

The Guaranty of Bank Deposits

by E. B. Hopper

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Submitted to the Department of Economics of the
University of Kansas in partial fulfillment of the
requirements for the Degree of Master of Arts

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GUARANTY OF BANK DEPOSITS

CHAPTER I.

Development of the Guaranty Idea

When the institution which we call the bank sprang up in America the question of the guaranteeing of bank deposits sprang up with it. At that time the bank was an institution which took in the money of a depositor and allowed him to draw on it by check. The plan also allowed the bank to loan out part of the deposit at a higher rate of interest in order to make profitable such an institution. Naturally there arose the question of what amount should be held as a reserve by the banker in order to make sure he would be able to pay all demands made upon deposits under ordinary circumstances. This reserve was placed at a low percentage in the first class cities, a lower percentage in second class cities, and a still lower percentage in third class cities by our National banking laws. However this does not apply to state banks. This scale was adopted because the demand for reserve varies according to the population. Again the percentage may be kept partly in cash and partly in deposits in other banks.

(1) When money was placed in these institutions there was plainly responsibility placed on the institutions by the depositors. To make sure of his money the depositor was soon also guaranteed by a double liability clause. By this, each stockholder of the bank is held liable for the debts of the

bank to twice the amount of the par value of the stock which he owns. This is, in reality, the first instance which can be called a guaranty of bank deposits. Other than this very little was added to guarantee the depositor except improvements made in the system of inspection provided by the banks themselves and by the Federal Government for national banks.

- (2) However, in 1829, under the New York Safety Fund system, which was created to secure note-holders against loss in the case of bank-notes, some attention was given to the guaranty of bank deposits. This law was intended by the legislature merely to secure the holder of a state bank-note against loss in case of the failure of the bank and the fund was created by subscriptions from the various banks in New York. They were to pay into the fund one-half of one percent of their capital until they should have paid in three percent. However, the law was poorly worded and customers of failed banks who had lost their money on deposit, by testing the law in the courts succeeded in getting it so interpreted that it meant the guaranty of all bank debts, or in reality, from that time, the fund was not only to redeem bank-notes of the bank which had failed but also the fund was to be used to pay all depositors of the failed bank. This, then, became a guaranty of bank deposits but it was not a success. In the panic of 1837, ninety banks failed in New York alone. (a) The heavy demand made upon the fund under the new interpre-

(a) Laughlin's Latter Day Problems, page 205-72.

tation caused it entirely to disappear. Attempts similar to this were made in other states and all of them resulted in failures. (b)

- (3) After this, little agitation appeared until the following century. One or two minor instances will be mentioned later which happened before that time. However, the next great agitation took place in 1907. This followed the panic of that year, which was called a bankers panic because the bankers were forced to refuse to pay depositors their money except in small sums and in many instances they paid them in cashier's checks or other forms of credit money. Those who had money in the bank began to wonder if the bank had the right so to hold their deposits and began to demand some measure by which they might be made more secure and be able to get their deposits whenever they might choose to demand them.

This demand came mostly from the middle western states. The money in these states consisted mainly of actual cash which the farmers had deposited in the local banks and the local banks had in turn sent it to the New York banks where they could secure interest on the same instead of holding it as idle funds in the local bank. When the panic came this money was held in New York and so this middle section of the country became uneasy and demanded some form of a guaranty measure.

- (4) In the presidential campaign of the following year both parties took up the agitation. Under the leadership of

(b) Journal of Political Economy. vol. 17, p 65-81

Mr. W. J. Bryan, the Democratic party, when it met in Denver, placed the following plank in its platform: "We pledge ourselves to legislation by which the national banks shall be required to establish a guaranty fund for the prompt payment of the depositors of any insolvent national bank, under an equitable system which shall be available to all state banking institutions wishing to use it." (a) This would bring about a compulsory guaranty. Mr. W. H. Taft, of the Republican party, in opposition to Mr. Bryan and still wishing to cater to this demand for a guaranty, proposed a voluntary insurance in the place of a compulsory guaranty. (b) Neither party spent much time in showing the fallacy of the other's guaranty plan but impressed the people with the fact that it, if elected, would secure for them a guaranty of their deposits.

- (5) Another prominent factor in the development of this idea of the guaranty of bank deposits was the writings of the leading economists, pro and con, and the comments by the editors of our leading journals. General A. B. Nettleton informs us that the guaranty of bank deposits is not a new thing since a group of one hundred banks in Georgia and Florida have a mutual depositors guaranty fund, held in trust and bearing interest, which is proving a success. (c) Again, in Mexico there is a voluntary league. This plan was adopted by President Diaz and there has been no failure under it as all banks

- (a) Outlook vol. 90, pp 60-1
- (b) Nation vol. 87, pp 220-1
- (c) Review of Reviews vol. 37, pp 340-7

come to the relief of any weak institution. More than this, prior to 1907 depositors could insure their deposits by paying one-fourth of one percent per annum to an insurance company. Banks also insured their deposits in other banks in this manner. Mr. Nettleton says: "The panic of 1907 shows that an insurance is needed for depositors, banks and communities." Likewise, Mr. Albert Shaw says: "We need confidence between the bank and the depositor." (a) There are twenty-four thousand banks in the United States who borrow the public's money and loan it. They used thirteen billion dollars in 1907 and gave no security. Ethically, bankers, refusing to pay depositors during the panic, were doing a wrong. A guaranty system will remedy this. The Democratic party favored a national guaranty to which each bank should remit a small percentage of its capital every year for five years and then the total fund collected should be used as a guaranty of deposits. They believed this would pay the depositors at once and then the fund might be reimbursed from the assets of the failed banks. They would have the Government set a standard to which the banks must rise before it could participate in the fund. The amount and the time of the assessment should be left to the Comptroller of the Currency. They claim this will render all banks sound. They propose to limit the liabilities of any one bank by limiting deposits to ten times the amount of the paid-up capital and

(a) Review of Reviews vol. 37 pp 340-5.

surplus and also limit the amount of interest and the rate to be paid on deposits.

Mr. Bryan was of the opinion that the way to get rid of the poorer banker would be by drastic legislation and by a system of supervision of the weaker banks by the stronger, that is, by mutual cooperation.

Mr. E. B. DeBell suggested a plan whereby Congress should set aside a fund for the purpose of paying depositors their losses the same as Congress appropriates money for other purposes. This plan is perhaps the most radical of all those suggested. (a)

Mr. W. F. McCaleb states that we had to have some form of guaranty and that because of the failure of our banks to adopt some plan the National Government was forced to do so and as a result of this we have the Postal Savings Bank. (b) Mr. Horace White asks why an additional guaranty is demanded for all public deposits and none is given to individual deposits. (c)

Prof. David Kinley opposes the guaranty plan because he thinks it will encourage wild-cat banking, cause the weak to be carried by the strong, cause the depositor to cease discriminating as to the bank he will use and as a result good banks will not grow any faster than bad banks.

- (a) Harpers Weekly Jan. 25th 1909.
- (b) Forum for June 1912.
- (c) "Money and Credit" Horace White.

He says it is all right for Savings Banks to guarantee their deposits. However, he shows that commercial banking is far different in that here deposits are made by loans, and to guarantee such a deposit is the guaranteeing of credit. He also says it is a blow at independent banking, a tax on banks for what they lend, a double guarantee on bankers deposits. He shows that the tax will either raise the discount rates or lower the profits of banking and probably the first, and thus the depositor will pay the insurance. Why not let those depositors who desire insurance get it themselves and not charge those who do not care for it and are not entitled to any insurance? (a)

Prof. J. L. Laughlin, an authority on banking, says that the purpose of a guaranty is to distribute the losses among a number of innocent banks instead of on a number of innocent depositors. It is impossible to guarantee payment at once because that would demand too large an idle fund. In 1907, for example, it would have taken over \$100,000,000.00 and a guaranty is not good in the hour of panic unless it will provide immediate payment. It is a guaranty of creditors because no distinction is made between the saving and commercial accounts. Why should all suffer rather than simply the wrong-doer? (b) The idea, as Mr. Laughlin sees it, is to relieve the banker from the responsibility of using bad judgement. If we do this, we must protect all creditors. "A demand," says he, "for guaranty of all deposits is rank socialism and we should protect ourselves rather by perfect-

ing our present banking system."

Mr. Paul E. Moore is of the opinion that the advantages at first evident are: insurance against loss, stoppage of runs, hoardings and panics, but he adds that on second thought, defects are manifest, such as injustice to the banks paying losses of poorer and weaker banks, encouragement of wild-cat banking, the impossibility of paying all depositors at once, and the fact that it is in substance a guaranty of bank loans. (c)

Dr. Raymond V. Phelan of the University of Minnesota, states that the real argument in favor of the guaranty of bank deposits is to bring about a unity and still maintain a large number of banks and that the real argument in opposition to the guaranty of bank deposits is the movement in the direction of adopting a plan of insuring honest and efficient banking through inspection and censorship exercised by the banks themselves acting collectively through the Clearing House Association. (d) He concludes by saying: "voluntary self-inspection through the Clearing House Association is better than compulsory government guaranty and does not tie up large funds in insurance."

