reserve System lose their membership

³ Based on data supplied by the Division of Statistics of the Federal Deposit Insurance Corporation.

⁴ H. R. 5357, introduced on February 5, 1935; S. 1715, introduced on February 6, 1935. The former was passed by the House of Representatives on May 8, 1935, by a vote of 271 to 110. [H. R. 7617]. See notes 5 and 6.

upon the termination of their insured status, while national banks will be liquidated. State non-member banks may, until July 1, 1937, obtain the insurance privilege. On this date the insured status of these banks [except mutual savings and Morris plan banks] expires, unless they have become members of the Federal Reserve system.⁵

3. Assessments are at the annual rate of one twelfth of 1 per cent of total deposits.⁶ The collection of this assessment is mandatory. The Board may fix a lower rate, or make a refund up to 50 per cent of the last assessment.

4. Insured state non-member banks are required to make reports of their condition to the Corporation, and the Corporation is empowered to examine these banks, as well as all closed banks. It may examine national banks and state member banks after having obtained the consent of the Comptroller of the Currency or the Federal Reserve Board, respectively, and is entitled to access to the reports of examination made by, and reports of condition made to, the authorities.

5. Insured banks must obtain the permission of the Corporation before they can consolidate with a non-insured bank. Insured non-member banks cannot reduce their capital without the Corporation's consent.

6. Insured banks are not required to subscribe for capital stock in the Corporation, all stock being owned by the Treasury and the Reserve banks. Stock will not be entitled

⁵ The provision relating to state nonmember banks was eliminated from the House bill. This is most regrettable. The Senate subcommittee has proposed that no state bank organized after enactment of the bill shall be insured after July 1, 1937, and no existing state bank which during 1936 or any succeeding year shows average deposits of \$1,000,000 or more shall be insured after July 1 of the following year, unless a Reserve member. This does not apply to savings and Morris Plan banks.

⁶ The bill as passed by the House calls for assessments of one-eighth of 1 per cent. The Senate subcommittee's report, however, has retained the rate of one-twelfth.

to dividends, and carries no vote. The board of directors is to prescribe what proportion of the proceeds of its sale of capital stock to the Treasury and the Reserve banks shall be allocated to capital, and what proportion to surplus.

7. Several technical and administrative measures relating to the conditions under which banks not now insured may obtain the privilege, to the insured banks' obligation to carry burglary and fidelity insurance, and to the method of paying off insured depositors.

It is apparent that these proposals, especially in so far as they relate to the amount of deposits that will be insurable, and to the contributions to be made by the insured banks to the insurance fund, will bring about a considerable transformation in the insurance scheme as originally envisaged under the "permanent" plan.^{6a} In the first place, membership in the Fund no longer carries unlimited responsibility on the part of going banks for the losses of failed banks. Insured banks will have to pay only one assessment of one twelfth of 1 per cent on their deposits yearly. A refund upon these payments is at the discretion of the Corporation. No contribution has to be made by them to the capital of the Corporation. Furthermore, the insurable amount has been considerably reduced.

The fact that the proposed plan provides for the mandatory collection of the annual assessment should have the approval of those who have objected to the permanent plan because it does not provide for the establishment of a reserve fund—as would be the case under a true insurance plan,⁷—

^{6a} Pending final action on the Banking bill of 1934, Congress on June 27 extended the temporary plan (which under the present law was to be replaced on July 1, 1935, by the permanent plan) for 60 days.

⁷ *The Guaranty of Bank Deposits*, a report by the Association of Reserve City Bankers [Chicago, 1933], p. 28.

but specifies that an assessment shall only be made when the debit balance of the insurance account equals or exceeds one-fourth of 1 per cent of the insured banks' deposit liabilities. Obviously, since the number of assessments that may be made is unlimited, the heaviest burden would fall during years when banks would be least able to pay. The proposed plan will enable the Corporation to build up a reserve fund.⁸

One feature of the permanent plan which has been subject to considerable criticism, but which has been retained in the proposed arrangement, is that assessments will be levied on total deposits, and not on insured deposits only, as is now the case under the temporary plan. Since the smaller banks have mostly small accounts, their contributions to the Fund ensure protection for a much greater percentage of their total deposits than will be the case among the larger banks. In other words, relative to the amount of their insured deposits, the latter will be paying a rate considerably higher than the nominal rate of one-twelfth of 1 per cent. Indeed it appears from Table 32 that this rate will be more than three and a half times larger for the largest than for the smallest banks.

