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# THE TRUST COMPANIES: IS THERE DANGER IN THE SYSTEM?

DURING the last few years, and especially during the year 1899, the student of the American banking system has been confronted with what is to all intents a new problem in the field. This new problem is the rise of the trust companies. The growth of resources and liabilities among the state and national banks, during this period of expanding American industry, has been of itself remarkable enough. For the present, I need only refer to two sets of comparisons — the statements of the comptroller of the currency, on the national banking system as a whole, and the reports of the New York clearing-house, on the banks (both national and state) of New York City. The comptroller's returns show that between October, 1896, when the American trade revival, now still in progress, fairly began, and December, 1900, the total resources of the national banks of this country increased more than fifty per cent — from $3,263,685,313 in 1896 to $5,142,089,692 at the close of 1900. It need only be observed, in addition, first, that the increase through the four-year period was normal and gradual and, second, that the increase in the number of banks reporting, during this period, was only a trifle over seven per cent, — from 3676 to 3942, — all of that increase, moreover, being made in the last few months. As regards the New York City institutions, it is sufficient to say that, as against a net deposit account of $523,589,900 on December 19, 1896, the report of December 22, 1900, footed up $838,804,400 — an increase of sixty per cent. The increase in loans had proceeded in equal ratio.

This expansion, in New York and in the country at large, was extraordinary; but it excited little surprise. It was accompanied by such significant phenomena as an equal increase of aggregate bank exchanges — the measure of current

trade. In the United States as a whole, the bank clearings of December, 1896, were $4,720,411,000; in the same month of 1900, they were $9,071,390,000. At New York City alone, bank clearings, which for the full year 1896 were $28,870,775,000, had risen in 1899 to $60,761,791,000, and fell not far short of this sum in 1900. In so far, therefore, as exchange of checks cleared by the banks is an index to the actual use of capital and credit, it will be seen that the fifty per cent increase in national bank resources was at a ratio very much less than the expansion, in the same period, of trade activity and the need for banking facilities. If we were to suppose that banking resources ought in the long run to increase in proportion to the volume of trade thus indicated, it must be evident that room was left for abundant increase in the credit facilities of other institutions.

This is undoubtedly the explanation of the immense expansion, during the last three years, of the resources of the trust companies. They found themselves possessed of facilities for indefinite extension of credit, less hampered than the banks by restrictions and taxation, and they reached this position at the moment when trade expansion outstripped the existing facilities of the deposit banks. What followed was therefore perfectly comprehensible. This article will be limited, for the sake of convenience in compiling the figures, to the companies of New York State; but what we find to be true in this state may be accepted as either reflecting or foreshadowing the conditions in other states. Now, if we take the reports of the state banking department and of the comptroller of the currency, we shall find that while between the end of 1897 and the beginning of 1900 the New York deposit banks of the national system increased their loans and discounts $135,000,000, or twenty-five per cent, the loans of trust companies in the state were expanded by $97,400,000, or thirty-seven per cent. The expansion of loans among the state banks has been in somewhat smaller ratio than in the national institutions. It appears, therefore, that loans of the trust companies have in this period increased in a ratio half as great again as the

increase at the deposit banks. I have already indicated why this disproportionately large expansion in trust company operations was natural. There are, however, some peculiar circumstances in this expansion which have already drawn the attention of practical bankers to the institution, with some doubts, if not misgivings, and which make necessary a more thorough examination of the trust companies than would be called for if the expansion had occurred in institutions subject to the traditions and laws of the older banking system. It is the purpose of this article to review briefly these phases of the situation.

In the first place, the trust company was not designed, by the framers of the law which gave it the right to existence, for the functions of a general depository which have now become a most important part of its business. The real purpose of the institution is set forth in the trust-company section of the banking law of New York State.[1] Under that statute the trust company is authorized:

1. To act as the fiscal or transfer agent of any state, municipality, body politic or corporation; and in such capacity to receive and disburse money, and transfer, register and countersign certificates of stock, bonds or other evidences of indebtedness.

2. To receive deposits of trust moneys, securities and other personal property from any person or corporation, and to loan money on real or personal securities.

3. To lease, hold, purchase and convey any and all real property necessary in the transaction of its business, or which the purposes of the corporation may require, or which it shall acquire in satisfaction or partial satisfaction of debts due the corporation under sales, judgments or mortgages, or in settlement or partial settlement of debts due the corporation by any of its debtors.