Mr. Thornton Cooke sums up the arguments for both sides as follows:— Those in favor of it advocate that the guaran-

- (a) Review of Reviews vol. 37, pp 345-7
- (b) Latter Day Problems by Laughlin. pp 205-72
- (c) Nation vol. 87, pp220-1
- (d) Moody Magazine.

teeing of bank deposits will prevent individual distress which always follows a bank failure; that it will prevent embarras^sments in other kinds of business; that it will prevent panics; that it will prevent the closing of sound banks by runs; that it will increase the use of banks by the general public and that it will provide a guaranty for private funds the same as is provided today for public funds. Those opposed to the guaranteeing of deposits maintain that it is unnecessary and there is only a small demand for it; that it will not prevent panics; that it will not prevent wild-cat banking; that it is unjust in that the sound banks must then pay the losses of the poor banks; that the cost of premium is more than the benefits derived; that it is a double tax on bankers deposits; that the risk of any one bank cannot be limited and that it involves too much interference with banking. (a)

- (5) An examination of the various state statutes reveals the fact that Oklahoma was the first state to pass a law guaranteeing bank deposits. This state passed such a law in December 1907. In less than two years both Kansas and Nebraska followed her example and passed similar laws. In 1909, Texas passed a law guaranteeing deposits and South Dakota passed a substitute measure providing for an organization of banks to insure deposits. Colorado put a bill through both houses similar to the Texas law but this was

(a) Quarterly Journal of Economics vol 24, pp 85-108.

vetoed by the Governor. The Senate of Missouri passed such a bill but it was not sustained by the House. A plan has been suggested in the State Legislatures of Illinois, Oregon, Washington, and California but failed in all these instances. At the present time there is much agitation in favor of a national guaranty of deposits and for some amendments to the laws in Kansas, Oklahoma, Texas and Nebraska.

Thus we now have a law operating for the guaranty of bank deposits in four states. An attempt will be made to trace the history and operation of the law in Oklahoma and Kansas, followed by a survey of similar laws in other states, and conclusions will be drawn from the experience of such legislation.

CHAPTER II.

The First Guaranty Law - Oklahoma.

- (1) Oklahoma, being the first state to pass such legislation will first be discussed.

In 1907, Oklahoma was a state of seventy thousand square miles, of over one million population and was in the early stages of its development.

The panic of 1907 which was precipitated among the bankers of New York City, Chicago, St. Louis, and Kansas City ^{and} ~~with~~ other reserve cities, they being compelled to refuse to pay out specie at the time. The tightening was felt through-out the whole country and particularly in Oklahoma. These financial centers are mentioned because they were the ones with which Oklahoma did its business, particularly is this true of St. Louis and Kansas City. Business in Oklahoma came to such a stand-still that on October 28th, the Governor declared a legal holiday for a week in order to assist the bankers in protecting themselves. However, this accomplished nothing. Meetings of bankers and politicians failed to relieve the money market. A plan of insurance was proposed but was turned down by the national bankers. When the legislature of Oklahoma met in December, one of the first things to come up was this matter of the guaranty of bank deposits and on December 17th, 1907, a bill was passed providing for the guaranty of bank deposits. (a)

(a) Quarterly Journal of Economics vol. 24, pp85-108.

This first bill provided for a levy of one percent on all deposits of state banks except state or national deposits otherwise secured. A Banking Board was appointed consisting of the Governor, two members appointed by him with the advice and consent of the Senate, and the Bank Commissioner as ex-officio secretary of the Board. All banks were compelled to pay this levy and must submit to a special examination and come up to the standard set by the Bank Commissioner before they could participate in the guaranty. The Board was to levy and collect sufficient amounts to maintain the fund at one percent of the deposits. New banks were allowed to enter by paying three percent of their capital subject to an adjustment at the close of the year on the basis of one percent of their deposits. All trust companies and national banks were allowed to participate after submitting to the examination and paying to the fund one percent of their deposits. (a) By an amendment passed in 1908 all trust companies and private banks were compelled to contribute to the fund. No provision was made for the banks to withdraw their contributions from the fund.

- (3) At the time this law went into effect there were four hundred and sixty-eight banks in Oklahoma. The banks at this time were in a better condition for a trial of this nature than were the banks of any other state. Their financial future was very bright, it being a new state. With the admission of Oklahoma as a state one hundred and

(a) Chap. VI. of Session Laws of Oklahoma, 1907-8

seventy-five banks, which had formerly been free from inspection, being in Indian Territory, now came under the care of the State Bank Commissioner. All of the four hundred and sixty-eight banks were examined during the sixty days previous to the time the bill went into effect, which was the 14th of February, 1908. A few banks were required to liquidate and others were given a short time in which to conform with the law and its provisions. The banks of Oklahoma went into the guaranty with practically a clean slate.

- (4) Just after the law went into effect the Noble State Bank asked for an injunction restraining the State Banking Board from enforcing the law, on the grounds that the bank charter rights were not subject to change by the Legislature and that the exact contributions to pay the depositors of the failed banks would be depriving the banks of their property without due process of law. However, the Supreme Court of Oklahoma ruled that the charter was framed under conditions that made the bank's rights subject to legislative amendment. The Court further stated that the assessments were for safe-guarding the public in its dealings with banks and therefore police power of the State could levy them and moreover they were only taken for a consideration of guaranty. (a)
- This case was appealed to the United States Supreme Court and the decision of the former court was upheld. Justice Holmes, of the Court said: "An ulterior public advantage may justify a comparatively insignificant taking of private
- (a) Quarterly Journal of Economics vol. 24, pp85-108

property for what, in its immediate purpose, is a private use. The share of each party in the benefit of a scheme of mutual protection is sufficient compensation for the correlative burden that it is compelled to assume."(b) Thus, the constitutionality of the law in Oklahoma was assured.

In May, 1909, a further addition was made to the law in regard to subsequent assessments. It was provided by the law at this time that one-fourth of one percent of the deposits should be collected each year until the fund should equal five percent of the deposits. Thereafter sufficient contributions were to be collected to maintain the fund at five percent of the deposits, but assessments were not to exceed two percent of the banks deposits in any one year. (a) This change was no doubt made so as to be less of a burden on the banks, and in the second place enlarged, owing to the rapid growth of deposits and the increased risk. Under such rapid growth it was felt that a larger percentage should be carried as a fund to guarantee the payment of the deposits at once. This additional law went into effect June 1st, 1909. Circumstances from time to time have made it necessary to remodel the law and in January, 1911, a bill was passed which did so.

(5) On the Statute books of Oklahoma today this law provides: First, a banking board of the Governor and two members appointed by him with the advice and consent of the Senate, with salaries of \$6.00 per day and expenses. The Bank Commissioner is ex-officio member of the Board. The Board is to have

(a) Session Law of Okla. 1909. (b) Outlook vol.97:48

supervision of the depositors Guaranty Fund. The Bank Commissioner's salary is fixed at \$4,000. a year with twelve assistants, who are to possess at least three years banking experience. One of these is to be the Building and Loan Association Auditor and is chosen by the Commissioner and the Governor. The salary of each assistant is \$2,000. per year.

Second, an assessment is levied against every state bank or trust company equal to five percent of its daily deposits of the past year in order to create the bank guaranty fund. One-fifth of the assessment is to be paid the first year and one-twentieth of one percent each year thereafter until the assessment is fully paid. The regular assessments heretofore levied are to be deducted from the five percent assessment.

Third, banks must report their daily deposits every year beginning the first year after the act is passed. If the report shows a higher average of deposits than those on which they are paying an assessment, the bank must make up the deficiency on the first subsequent payment, by giving credit to the fund and issuing special certificates of deposit payable to the Bank Commissioner with four percent interest.

Fourth, the State Banking Board may levy emergency assessments but never in excess of two percent in any one year. If this is insufficient the Board may issue certificates of indebtedness to the depositors bearing interest at six percent, payable at the call of the Board in the order of their issue, out of the emergency levy of later years. They shall levy

two percent each year until the fund is replaced and all liabilities are paid. As soon as assets are realized on by the Commissioner from the failed bank, they shall be applied to the guaranty fund and toward refunding the emergency levy which followed the failure of the bank.

Fifth, the guaranty fund collected under this act, shall be deposited with the banks who paid it, in exchange for certificates of deposit to the Bank Commissioner with four percent interest.

Sixth, new banks shall pay three percent of their capital into the guaranty fund upon opening for business and it shall be adjusted according to their deposits at the end of the year. This clause is not to hold in case of reorganization or consolidation.

Seventh, when the Bank Commissioner takes charge of a bank, he shall pay depositors in full. If the funds obtained in liquidation are insufficient, he shall draw on the guaranty fund, and in return, the Bank Commissioner shall take a first lien on the failed bank's assets and likewise on all liabilities against the stockholders, officers, directors or other persons or corporations or firms owing the said bank.

Eighth, the Bank Commissioner shall issue certificates to each bank, as it complies with the act, stating that the bank has complied with the laws of the state for the protection of bank depositors, and that safety to its depositors is guaranteed by the Depositors Guaranty Fund of the State of Oklahoma. This certificate shall be conspicuously displayed

by the bank. The bank may print or engrave on its stationery or advertising matter words to the effect that depositors are protected by the guaranty fund, but such banks are never to advertise that depositors are protected by the State of Oklahoma, under penalty therefor of not over five hundred dollars fine and thirty days in jail.

Ninth, any bank, complying with these laws, shall be eligible as a depository for part of the guaranty fund or of any state funds upon compliance with the laws of the state relating to deposits of public funds. The Bank Commissioner may call on any bank under this act for a report of its condition at any time.(a)

The effect of this law on state banks was very noticeable. There was an immediate increase of state banks due to the conversion of national banks. Just after the law was passed ninety-seven national banks submitted to the examination and applied for participation in the guaranty fund.(b) However, Attorney General Bonaparte declared that national banks could not guarantee payment of loss in other banks and so the Comptroller of the Currency, Mr. L. O. Murray, notified the national banks and they were not allowed to participate in the fund.(c) In 1908, fifty-eight national banks withdrew and took out state charters. Between the 14th of February and the 1st. of September 1909, there were chartered one hundred and seventy-nine state banks. Many of these were

(a) Session Laws of Okla. 1911. (b) Lst. Annual Report of Okla.
 (c) Independent vol.65:418-9

created because of the demand for the guaranty of deposits by the farmers. Some were chartered and run in connection with national banks merely to hold their farmer depositors. (d) In 1909, nineteen more national banks withdrew and took out state charters in order to use the fund.