A more general criticism has been that the guaranty scheme is not insurance, because the assessment rate is the same for all banks, instead of being graded in relation to the degree of soundness of the individual banks. Besides, the assessment is not paid by the beneficiary—the depositor—and under the present permanent plan, no provision has been made for the building up of a reserve fund.⁹

We have already seen that the proposed plan will permit building up a reserve fund, and that, by fixing the number

⁸ The Senate subcommittee has reported in favor of suspending assessments whenever the Corporation's net assets amount to \$500,000,000 or more, and of making no new levies until the amount is less than \$425,000,000.

⁹ *The Guaranty of Bank Deposits, ibid.*, p. 1, note.

of assessments that may be made, bank managements will not be confronted with the problem of having to make provision for unascertainable or unpredictable risks. But what about the assessment rate? Would it be possible, by demanding penalty rates from the unsoundly managed or the uneconomic banks, to force the necessary reorganization or reform? Of course, no difficulty on this score is encountered if it is insisted that the guaranty plan, in order to conform to insurance principles, should levy the assessment upon *depositors*, because it would obviously not be feasible to demand that depositors in an unsound bank pay a higher premium than those in a sound bank. But is it not just as apparent that depositors would withdraw their funds if they knew that the *bank* was being penalized because its operations threatened insolvency?

The notion that under a true insurance plan depositors would be paying the assessments ignores the fact that deposits are for the greater part the result of the banker's guarantee of the borrower's credit. For exchanging its own credit for that of the borrower, the bank makes a charge, and in return undertakes to pay on demand each and every one who may come into possession of a claim upon it as a result of the payments made by the borrower out of the deposit which the bank has set up for him. Is there any logic, therefore, in demanding that these creditors or depositors, or, for that matter, borrowers, should contribute to a fund which will enable the bank to discharge the obligation it has undertaken? After all, stockholders do not expect dividends to come from the earnings made on the employment of the capital they have invested, but from the conduct of banking operations. And it should therefore be evident that the risk involved in the extension of credit is theirs, and theirs only. The only question raised by the guarantee or insurance plan is whether banks should be mutually respon-

sible for these risks, i. e. whether their contributions should go to a *mutual* fund.

Will the guaranty plan be successful? It would appear that the present permanent plan is mainly concerned with providing the wherewithal to protect the depositors of failed banks against losses. In the proposed plan, however, emphasis has been laid on the necessity of preventing the occurrence of failures. Thus, provision has been made for centralizing the examination of all insured banks, and the Corporation will be able to set up definite standards with which most banks must comply before they will be admitted to the Insurance Fund, and if they wish to retain the privilege. Furthermore, it will be possible to insist on the resignation of banking officials who are engaged in illegal and injudicious or unsound practices, and thus prevent the development of a situation which in the past has been so fruitful a cause of bank failure. Of material assistance will be the power of the Corporation to review all mergers and consolidations affecting insured banks. The supervision and control which the Corporation will thus be able to exercise over the country's banks should go a long way toward preventing the growth of careless and dangerous methods of banking.

It should be realized, however, that the situation is beset with many difficulties and dangers. The banking system is still overburdened with a host of small banks of the type which has shown little resistance to failure, but which have been resuscitated for the reason that permanently closing them would, in the absence of permission to establish branches, have denuded large sections of the country of all banking facilities. An idea of the predominance of the small bank is obtained by noting that of the 14,000 odd insured banks on October 1, 1934, about 11 per cent had deposits of \$100,000 or less, while 58 per cent had \$500,000 or less. A good number of these banks have been enabled

to take a new lease on life, and qualify for membership in the temporary fund, only because of the liberal aid given by the Reconstruction Finance Corporation. Will the future earnings of these banks be sufficient to enable them to write off the large amounts of questionable and valueless assets which still fill their portfolios? Will they be able to build up reserves sufficient for future emergencies? There is certainly nothing in their past record to warrant the fulfillment of these expectations to any considerable extent. In other words, if the guaranty scheme is to be a constructive force, and not become a refuge for a multitude of small banks which at the first sign of unfavorable conditions will have to close, it will be necessary to provide a basis for our banking system sounder than is at present provided by our dual unit-structure.