In the first four months the deposits of the state banks increased \$3,000,000. and the national bank deposits decreased \$2,000,000. (a) By June, 1909, the deposits of the state banks had increased from eighteen million to forty-three million dollars. Some of this money came from the school fund, some from the banks which gave up their national charters and some from other states. An example of the rapid growth is best shown by the increase in deposits of the Columbia Bank and Trust Co. of Oklahoma City, which came to be the largest bank in the state. The deposits of this bank were as follows:

In September	1908	- - -	\$	365,686.01
In November	1908	- - -		602,529.90
In February	1909	- - -		1,111,805.64
In June	1909	- - -		2,345,100.33
In September	1909	- - -		2,806,008.61 (b)

The following statistics show how the law attracted money from other states.

In Arkansas;
16 nat'l banks in 8 counties adjoining Okla. Gain in '09, only 7.2%
while other counties show a gain of 22.5 % the same year.

The following figures from the same table of statistics show the reaction after the law was put to a severe test.

In Arkansas
16 nat'l banks in 8 counties adjoining Okla. Gain in '10 21%
while other national banks in Okla in the same year gain 12:5%

(a) Quarterly Journal of Economics vol.24:85-108
(b) & (d) Same as (a)

In Texas

67 banks in 20 counties adjoining Okla. Gain '09, only .8% while remaining 460 banks gain in the same year 3.2%

67 banks in 20 counties adjoining Okla. Gain '10, 14.6% while 460 remaining banks gain in the same year only 10.5%

In Kansas

34 banks in 14 counties adjoining Okla. Gain '09, only 10.7% While 170 banks in same part of Kansas gain in same year, 15.4%

34 banks in 14 counties adjoining Okla. Gain '10, 10.6% while 170 banks near by gained in same year only 6.4% (c)

These statistics show the rapid decrease of deposits in banks adjoining Oklahoma after the law went into effect. However, they also show that the rapid increase in Okla. was only temporary and that a reaction set in as soon as the wave of the law's popularity had passed and it had proven itself unable to pay depositors in cash at once.

(7) As to the effect upon national banks we find that ninety-seven at once tried to take advantage of the guaranty fund, but when they were refused, but fifty-eight gave up their charters and took out state charters in order to use the fund. (a) Some national banks found their deposits falling off because of a lack of a guaranty similar to that offered by the state banks and so they secured a state charter and ran a state bank under the same management as their national bank in order to hold those depositors who paid in cash and wished the guarantee feature in connection with their deposits. Many of the national bankers of Oklahoma said they believed the law wrong in theory and economy but they were obliged to comply with it in practice in order to hold their customers. One banker states

(a) Q. J. of E. vol. 24:85-108 (d) Journal of Pol. Eco. vol. 19:131-

that the law took his business and gave it to the state banks in spite of the strength and personality which had built up the bank to its present state.

Mr. H. H. Smock, the first Bank Commissioner of Oklahoma under the law, states: "The law was most effective in the banks of small communities. The state banks were all compelled to take out their share of the guaranty fund while some few national banks in the cities doing only a commercial banking business were able to withstand the strong popularity of the guaranty law." By the first assessment in Oklahoma \$150,000. was collected by the Board, \$110,000 being invested in state warrants and the remainder placed in banks at three percent. (a)

8) One or two minor failures might be mentioned before we examine the great and sever test of the fund. In May 1908, the State Bank of Colgate failed owing its depositors \$37,000. The Board at once took charge of the bank and were able to secure from the bank \$13,000. and by drawing on the guaranty fund for \$24,000. they paid all depositors in full on demand. After the liquidation of the bank the \$24,000. was returned to the guaranty fund.

Another minor failure was that of the State Bank of Kiefer. This failure was due to the failure of the Farmers National Bank of Tulsa. The state bank had \$30,000. deposited in the national bank and so was drawn under by the failure of the latter. The Board at once took charge of the bank and drew from the guaranty fund \$40,000. to pay losses and after settling the affairs of the bank they returned to the guaranty

fund \$38,000. from the assets of the bank.(a)

In September 1909, came the first real test to the new law. At this time the Columbia Bank and Trust Co. , being the largest bank in Oklahoma, failed. The total liabilities of the bank at the time it failed were:

Individual Deposits - - -	\$1,165,747.42
Savings Deposits - - - -	75,061.36
Certificates of Deposit -	353,184.86
Bankers deposits - - - -	1,293,385.73
Cashier checks - - - -	10,090.96
Certified checks - - - -	3,577.60
TOTAL -----	\$ 2,901,047.93

At the time this bank failed there was in the guaranty fund only \$400,000., \$76,000. of which had been placed in the Columbia Bank and Trust Co. The Board immediately took charge of the bank and finding a debt of over \$2,000,000. they at once levied the limit of two percent on all banks. However, there was such an uproar from the banks that the assessment was finally cut down to three-fourths of one percent. This uproar came mostly from eleven banks but they finally paid the assessment rather than give up their charters.

The cause of this uproar was that the Board, in view of the fact that all depositors could not be paid in full even out of the fund, adopted the policy of paying the small individual depositors first, and therefore the banks were displeased because they must pay the assessment in order that the fund might be made large enough to pay all losses and then not receive their deposits from the closed bank at once. This assessment of three-fourths of one percent yielded \$248,000. Mr. W. L. Norton, the president of the failed bank and also a

holder of much of the bank stock of Oklahoma state banks, with a few other men helping him, paid to the Board \$563,600. The assets realized from the failed bank by the last of October were \$1,199,600.63, thus making a total of \$1,763,200.63

By the last of October all of the individual depositors had been paid and all bank deposits except \$411,000. In two months the amount due banks was cut down from \$1,300,000. to \$190,000. On December 6th, the State Banking Board advertised that they would pay all individual and time deposits. The total expenses of liquidation were \$2,400, (a) Just after this failure four state banks merged with national banks and sixty-five state banks asked for national charters. (b)

By October 30th, 1909, \$503,000. of the guaranty fund had been paid to debtors of the Columbia Bank and Trust Co. By the 1st. of January 1911 the total net collections for the fund amounted to \$818,740. and the amount remaining in the fund at that date was \$333,787., the net loss to the fund being \$484,953. An emergency assessment of one percent was levied on the first of March 1911, to restore the fund.(b)

A report of the workings of the law up to May 1st, 1911, showed that \$878,352. of the guaranty fund had been used up in three years. Ten banks had been recipients of the fund and one failure of \$600,000 was due entirely to bad management. The fund at this time amounted to \$36,292. At this time attention was drawn to the fact that a bank of \$10,000 capital and \$100,000 deposits, in paying an assessment of one percent, (a) Q. J. of E. vol.24:327-91 (b) Independent vol.98:89-90 (c) Money and Banking by Horace White.

would pay its earnings for the entire year, or ten percent on its capital. (a)

From a report made June 7th, 1912, we find there were 638 state banks with \$10,000,000 capital and \$42,000,000 deposits. In 1908, there were but 400 banks. During the four years since the passing of the act 93 national banks were either liquidated or changed to state banks and only ten actually changed to national banks. The guaranty fund at this time amounted to \$200,000 and there were no outstanding liabilities.(d)

(9) Mr. H. H. Smock, the first Bank Commissioner under the new law, favored it, enforced it rigidly and did all that he could to make it a success. Mr. A. M. Young, the Commissioner who succeeded Mr. Smock, also favored the law and did equally well in making it a success. In his report he states that fifty percent of the fund is kept in six percent state warrants and the remainder is kept in banks at three percent ~~and~~ subject to check, and the interest thus derived has been more than enough to pay all expenses of the Board and of failures under his administration.(b) Mr. E. B. Cockrell, the Commissioner who followed Mr. Young, did not think the law just and recommended its repeal. Governor Cruce often went on record as favoring the law.

Certain additions to the general banking laws of Oklahoma during this period should also be noticed in considering the growth during this period. These are partially the cause of

(a) Outlook vol.98:89-90 (b) 2nd. Report of Com. of Okla.
(c) Forum for June 1912.

the success of the state banks. The most important additions were:

- First; Bank Directors must own \$500 worth of stock free.
 Second; Managing officers cannot borrow money from their bank.
 Third; Loans to any individual shall be limited to twenty percent of the capital stock.
 Fourth; The Bank Commissioner shall have power to remove any officer for sufficient reasons. (a)

Thus after five years experience, we find the law still operating in Oklahoma. The question of justice arose in regard to whether the state had a right to pass a law compelling all banks to participate, and, after due testing ~~out~~ by the courts, the law was decided to be just. The assessment the first year was one percent. This sounds low but when one considers a case of a bank of \$10,000 capital and \$100,000 deposits this one percent of deposits amounts to ten percent of its capital which takes all its profits. By June 1st, 1912, the banks had paid into the fund over \$1,000,000 but owing to the failures and losses, only one-fifth of that amount remains in the fund at the present time. The law has taken thirty percent of their capital in five years or an average of six percent per year and has not given them ample returns for this.

The law states that depositors shall be paid in full at once and yet with the first real test funds were not to be had to do so. Thus actual practice has shown this part of the law to be wrong and some substitute must be worked out for this. Again, the law provides an emergency levy of two percent, and yet under it they are unable to collect over three-fourths of one percent at the first emergency. Experience has

(a) 1st. annual report of Bank Com. of Okla.

taught them that this is too much to be exacted at one time, and more especially in a time of stringency. Oklahoma made another mistake when they permitted banks to pay four percent interest on deposits. This drew much money from other states. As soon as they were unable to pay depositors at once this money was drawn out and placed in the banks where it was formerly deposited, making the stringency worse.

Too many banks sprang up, owing to the new conditions made for organizing and for participation in the guaranty fund system. Thus Oklahoma has shown the weaknesses in her law when the law was placed in actual practice and really tested.

CHAPTER- III -

The Guaranty Law of Kansas.

- (1) In agitation, Kansas is precedent to Oklahoma although Oklahoma first passed a law providing for the guaranty of bank deposits. As early as 1895, such a law was advocated or rather Government Insurance was advocated, by Governor Morrill in his message to the State Legislature.(a) However the real plan was evolved by Mr. John W. Breidenthal, the second Bank Commissioner of Kansas. He took his position in 1893 and was such an efficient man for the position that he held it until 1901. In his fourth biennial report of 1897-8 his reasons and plan for a guaranty law are so like the real law as passed in 1908 that liberty will be taken to quote his reasoning and plan.

He begins by asking why bankers should not be required to provide absolute security for the money entrusted to their care. Following this he shows the distress and inconvenience to the average community from a bank failure although almost every bank has met its liabilities in due time. The funds, which have been accumulated for a special purpose, are tied up. Loans must be paid and this compels the selling of securities ~~for loans~~ at a forced sale which is unfair. He adds: "Since the State has undertaken supervision, banking is not a right which any man may enjoy but a privilege only those who comply with the requirements of the law may enjoy. Are the profits resulting from its enjoyment sufficient to enable those engaged in banking to conform to the present require-

ments and in addition create a fund which shall guarantee the prompt payment of deposits of all closed banks?"(a)

He believed that 1899 was the time for Kansas to take the lead and create a guaranty fund and at that time he said: "Her banks are all sound and ready for it."

His plan was as follows:

First, the fund should not be raised by a tax on bankers but should be in the form of a deposit, based on the average deposits of each bank, to be made by it with the State Treasurer.

Second, that the fund should belong to the respective banks and should be carried on their books as part of their legal reserve.

Third, the amount of such deposit should be five percent of the average daily deposits of the bank as shown by the official report made to the Bank Commissioner, the same to be readjusted by him at the close of the year.

Fourth, funds so deposited with the State Treasurer, should be deposited by him in banks in sums not to exceed ten thousand dollars, such banks to pay two and one-half percent interest thereon and to furnish surety bond for the full amount of the deposit. If banks of the state refuse to accept the deposits on these terms then the State Treasurer may purchase United States bonds with their deposits.

Fifth, the interest on such deposits or bonds shall be set apart as a fund out of which losses resulting from closed banks shall be paid.

(a) Bank Com. Report of Kansas for 1897-8

Sixth, that immediately upon closing any bank, a receiver shall be appointed, who shall be given sixty days in which to prove up claims, issue certificates therefor, and collect the quick assets of the bank.

Seventh, that at the expiration of the sixty days, he shall pay such dividend as the funds in his possession will permit, endorsing the same upon the certificate of each depositor, and that upon receipt of such dividend the holder of all certificates will forward the same to the State Treasurer who will pay the balance due thereon upon presentation, charging the amount so paid to the bank, and using first the deposits of the closed bank, second the interest fund, third if these be not sufficient, so much of the guaranty fund as may be necessary.

Eighth, that the receiver shall continue in charge of such closed bank, collecting its assets and remitting to the state Treasurer, whenever he shall have collected \$1,000 over and above expenses until the amount advanced by the fund shall be fully repaid, together with six percent interest from the time it was advanced.

Ninth, when the guaranty fund shall have been fully reimbursed, the receiver may be discharged and the remaining assets turned over to the officers of the bank for the benefit of the stockholders as they may elect.

Tenth, should the assets of the bank prove insufficient to reimburse the guaranty fund, the receiver shall enforce the double liability of the stockholders. Should there still be

a deficiency, the same shall be charged to the interest fund.

Eleventh, that in case any bank should go into voluntary liquidation, the State Treasurer, on receipt of a certificate by the Bank Commissioner, showing that such bank has paid all its depositors in full, shall refund to said bank the amount to its credit in the guaranty fund.

Twelfth, in case of the consolidation of two or more banks, the amount to the credit of the bank or banks retiring from business will be transferred on the books of the State Treasurer to the bank continuing in business, upon receipt of a request from the Board of Directors of the bank discontinuing, approved by the Bank Commissioner. (a)

He adds a few explanatory remarks to his plan as follows: Such a plan involves no tax, it merely transfers one-fourth of the legal reserve, that is, five percent of the deposits to a deposit with the State Treasurer. The fund is not idle nor lost to the bank. It is subsequently deposited in individual banks in sums not to exceed \$10,000.00 at two and one-half percent with a surety bond for safety. The average daily deposits in Kansas, in 1898, were \$22,000,000.00. Five percent of this would be \$1,100,000.00 and two and one-half percent of this sum would be \$27,500.00 and this would be sufficient to pay all losses.

Now, prior to 1891, there was no banking law. As a result, many banks invested in speculative securities, real estate and other questionable assets of doubtful and uncertain value for a bank. Even this bank law did not require

banks to make good any impairment of capital or charge off questionable or worthless assets. Later, however, the law of 1897 gave the Commissioner power to enforce these provisions. As a result, we have been undergoing a house-cleaning along the line of banking. Under the national banking system the total losses have equaled one-twelfth of one percent of the total deposits per annum. Therefore two and one-half percent per annum seems to be sufficient for Kansas.

- (2) A bill was drawn up on the strength of this plan as published by Mr. Breidenthal, which provided that the banks pay one-eighth of one percent of their average daily deposits ~~to~~ to a guaranty fund or place five percent of their deposits with the State Treasurer, the income from this five percent deposit to go to the guaranty fund. (a) Governor Leedy, being defeated for the second term, immediately called a special session in order to get such a bill passed. However, the bill was lost by four votes. Thus, in 1898, under the careful plan of Mr. Breidenthal and the help of his party, a guaranty law was lost by only four votes.

Ten years later, Governor Hoch called a special session of the Legislature for the same purpose. However, the bill was attacked by the national bankers and as such was amended until it merely provided for the formation of a company to insure deposits. Governor Hoch was disgusted with this measure and vetoed it, adding by way of explanation, that he would rather delay the measure than have it placed on a

(a) Q. J. of Econ. vol 24, pp344

wrong basis. (a)

Mr. John Q. Royce, the Bank Commissioner for the year 1907-8, was in favor of a guaranty law and in his report gives many of the ideas which were closely followed in the real statute and as such deserves mention. He said: "I recommend a law authorizing the banks of Kansas to voluntarily associate themselves together for the purpose of guaranteeing the deposits of such banks as desire to do so." He adds: "The recom^{me}ndation was not made at the request of depositors nor because the banks of this state are less safe than are the banks of any other state of the union, but that it was made for the reason that confidence in banks would be greatly strengthened if the people could all know that their deposits were secured by a fund in the hands of the State Treasurer, to be kept and disbursed under the authority of the State law, and such confidence would greatly increase deposits." He also said: "That law which will furnish the largest measure of confidence in the banks, will insure the greatest prosperity. It must be a genuine guaranty deposit law that will guarantee the repayment of deposited money, promptly, in the event of the failure of a bank and one that is not a makeshift to bring confidence to the people. An insurance law or any other subterfuge that will serve to deceive the people into the belief that they have a guaranty law when they have not, will do infinitely more harm than to ignore the subject entirely. It should permit banks to voluntarily contribute

(a) Gov. Hoch's Message.

to the guaranty fund, but once having accepted the provisions of the law no bank should be allowed to withdraw. The funds should be placed in the hands of the State Treasurer and disbursed by the Bank Commissioner. Depositors should be paid as soon after the bank closes as their balance can be determined or their deposits should bear the the legal rate of interest from that day until paid. They should only use the guaranty fund after the assets of the banks have been exhausted. The fund should be replenished, after paying deficits, by an assessment in order that it may be kept intact. I believe such a law would result in greater good to the banker than to the depositor, as it would strengthen confidence in the banks, prevent runs and make bank failures impossible except when officered by dishonest men. To protect the banker, the present law should be strengthened in some particulars and penalties provided for its violation. Banks desiring to contribute to and participate in the guaranty fund, should be admitted only upon written application approved by the Bank Commissioner after a thorough examination by him and his approval in writing. Any violation of the banking law should cause the violating bank to forfeit its share in the fund and its protection" In commenting on this plan he says: "With proper safeguards I feel that such a law would greatly improve the banking business in this state and this important subject should receive the early and favorable attention of the

legislature. (a)

Much discussion followed this report, both political parties promising such legislation in their state platforms. Bankers and depositors alike were interested. After the election the Republicans provided for the guaranty of bank deposits. This bill passed and became a law on the sixth of March, 1909, to be effective on the first of July of the same year.

- (3) The Bankers Guaranty Law of the State of Kansas contains the following provisions:

Section one provides that banks must have a surplus equal to ten percent of their capital stock. Banks are not compelled to enter and participate in the guaranty but may do so voluntarily. Banks must have been in successful operation for at least one year. However, if all the banks of a town fail to take advantage of the fund within six months then a new bank may take advantage of it. Banks must file, with the Bank Commissioner, resolutions of their Board of Directors, authorized by the stockholders, certified by the Secretary and President, asking for membership. After this, the Bank Commissioner shall examine the bank and if he finds it in good condition, it may participate in the fund.