The anomalous policy forced upon the federal authorities in connection with branch banking is an outstanding example of the defects inherent in the division of authority over the country's banks. Although, as we have seen, Congress has shown no hesitation to emulating the state authorities in their promotion of unsound and dangerous legislation, it has carefully refrained from conferring upon the national system any constructive advantages. On the other hand, state banks have been granted the right to partake of the benefits of the deposit guaranty, which, in connection with the fact the minimum requirements for a national charter have been reduced, must necessarily result in the re-establishment of many small state banks, and will enable many un-economic banks to continue to vegetate on the communities in which they are established. Of course, the revival of the independent unit system was one of the major purposes of Representative Steagall's Deposit Insurance bills of 1932 and 1933.¹⁰ It is indeed unfortunate that political expedi-

¹⁰ See, e. g. the *Hearings on H. R. [10241] 11362* [72d Congress, First Session], p. 1.

ency necessitated the elimination from the earlier Glass bills of those sections which would have permitted national banks to establish branches irrespective of the State statutes, and would have enabled a sounder reconstruction of the banking system. The fact that several states during the past few years have abandoned their exclusive unit-banking policy, while others have liberalized the existing branch banking provisions of their statutes, hardly alters the situation, because of the absurd restrictions on the establishment of branches, in most of these statutes.

It should be apparent that only by unifying legislative control over the country's banks will it be possible to carry through the necessary reconstruction and reorganization of the banking system.¹¹ Abandonment of dual jurisdiction will do away with the ruinous competition between the national and state authorities which has attended banking legislation in the past, and enable the national government to adopt a uniform branch banking policy for the entire country. This will permit the orderly elimination from the banking system of the multitude of small banks which are at present, and will continue to be, a threat to the safety of the guaranty fund. By closing the loophole through which banks have been able in the past to escape from one jurisdiction, which for one reason or other was obnoxious to them, to another of more leniency, it will be possible to force all banks to adhere to one standard of operation, thus increasing the safety of the institutions. The nature of the

¹¹ On the constitutionality of unifying legislative control, see the report by the General Counsel of the Federal Reserve Board, entitled "Constitutionality of Legislation providing a Unified Commercial Banking System for the United States" [*Federal Reserve Bulletin*, March, 1933; *Annual Report of the Federal Reserve Board*, 1932, pp. 229-259]. Also, Hammond, Bray, "The Banks, The States and the Federal Government" [*The American Economic Review*, vol. xxiii, no. 4, December 1933, pp. 622-636], and Anderson, Jr., Th. J., *Federal and State Control of Banking* [Cambridge, Mass., 1934].

measures which should raise this standard above the level of the past years, and strengthen the internal condition of the banks, has already been indicated. The assumption that the guaranty-of-deposit plan has disposed of the problem created by the intermixture of deposit and investment banking is entirely unwarranted. On the contrary, this plan calls for closer circumscription of the sphere of operations of commercial banks, and for placing further restrictions on their security investment and speculative operations, in order that their portfolios may not again become filled with all sorts of securities unfit to provide the bank with the necessary liquidity. If commercial banks are to be permitted to continue their savings banking business, provision should be made for the separation of savings deposits from those arising from commercial activities. Thus the law should lay down definite rules regarding the type of investments which should be kept in the savings department.

Of course, the task of preventing banks from developing an unsound or embarrassed condition looms larger than ever before among the duties of the supervisory and examining authorities. They should, therefore, be given adequate powers, and be required to make full and effective use of them, in order that an incipient unhealthy condition may be immediately corrected, and that uneconomic banks may be closed before they reach a state where liquidation would involve losses.

These considerations emphasize the fact that a guaranty-of-deposits plan is itself no solution of the bank-failure problem. However, by combining the beneficent features of the plan with legislation equally applicable to all banks, and adherence to which is enforced by strict supervision and regular, effective examinations, it should be possible to obtain a sounder and stronger banking system, and prevent the recurrence of failure epidemics.

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V I T A

THE writer was born October 2, 1896, in Haarlem, Netherlands, and graduated in 1915 from the *Haarlem Hoogere Handelschool* [School for Economics and Literature]. As the result of a competitive examination he was granted a fellowship by the Department of Colonies at its Institute in Leyden, where he followed lectures during 1916 and 1917. In the latter year he also attended the Colonial Institute in Amsterdam. After having been engaged for a number of years in commerce and banking, he resumed his studies and came to Columbia University. In 1929 he became a member of the staff of the Department of Economics of the College of the City of New York. During his residence at Columbia University he attended lectures and courses by Professors H. Parker Willis, Wesley C. Mitchell, Henry R. Seager, John M. Chapman, Frederick C. Mills, Donald A. Davenport, Herbert A. Davenport and by Messrs. R. P. Eastwood and B. Graham; the Economic Seminar under Professors E. R. A. Seligman, Wesley C. Mitchell, Henry R. Seager and V. G. Simkhovitch; the Banking Seminar under Professors H. Parker Willis and John M. Chapman; and the Seminar in the Law of Business Organization under Professors A. H. Stockder, James C. Bonbright, Hastings Lyon and Underhill Moore. More recently he has been engaged in research for the Twentieth Century Fund.