Section two provides that the banks must deposit with the State Treasurer, subject to the order of the Bank Commissioner, United States bonds, State bonds, County bonds, Township bonds, School District bonds, or City bonds to the

(a) Bank Com. Report for 1907-8.

amount of five hundred dollars for every one hundred thousand dollars of their average daily deposits, this average to be found by taking an average of the last four quarterly published statements. Only such bonds are accepted as School Fund Commissioners are permitted to buy and shall bear the certificate of the Attorney General of the state that they are legally issued. Upon receipt of these bonds, the State Treasurer shall issue triplicate receipts, one to the bank, one to the State Auditor and one to the Bank Commissioner. These bonds are not to be charged out of the assets of the bank but are to be carried on the books as guaranty fund. The bank may at any time deposit money and take out the bond. Each bank must pay in cash to the State Treasurer one-twentieth of one percent of its average daily deposits which shall be carried on the State Treasurer's books as guaranty fund. The minimum assessment shall be twenty dollars and the same triplicate receipt shall be issued for the cash as for the bonds. Any new bank, or other bank, wishing to enter after the first year, shall merely pay their proportion of the money already in the fund. This last is not to include reorganized banks.

Section three provides that the Bank Commissioner shall make assessments in January of each year of one-twentieth of one percent of the deposits less the capital and surplus with the twenty dollar minimum until the cash fund shall amount to \$500,000.00 over and above the cash deposited in lieu of the bonds. At this time the annual assessment shall cease.

Not more than five of these assessments may be levied in any one year. This fund shall be placed on deposit in the State depository banks and the interest added to it quarterly as with all the other state funds.

Section four provides that the Bank Commissioner, on taking charge of a failed bank, shall issue at his earliest convenience a certificate to each depositor, on proof of his claim, at six percent unless the depositor holds a certificate from the bank at some other rate of interest. Upon this certificate dividends shall be entered when paid. Notice of payments shall be issued and interest stop on all dividends offered by such notice. After the resources of the bank are paid out, the Bank Commissioner shall draw on the guaranty fund. If the special assessment fails to cover the loss, the Commissioner shall pay depositors out of the guaranty fund. All right of action of the depositor shall be surrendered until the fund shall be reimbursed for payments so made with interest at three percent per annum.

Section five provides that a penalty of fifty percent of the assessment shall be inflicted if the bank fails to remit in thirty days. At that time a part of the bonds of said bank shall be sold with unexpired coupons and the proceeds used to pay the assessment. Any balance shall go to the bank's credit in the guaranty fund. This balance and the remainder of the bond shall be forfeited within sixty days. Upon the bank's failure to remit, it shall be examined and if found solvent, it shall be allowed to go on, but a card not smaller than twenty-by-ten inches and in large type

shall be displayed to read as follows: "This bank has withdrawn from the bank depositors guaranty fund and the guarantee of its deposits will cease on and after (blank for date)". The date on the card shall be fixed at six months after the posting of said card. A bank may voluntarily withdraw after six months notice to the Commissioner by displaying the above described card, provided its assessments are paid in full. Its bonds will then be returned to it.

Section six provides that all deposits, not otherwise guaranteed, are guaranteed under this act. At each report the bank shall state the amount of money otherwise guaranteed.

Section seven provides that each bank under the guaranty fund shall be liable to lose its share in the guaranty fund if it pays interest on demand deposits, if it pays more than the rate prescribed by the Commissioner, which shall be uniform in each county, if it pays interest on time deposits drawn before the time is up, or if it uses time certificates as security or if it advertises that deposits are guaranteed by the State. Any of the above named offenses shall disqualify the bank from participating in the guaranty fund and shall forfeit its bonds and money in lieu there-of and any officer, who shall advertise that deposits are guaranteed by the State shall, if convicted, be subject to a fine of not more than \$1000.00 and not less

than \$500. However, they are allowed to advertise that depositors are guaranteed by the Bank Depositors Guaranty Fund.

Section eight provides that any private or national bank or trust company may reorganize as a state bank and participate in this fund.

Section nine provides that any failed bank, after all its liabilities and ~~the~~ expenses are paid, shall receive all its bond and money pledges, which remain but not any of the money collected as assessments.

Section ten provides that bonds may be exchanged for other bonds or for cash whenever the bank may so desire.

Section eleven provides that any bank, found violating any provision of this act, upon examination, shall be given thirty days in which to comply. If it does not, its bonds shall be forfeited and the proceeds shall go to the guaranty fund.

Section twelve provides that all money and bonds deposited under this act shall be kept separate and used for no other purpose.

Section thirteen provides that national banks may enter the system upon compliance with all the provisions of this act.

Section fourteen provides that no bank shall receive deposits continuously for six months in excess of ten times its paid up capital, under penalty of loss of its guaranty fund and forfeiture of its bonds.

Section fifteen provides forms and blanks in order to

carry out the preceding provisions.

Section seventeen provides that the act shall take effect June 30th, 1909. An additional clause provides that all officers having state funds and depositing them with banks under the guaranty fund shall not require of them additional security. (a)

Kansas removed the criticism of compelling good banks to support the poor banks by making the law voluntary. She also cut the interest to three percent to keep down the rapid superficial growth which came about in Oklahoma. She made it more secure by demanding a year's successful operation. Thus the Kansas Law is superior to the Oklahoma law in that it classifies the risks, is voluntary, and more secure.

- (4) By the first of October, 1909, three hundred banks were actually using the guaranty fund. By the end of the year, three hundred and sixty-five banks were using it and there was in the fund, cash to the amount of \$17,000. and bonds and cash deposited to guarantee the payment of future assessments to the amount of \$278,876. In these guaranteed banks there was a total of \$40,000,000. of individual deposits. (b)

At the close of 1912, there were four hundred and fifty-six banks under the guaranty law. There was \$83,231.03 in the assessment account, and funds in bonds and cash to guarantee the payment of future assessments \$341,349.10. Not a penny had been drawn out. Guaranty certificates to the amount of \$46,809.75 were issued against the fund for the amount the Abilene State Bank owed its depositors when that bank was closed. (a) Chapter 61 of Session Laws of Kansas, 1909. (b) Q.J. of E.

However, this was all paid ^{back} in after the Bank Commissioner closed up all its assets. (b)

On March 1st, 1913, there was in the fund \$98,560.89 cash assessments and bonds and cash held as security for future assessment \$335,902.10, making a total of \$434,462. At this time, there were four hundred and sixty-one state banks using the fund and four hundred and forty-one which were not. The amount of the assessment levied on the first of January, 1913 was \$23,931.61 or an average of \$51.91 per bank. The cash fund is deposited in banks, the same as the state funds, and is drawing interest at the average rate of three percent. (a)

- (5) The national banks in Kansas upon being refused admission to the guaranty funds immediately got together and organized the "Kansas National Bank Deposit and Surety Co." with a capital of \$500,000. The rate of insurance was fifty cents a thousand up to the amount of their capital and surplus and all above that at the rate of one dollar a thousand. This is equal to one-twentieth and one-tenth percent respectively. National banks cannot use their funds to pay premiums so each bank wishing to aid in the organization of such a company had its share-holders appoint one, usually the president, as trustee to hold insurance stock in behalf of the share-holders. A dividend of two and one-half percent is declared and this is then the property of the stock-holders. Since the trustee had been given power by them, he uses this dividend to pay their premiums. By September, 1909, \$346,550. had been subscribed and \$257,850. paid in. In this was the national banks pro-

(a) Bank Commissioner's books at his office March 1st.
 (b) 11th Biennial report of bank commissioner of Kansas.

vided a plan of their own for insurance of deposits.(a)

(6) Senator Joseph in the State Legislature of 1912-3 proposed several bills trying to amend the present state banking laws. They are as follows:

Senate bill No. 551 provided that every bank which receives deposits from other banks shall keep a twenty-five percent reserve.

Senate Bill No. 607 is a substitute law for our present guaranty law and among the most important provisions of this bill are: An assessment of one-half of one percent of the average daily deposits, not otherwise secured, less the capital and surplus; no bank to pay less than \$100 assessment; in case the deposits are less than twice the capital and surplus, the amount paid to be a percentage of the capital and surplus instead of a percentage of deposits; no bank to have less than one-fourth of one percent of its deposits in the fund and not more than two percent, and providing for one-twentieth of one percent annually until the fund reaches this amount; the fund never to exceed \$10,000; if over this, the surplus to be returned pro rata to the banks.

Senate bill No. 609 provided that banks under the fund system shall in no case be asked for additional security for deposits made to it by any public or private corporation or individual.

Senator Joseph informs us that these bills were not reached on the calendar because of opposition by the politicians who framed the present law. The politicians said that

any change would disturb banking and that the guaranty law had best not be changed now. He adds: "It will take some time to educate the people to the wisdom of some changes. The banks were five to one for the change but the political bankers had their way as usual." (a)

(7) After the guaranty law was passed in 1909, and before it went into effect, there was an organized movement to kill the law. The Assaria State Bank, effected an organization with seventy other state banks, which were opposed to the law, and brought suit to enjoin the operation of the law. They maintained that if they did not participate, it would be a hardship as banks that did guarantee the deposits would get the money of their customers. At the same time the Abilene National Bank effected an organization with a group of national banks, which were opposed to the law, and brought a similar suit, maintaining that the guaranty of deposits in state banks would work a sever hardship on national banks and this would be in violation of the constitution.

Mr. Frank Larabee, a stockholder in the Hutchinson State Bank, also brought a suit to prevent his bank going in to the fund. These suits were brought in the U. S. Circuit Court and Judge Pollock ruled that the law was unconstitutional in the first two cases and threw the third case out of court. However, a little later Mr. Larabee was granted an injunction which showed that one stockholder had the power of keeping a bank out of the system. (b)

Shortly after this a successful suit was brought by the

(a) Personal Letter from Senator Joseph 3/27/13

(b) Kansas City Star for March 17th.

Attorney General compelling the enforcement of the law in Kansas. The Assaria State Bank and the Abilene National Bank appealed their cases to the U. S. Court of Appeals and there the decision of Judge Pollock was reversed. In 1910 the Assaria State Bank case was carried up to the U. S. Supreme Court and this court upheld the decision of the Court of Appeals. In this case Justice Holmes, gave the decision of the Court and in so doing he referred to the Oklahoma decision. This caused Bank Commissioner Dolley to make the statement that the constitutionality of the law was beyond question. However the Abilene National Bank case was still to be decided. This case was tried recently in the Supreme Court and the decision of the Court of Appeals was again upheld. Thus, this last decision rendered March 17th, 1913 established the constitutionality of the Kansas Bank Depositors Guaranty Law beyond much doubt.

- (8) There is some criticism of the present law due to the loss of interest to the banks. Money is worth about eight percent in Kansas and this fund only earns three. So, more than goes into the fund is lost every year in the form of interest. The proposed amendment by Senator Joseph does away with this loss of interest.

Honorable J. N. Dolley, our Bank Commissioner from 1909 to 1913, in his report for the years 1909-10 made the following statements with reference to the new guaranty law: "The law is now in full operation, it has stood the test of all the courts, it gives absolute confidence to depositors as well as to bankers; it is as valuable to bankers and stockholders as

to the depositing public; it is the first duty of the banking department to protect the depositing public; the cause of loss to depositors is dishonesty, incompetency and speculation with bank funds through and by men behind the counter of the bank; it is the duty of the State to protect all savings of the laboring classes." (a)

In commenting on this law in his report for 1911-2, Mr Dolley writes: "It has placed proper confidence in state banks and helped the Bank Commissioner to regulate and supervise banks, raising them to their present high standards. It has been a success in every sense of the word." (a)

However, the fund is seldom made available in a town with only one bank, which shows that people are not really demanding it. It is used in almost every instance as an advertising measure in order that the bank may draw depositors from its competitors and has proven an efficient weapon against these state banks which are not using the fund and also against national banks.

The efficiency of the law in Kansas has never been tested. There were few failures before the law was enacted and few since. It failed to increase the deposits as was prophesied. The deposits show only an average growth, the same as before the law went into effect. It is more effective as an advertising medium in Kansas than in Oklahoma, because the law is voluntary. Commercial bankers in Kansas oppose it the same as they have in Oklahoma. It is used only as a means of expediency

(a) 10th and 11th Biennial report of Bank Com. of Kansas.

and now that we have the Postal Savings Bank to care for the savings, we have no need for such a law.

The law in Kansas shows improvement over that of Oklahoma. They made it voluntary so strong banks might not be compelled to sustain the weak banks, and yet they give banks an opportunity to cooperate and help each other in case of a failure. They have been more careful by compelling a year of successful operation, and have thus kept down the surplus of banks which Oklahoma suffered. They put the limit of interest on time deposits at three percent and thus provided against the rise and fall, as followed in Oklahoma's deposits due to outside deposits seeking both safety and higher interest. They have the same rate of assessment and made provision for payment at the ratio of five hundred dollars in bonds for every \$100,000 of deposits. In view of the experience of Oklahoma, they set the limit of emergency levy at one fourth of one percent. They placed the limit of the total amount at \$500,000. In view of other banking laws and the few failures, this is too high, for more money is lost in interest than is paid into the fund. Senator Joseph proposed to stop this by cutting the total fund down to \$10,000 and allowing an emergency levy of one-half of one percent.

Kansas saw that immediate payment was impossible and so provided an issue of certificates at once, and payment as the bank funds are liquidated, ~~and~~ The guaranty fund will provide for such payment. The assessment of one-twentieth of one percent in 1913 on the four hundred and sixty-one banks in

the system was \$51.91 per bank. The four hundred and forty-one banks outside the system paid no such assessment. The banks in the fund are indeed paying a high rate of insurance for they are no better off financially or have no better standing today than the other banks. The state banks are paying at the rate of fifty cents for each \$100 while the national banks are paying at the rate of fifty cents for each \$1000. and one dollar for each \$1000 over and above their capital and surplus.

The justice and constitutionality of the law has been questioned even after the law of Oklahoma had been passed upon and declared constitutional by the Supreme Court. It was later tested in Kansas and only recently did the Court uphold the law. Thus we find that the Kansas law is much of an improvement over the law in Oklahoma. However, the practical and economic success of the law, even in Kansas, is questionable.

CHAPTER - IV -

Laws of Other States.

- (1) In Nebraska, a law was finally passed in July, 1909. This was after a bill had been introduced every year successively for twenty years. (a) This law is like that of Oklahoma in that it is compulsory for all state banks to participate. It provides for four semi-annual assessments of one-fourth of one percent each and after this one-twentieth of one percent every six months. Not over one percent is allowed to be collected in any one year. If this one percent assessment should not prove sufficient to pay all depositors, those unpaid, must wait until the following year. They give certificates to the depositors to hold until the following year. A limit on time deposit interest was placed at four percent. (b) The law compelling men to enter banking only through corporations, and they ^{in turn} to pay to the guaranty fund was declared unconstitutional by the U. S. Circuit Court. This seemed to put out of existence the thirteen private banks then doing business in that state. No national bank took out a state charter, but on the contrary state banks took out national charters.

Here they have no Bank Commissioner but a Banking Board composed of the Governor, Attorney General, Auditor of public Accounts and Secretary. It is provided in the banking act that assessments shall never exceed one and one-half percent of the daily deposits. Assessments may be levied when the fund

- §a) Independent vol.666:1268-9
 (b) Section 45 of the banking act.

falls below one percent of the total deposits of all the banks. There have been no bank failures in the last five years and only one in the last eight years.(a) With no failures there has been no opportunity to try out the law.

There was, March 1st, 1913, in the fund \$77,414.58. No money has ever been paid out of the fund. The fund is merely set aside on the books of the separate banks to the credit of the State Banking Board.(b)

The Nebraska law, being compulsory, went into effect with visible results. There was no need for such a law because there were no failures. It was merely a wave of public sentiment. It is an item of expense to the bankers without an adequate return.

(2) The idea of a guaranty law was developed in TEXAS by the Democratic party. Mr. Bryan, on his tour in 1908, made a speech in the House of Representatives of Texas, in favor of such a law. The Governor at that time favored it and so did the Bank Commissioner, Mr. Love. The city banks fought the idea with the same arguments that were used elsewhere and the town and village banks favored the idea because the farmers wanted it. The failure of the Western Bank and Trust Co. of Dallas probably hastened the day for the measure.

In 1909, the Governor called two special sessions of the Legislature, and it was at the second session that a guaranty law was passed. This law differed from former laws in that it offered two propositions for guaranty-- a Guaranty Fund and

(a) 20th annual report of State Board of Nebr.

(b) Personal letter from Sec. of Board E. Royce 3/10/13.

and a Guaranty Bond system. This last was brought in mostly for the benefit of Trust companies and to induce national banks to enter.

The State Banking Law of 1909 provides:

For Savings Banks. When interest at not less than three percent shall have been paid or credited by a savings bank out of the net profits of the current six months, the Board of Directors may declare and pay dividends on the capital not to exceed ten percent, providing no such dividend is declared until at least one-tenth of the profits for six months shall be carried to the guaranty fund,^{OR} until such fund shall equal the capital stock.

As to advertising for all banks. All guaranty fund banks are allowed to publish, by any form of advertising or upon stationery, that non-interest bearing and unsecured deposits of this bank are protected by the depositors guaranty fund of the State of Texas. Those banks under the bond system may advertise that deposits of their banks are protected by guaranty bonds under the laws of Texas. They may use the terms "Guaranty Fund Bank" or "Guaranty Bond Bank" as the case may be, but no other terms than those mentioned shall be used.

The law is compulsory and compels every bank to protect its depositors by either the fund or the bond system.

A state banking board is provided for, consisting of the Attorney General, Commissioner of Banking and Insurance, and the State Treasurer. This Board has control and management of the depositors guaranty fund system and of the depositors

guaranty bond system. This Board has power to regulate, control, and supervise all state banking corporations and trust companies. All banks must choose their plan by Oct. 1st, 1910.

Under the guaranty fund system the bank must apply ^{for} and pass the examination of the Commissioner and then pay to the Banking Board one percent of its average daily deposits for the preceding year. This is not to include United States, State or Public funds if they are otherwise secured. Annually thereafter, they shall pay one-fourth of one percent until the guaranty fund shall equal \$2,000,000 and no payment thereafter shall be made until the fund is depleted. In case the fund should be depleted the Board may levy any amount up to two percent in any one year in order to replenish it.

Twenty-five percent of each payment is made in cash to the Board and deposited with the State Treasurer and paid out as ordered by the Board. The fund is never to become a part of the state fund. The other seventy-five percent may be paid by each bank, merely crediting the Board with the amount on the bank's books as a demand deposit subject to check by the Board.

All banks organizing after Aug. 9th, 1908, shall pay a tax of three percent of their capital and surplus and at the end of the year it shall be regulated to one percent of their average daily deposits. Any national bank may enter under the same conditions.

Under the Bond Security system the bank shall, on the

first of January 1910, and annually thereafter, file, with the Commissioner of Banking and Insurance, for and on behalf of the lawful depositors of such bank, a bond, policy of insurance, or other guaranty of indemnity, in an amount equal to the capital stock. Such instrument and security thereby provided shall be approved by the County Judge of the County where the bank is ^{located} and take effect immediately upon being filed.

Every corporation, on filing its charter, must take up one of these two plans before receiving deposits. The bond shall be security for all deposits for the following twelve months. The bond shall not be executed by personal obligation and security unless by three different persons whose finances are sufficient to make the bond secure. The guaranty fund corporation cannot be surety for bond corporations. Private banks and non-supervised banks may utilize the bond system. They must have been in business one year prior to taking up the bond.

Upon a failure, the amount of the bond shall be due in sixty days. The Commissioner of Banking and Insurance can demand all or any part and hold it for depositors. Any corporation, signed as surety and refusing to pay, loses its charter, or if secured by corporations in other states, these, if refusing to pay, shall not be allowed to do business within the state. If the bond is not paid in ninety days the Attorney General shall bring suit in the name of the state. Action shall be brought within a period of one year. The surety, in case of the bank's default, shall be subrogated and such surety must

pay the debts of depositors. A fee of twenty dollars is charged for examining a bank and ^{for} determining how large a bond it should put up.

The form of the bond to be used is as follows:

" State of Texas. County of -----

Know all men by these presents; that we--- as principal and --- and --- as sureties are held and firmly bound unto the Governor of the State of Texas and his successors in office in Trust for the benefit of depositors, having funds deposited with --- in the sum of --- dollars payable as provided by the laws of Texas, at the time of execution thereof, conditioned that above bound--- will pay on demand, or in accordance with the certificate of deposit, to the persons entitled thereto, all deposits made therein during the period of one year from the date hereof. Upon payment of any sum or sums made obligatory by reasons of the terms hereof, any surety herein making or participating in such payment shall thereby be subrogated to the rights of a depositor who is secured by the terms hereof."(a)

The security may be divided into two or more bonds provided the aggregate thereof equals the sum demanded as security for the guaranty. Whenever the deposits exceed six times the capital and surplus then the bank must furnish additional security.

Any bank which shall fail to secure the bond or fund system shall forfeit its charter. The Board may require additional security whenever it deems it necessary. In banks of \$10,000 capital or more, if their deposits exceed five times their
(a) Report of Bank Com. for 1911-12 of Texas.

capital, they are required to increase their capital twenty-five percent.

In 1909, four hundred and ninety-three banks chose the Fund system and forty-two chose the Bond system. The Continental Bank and Trust Co. of Fort Worth, discontinued its thirty branches and reorganized them as separate banks in order to get the advantages of the guaranty fund. (a) By December, 89 state banks had been organized and 8 national banks converted into state banks.

The efficiency of the law is shown in Commissioner Gild's report for 1911-2. He reports that State Bank Examiner J. K. Woods advised him, in regard to the liquidation of the Harris County Bank and Trust Co.- capital (\$50,000) that depositors were exceedingly show in presenting their pass books in order to withdraw their deposits from the bank. (b)

A report on the workings of the law, by Mr. McCaleb in June 1912, says that the Texas law after over three years of actual operation has not paid out a dollar until recently. When the Houston bank failed in August 1911, \$100,000 was taken from the fund. \$50,000 of this was very soon returned from the assets of the bank. The state banks out-number the national banks, there being 698 state and 500 national. (c)

The report of Commissioner B. L. Gild shows that on Sept. 1st. 1911, the fund amounted to \$495,685.67. By means of assessments, the fund amounted to \$615,132.66 in September 1912.

(a) Q. J. of E. vol.24:361-7

(b) Report of Com. of Banking and Insurance for Texas 1911-2.

(c) Forum for June 1912.

However, \$15,780.62 was paid out to banks who withdrew from the fund and nationalized, and \$34.28^{for} expenses in the Harris Bank Co. This left in the fund for the beginning of the new year \$599,317.76; (One fourth, or \$149,843.03, being deposited with the State Treasurer in cash, and three-fourths, or \$449,474.73, consisting of demand deposits.) This makes an increase for the year of \$103,632.69 in the guaranty fund. (a)

In 1911 there were 45 banks and trust companies using the guaranty bond system. The total amount of the bonds put up under this system was equal to the capital of these institutions and was \$4,281,000. Nine new institutions took advantage of this system in the year 1912, while the Bonita State Bank alone withdrew and took out a national charter. This left 53 banks and trust companies under the system with \$5,581,000. in bonds held as security. (a)

In Texas, we find two systems. First there is the Fund system which is more costly than the Kansas system in that after the one percent levied the first year they ask one-fourth of one percent instead of one-twentieth of one percent and keep on assessing until the fund equals \$2,000,000 instead of \$500,000. Again in Texas they allow an emergency levy of two percent. However with such a costly system no emergency levy will probably be needed. Their law provides that the bank shall pay only twenty-five percent of this in cash and the^{the} seventy-five percent must be kept on their books as a credit or held as reserve. A great loss of interest is thus incurred and as yet they have received no benefit in return.

(a) Report of Com. of Banking and Insurance for 1911-2

Only a few banks took up the bond system. This is practically a third liability clause. It causes the banks much trouble and expense with no adequate return.

- (3) In SOUTH DAKOTA instead of a state organized bank deposit fund, we find a plan for an Association of banks for the purpose of providing deposit guaranty insurance. The agitation, which led up to this was the national republican platform of Chicago in 1908, and the money stringency in South Dakota in the early part of the year 1909.

The National Republican platform of Chicago contained the following: "Our national platform favors the establishment of a Postal Savings Bank system for the convenience of the people and the encouragement of thrift. The protection of depositors against loss by insolvent and mismanaged banks and protection of the solvent and well managed banks against runs and panics require the Postal Savings Bank laws be accompanied by efficient laws, state and national, providing for the insurance of depositors against loss." (a) The immediate cause which brought this expression in the party's platform, was the failure of the Milwaukee Avenue Bank of Chicago, a bank which had built itself up ^{largely} by collecting the savings of the laboring classes, and the failure of this institution caused much hardship in a certain part of that city. The depositors of this bank received seventy percent of their money after five months, but people who live from hand to mouth could not avoid much distress because they were not prepared to wait for

for their money.

In the early part of 1909 there was a money stringency in South Dakota and the bankers, being in much distress as to how to meet the difficulty, asked Governor Crawford for a holiday in order to get together and plan some method of concerted action. However, the Governor refused and a panic was only averted by the co-operation of the bankers and the confidence of the depositors.

In reply to the popular demand for a guaranty of deposits, a law was proposed by Governor Crawford which did not provide directly for a guaranty fund but provided for an association of bankers, which might provide a guaranty for their depositors. This bill was passed and the contents of the law are as follows: Provision was made for a "Voluntary Incorporated Association" to be formed by the union of one hundred banks with an aggregate capital of \$1,000,000. A charter fee was to be charged of from one hundred to one hundred and seventy dollars according to the amount of the capital stock of the bank. An annual premium was to be paid in by each bank of one mill for every dollar of capital stock. This rate of insurance was based upon the previous losses under the national banking system. This loss had been 2.17 percent in 43 years, an average loss of one-twentieth of one percent per year of the daily average deposits. From 1863 to 1907 the average loss to depositors was less than one-ninth of one percent of the capital and surplus. Upon entering and for the first three months the rate was fixed at one-tenth of one percent and one-tenth

of one percent annually there-after. Four-tenths of one percent was made the limit of assessment for any one year and a limit of five percent was placed on time deposits.

Payments on losses were to be made the same as in the case of insurance companies. The association was under the control of the Bank Commissioner.(a)

The law is not operative (In a letter from Mr. J. L. Wingfield, Public Examiner, received the first of February, we are informed that the law is not operative.) In short, after a statute was passed, giving opportunity for an organization to insure deposits, no company was formed, which seems to show that no necessity for such a law existed. (b)

Thus, we find that in the case of South Dakota, no fund was established, but merely a law providing for such a thing was passed, and this satisfied the public demand without any guaranty of deposits. There was no need for such a thing and the banks have avoided the needless expense.

- (4) Two bills were proposed in Colorado in 1909, but neither bill succeeded in getting to the Governor, - one being supported by the House and one by the Senate.

The House advocated a "Mutual Guaranty Fund" to be raised by an assessment upon the banks of one percent, two-fifths to be paid in at once and one-fifth each year thereafter until it should be all paid in. This fund was to bear interest at the rate of four percent. The tax for any one year was never to exceed one percent of the average daily deposits. The system was also to be made compulsory by making every bank participate.

(a) Independent vol.66:1268-9

(b- private letter from Wingfield 3/10/13

The bill which the Senate advocated, provided for the "Accumulation of a Guaranty Fund" by each bank being compelled to lay aside one percent of its deposits every year for ten years. This fund was to be invested in bonds and the bonds deposited with the State Treasurer. These two bills were advocated, but both House and Senate were unwilling to compromise and as a result no law was passed.

In 1911 a bill was proposed similar to that of Texas in that a fund and a bond system were included in the bill. The bill provided for a Banking Board consisting ^{of} the Governor, Attorney General, State Bank Commissioner, State Treasurer, and one state banker, to be appointed by the Governor.

Under the guaranty or fund plan the bank was to pay to the Board by January 1st, 1913, one percent of unsecured deposits and one-fourth of one percent every year thereafter until the total should equal \$1,000,000. A limit for any one year was placed at two percent. Twenty-five percent of this was to be paid to the Board in cash and the Board was to deposit this in banks which would pay the highest interest. The banks, receiving the fund, were to put up bonds for the same. The interest was to be added to the fund from time to time. The seventy-five percent was to be credited to the Banking Board by the bank and subject to its check. A provision was made so any bank might withdraw and secure its portion of the remaining fund after all debts were paid.

Under the security or bond plan, the banks must put up

bonds to the amount of their capital and surplus, the same as in Texas. No advertising was to be permitted.(a)

The political party in power considered this a substitute and not a real guarantee of deposits and so the bill was lost in the House. Attempts to secure a guaranty law have met with failure in MISSOURI, ILLINOIS, OREGON, WASHINGTON, and in CALIFORNIA.

(a) Senate bill #374 of Colorado Legislature of 1911.

CHAPTER - V -

National Agitation for Guaranty.

In the presidential campaign of 1908, Mr. W. J. Bryan proposed a guaranty of deposits in national banks, as was quoted from the democratic platform in the fourth section of the first chapter. This, while not including all banks, is the nearest thing to a nation-wide guaranty of deposits which has been suggested.

The Democratic party was defeated and the Republicans now say that a guaranty law has been voted down by popular vote. This is hardly a fair view of the question, since there were numerous issues in the campaign and the guaranty question was merely one of minor importance.

The proposed law was to place a tax on all national banks, the proceeds of the tax to be placed in a fund under the care of the Comptroller of the Currency for the purpose of paying losses when there was a national bank failure.

This bill was presented in Congress in 1908 by Senator Owen of Oklahoma, then chairman of the Senate Committee on Banking and Currency. The bill was voted down in Congress and no further bill has been presented up to the present time.

However there is much agitation for and against such a law. The prospects that such a bill will be laid before Congress at the next regular session are bright, to say the least. Mr. Bryan, the author of the idea, is now in an influential position. President Wilson has said: "Perhaps it would be a good thing,"(a) and reports have appeared to the effect (a) Banking Reform for April 1913.

that Congressman Glass, chairman of the sub-committee on banking and currency, in conference with his committeemen and President Wilson, is framing such a bill. (b)

Some thought such a bill would be a part of the "Reform Bill" for our currency and banking system, but Representative Glass said: "The guaranty of deposits should be considered as an independent proposition and not made a part of the plans for revision." (c)

Thus a bill will probably be presented to Congress asking for the national guaranty of deposits. The prospects for a law to that effect are, however, an entirely different proposition and not so hopeful as the following chapter will show.

CHAPTER - VI -

Conclusion

With the foregoing history of guaranty laws before us, we are now in a position to discuss the theory and the practical workings of such laws.

One of the first features of such laws was the determination to be able to pay depositors of a failed bank at once, in order to relieve the pressing needs of depositors, who need their money from day to day and ^{who} cannot wait until some future time when the affairs of the bank are settled, to received their deposits without much privation and suffering. Now in Oklahoma the first real test showed that such a provision could not be secured by a guaranty fund.

In the first place, as pointed out by Mr. Hepburn, there is over \$6,000,000,000 in deposits in national banks alone and in actual money in the United States there is less than \$2,000,000,000. Now in case of a panic where could the money be found to pay depositors at once? The very principle upon which the bank is founded takes it for granted that it cannot pay all depositors at once. No fund could be secured large enough to accomplish this. Again, in case the money should be invested in securities so as not to be lying idle, the securities must then be sold and if there is no money to buy them they cannot be turned into cash and the depositors paid. Moreover this would involve a forced sale of securities. Thus, one of the ideals which the guaranty fund was intended to provide, has

been shown to be absolutely impossible in actual practice. Where the banks are merely compelled to carry so much on their books subject to the call of losses in other banks, there would be no more reserve than there is at present.

The strong bank would not be as secure as it is at the present time, since it would be compelled to pay the losses of any other bank as well as hold a large reserve for itself and yet not be in a position to dictate the policy of the weaker bank. This is unjust to the strong bank. Banking, in its very nature, is a business conducted by an individual or group of persons and it depends entirely on the judgement and ability of the managers of the loans as to whether the bank shall be prosperous or not. If the safe banker must pay the losses to depositors in weaker banks he ought to have, at least, a part in dictating the policy of the weaker banks. If the banks are left free to co-operate, as they have under the Clearing House system in large cities where each bank to a certain extent does dictate the policy of the others, then they can pool their reserves and help pay the losses without the unfairness which is produced when they are forced to pay a part of the loss in the guaranty system.

In Mexico, the banks by a mutual agreement, help each other and no loss to the depositors has been the result. The same thing is true in England, and is true for all Clearing House systems. Why not treat the banks just and revise the banking system and allow them to have a voice in the way a bank is to be operated if they are compelled to pay its losses?

If banks are compelled to pool their reserves and yet not have any authority over weaker institutions the situation of the entire locality is weakened rather than strengthened, for in case of a panic, the strong banks will not only have to secure enough cash reserve to secure themselves but also enough to pay their share of the loss of the weaker banks.

Any compulsory system cannot be enforced without putting a premium upon reckless banking. If the deposits of all banks are guaranteed and no check is put upon who shall operate banks, then many incompetent men will go into the business as was the case in Oklahoma. The more ^{men} of this character who go into the business the weaker the system as a whole is bound to be. It makes a few more weak banks for the stronger banks to hold up and the pursuance of such a policy would cause the downfall of our entire banking system.

Mr. A. B. Hepburn has well stated the facts when he says: "A law guaranteeing deposits is unsound for the reason that it gives careless bankers the same protection that it does to conservative bankers and at the same time it places the burden upon the conservative bankers."(a)

The majority of deposits are created by loans. A man goes to the bank and asks the banker to buy his note or the note of some other person or firm. Now, it is strictly a private matter between the man and the banker as to what the banker shall do. The public is not concerned in this transaction. With railroads it is a different matter; they have a quasi-public function to perform and accordingly the Government

(a) New York Sun for February 5th, 1913.

has taken steps to regulate them. Mr. Paul M. Warburg of Kuhn Loeb & Co. makes the above statements and adds that if the Government steps in and demands that the banker shall guarantee all deposits, which are a private matter between the banker and the customer, why should it not also make the private man guarantee to pay his note when due?"(a) If banking were put under enough regulations to take away the personal element then a guaranty might be all right but as long as it is almost entirely a matter of personal policy so long it will be unjust to ask one bank to guarantee the deposits of another without some system of mutual co-operation.

Joseph Talbert, vice-president of the National City Bank of New York, says: "I would consider a national guaranty of bank deposits as a national calamity."(a) Many bankers in speaking of the subject say: "Look to Oklahoma." The working out of the Oklahoma law found, of course, almost the entire burden of loss put upon banks which were exceedingly well conducted and entirely safe and efficient. These banks paid the debts of the others to the detriment of their own clients and community.

In commenting on the law, Prof. J. L. Laughlin states: "For deposits made in cash the Postal Savings Bank has been adopted. Whether in the form of a guaranty fund directly administered by the Federal Government or in the form of the compulsory assessment of one national bank to pay the debts of another, the scheme is pernicious, unjust and irrational from (a) New York Sun for Feb. 5th, 1913.

any point of view of sound business. It would put a premium on inefficient banking methods and a burden on good management. The safeguard against loss which Federal supervision and examination afford to the depositor is all that the Government can legitimately undertake and any plan of financial insurance is beyond the province of said Government."(a)

The double liability of stockholders places the responsibility where it should be placed. If some outside institution should guarantee the deposits, the stockholders and officers of a bank would have a lessened responsibility to the depositors and could be induced to take greater risks in the loaning of money. In the general management of the bank they feel very keenly their liability to the depositors and to the general public. Any plan, that will lessen this feeling of responsibility will tend to put the bank on the same basis as any ordinary commercial enterprise. The officers might take risks, which would seem good enough at the time, in view of the fact, that the depositor, at all events, would be secured by an outside guaranty.

The guaranteeing of bank deposits is one way of making it easier to induce bank managers to loan their money to irresponsible parties. The honor among bankers is now on a very high plane and the losses to depositors are insignificant. With a guaranty, there would come poorer bankers and this plane would be lowered. Mr. W. T. Galliher, of the American Bank of Chicago, well described it in the following manner:

(a) Banking Reform for February 1913.

"It puts a discount upon integrity, financial responsibility and sound and conservative banking, and a premium upon what is usually described as "Wild-Cat Banking". It is effective because it results in imposing the unfair and impolitic burden of responsibility for the default, miscarriage, or mismanagement of a badly or poorly managed institution upon its successful neighbor, who ought to be encouraged and approved, instead of being, by this plan, unjustly penalized." (a)

The actual loss to depositors has been less than one-twentieth of one percent. In every case where a guaranty has been tried it has cost the bankers more than this. It would seem from this that it is practically impossible to secure a guaranty at a lower cost than the losses under our present system. If the depositor pays for it, as he does in either case, why should he not have the cheaper method and stand the loss which is small and uncertain rather than the cost of a guaranty which is larger and which is a constant burden?

Public confidence in the banker's ability to meet his obligations is an indispensable asset to the banker. This removed, will place incompetent men in the business. Those now doing the business would become reckless, standards of banking integrity would be lowered, and thus in an endeavor to protect the depositors from loss, the whole country would be subjected to a menace.

The benefits accruing to depositors under a guaranty law are nothing compared with the effects upon banking efficiency. If the known defects of our present banking system

(a) Banking Reform for April 1913.

were corrected, we would not need a guaranty law because the proportion of insolvency, due to credit strain, would be reduced to a minimum.

Judging from past experience and from observations of banking systems of European countries, it would seem that what our present system needs is a centralization of reserves and the rediscount feature ~~made possible for~~ our commercial paper ^{with an} together, elastic currency.

These defects have been remedied in our cities to a large extent by means of the Clearing House system and with this system enlarged so as to cover the United States, making a Central Reserve, and adding the feature of rediscount for all times, and not only for cases of emergency, and a currency such as that proposed by the Aldrich Monetary Commission, would, to my mind, be the proper method and would correct these defects.

The Guaranty Law is not needed for four reasons.

First; because the losses from dishonest and incompetent banking are negligible.

Second: because it is unjust to ask the strong to guarantee the weak banks unless the strong banks are permitted to supervise the weak by such a system as the Clearing House.

Third: there is already a guaranty fund in the shape of the capital and surplus and double liability clause.

Fourth; because all trials of the law have proven inefficient and also expensive.

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