4. To act as trustee under any mortgage or bond issued by any municipality, body politic or corporation, and accept and execute

[1] The general trust company law was passed in 1887, and amended in 1893 and at other subsequent sessions. There are, however, seventeen trust companies in the state chartered under special acts, their incorporation in nearly all cases having occurred between 1822 and 1887. These companies are subject to the provisions specified in their charters, rather than to those of the general act. But as their charters are usually more liberal than the general law, I have assumed the provisions of 1887 as applying to all.

any other municipal or corporate trust not inconsistent with the laws of this state.

5. To accept trusts from and execute trusts for married women, in respect to their separate property, and to be their agent in the management of such property, or to transact any business in relation thereto.

6. To act under the order or appointment of any court of record as guardian, receiver or trustee of the estate of any minor, the annual income of which shall not be less than one hundred dollars, and as depository of any moneys paid into court, whether for the benefit of any such minor or other person, corporation or party.

7. To take, accept and execute any and all such legal trusts, duties and powers in regard to the holding, management and disposition of any estate, real or personal, and the rents and profits thereof, or the sale thereof, as may be granted or confided to it by any court of record, or by any person, corporation, municipality or other authority; and it shall be accountable to all parties in interest for the faithful discharge of every such trust, duty or power which it may so accept.

8. To take, accept and execute any and all such trusts and powers of whatever nature or description as may be conferred upon or intrusted or committed to it by any person or persons, or any body politic, corporation or other authority, by grant, assignment, transfer, devise, bequest or otherwise, or which may be intrusted or committed or transferred to it or vested in it by order of any court of record, or any surrogate, and to receive and take and hold any property or estate, real or personal, which may be the subject of any such trust.

9. To purchase, invest in and sell stocks, bills of exchange, bonds and mortgages and other securities; and when moneys, or securities for moneys, are borrowed or received on deposit, or for investment, the bonds or obligations of the company may be given therefor, but it shall have no right to issue bills to circulate as money.

10. To be appointed and to accept the appointment of executor of or trustee under the last will and testament, or administrator with or without the will annexed, of the estate of any deceased person, and to be appointed and to act as the committee of the estates of lunatics, idiots, persons of unsound mind and habitual drunkards.

11. To exercise the powers conferred on individual banks and bankers by section fifty-five of this act, subject to the restrictions contained in said section.

A careful reading of these paragraphs will establish the fact that the purpose of the legislators was to give powers to organizations for the specific and single purpose of acting as trustee — whence the name "trust company." In the matter of estates to be administered, whether directly or in coöperation with individual executors, and of action as agent for public or corporate bodies, the powers of these companies are clearly set forth in the statute. But there is not a word as to transacting the general business of a deposit bank. The state law regarding banks confers general powers for "receiving deposits," and the national bank law makes similar provision. The trust company act specifies in this regard merely the right "to receive deposits of trust moneys." The deposit of his personal balances by an individual does not, of course, fall under this category. But, on the other hand, the statute does not explicitly deny such powers, and indirectly it may be claimed that they are granted. The proviso of Section 8, cited above, that the company may accept "any and all such trusts and powers, of whatever nature or description, as may be conferred upon or intrusted or committed to it by any person or persons," is sufficiently sweeping to cover the general business of a depository. Therefore, no valid legal objection could be or has been raised against the invasion by the trust company of the peculiar field of a deposit bank. Whether the framers of the act did or did not anticipate such an outcome, — and it is quite certain that they did not, — the receiving and loaning out of deposits, similar in nature to those which an ordinary deposit bank invites, has become, in values involved, the larger part of the trust company's business. As long ago as the mid-year reports of 1899, the trust companies of New York State held as "deposits in trust" $261,588,488, while their "general deposits" had risen to $332,874,217.

One important difference between the law for trust companies and the law for banks resulted from the conception of the trust company as an agent or trustee. For reasons obvious enough, the individual agent, executor or trustee is not required to keep on hand as a reserve any sum of idle cash;

and so no requirement of the sort was exacted from the trust company. But the bank of deposit, under both national and state laws, is required to keep at all times in its vaults a cash reserve varying from seven to twenty-five per cent of its outstanding deposit liabilities; and the purpose of the stipulation is plain. Depositors in banks, except those described and provided for as savings banks, have at all times the right to the immediate withdrawal of their deposits. Experience has taught that occasions will arise, in time of sudden alarm on the financial markets, when a great number of these depositors will demand their money simultaneously. If such demand falls only on one institution, or on a few, a solvent bank finds no trouble in promptly converting its loans or other investments into cash, which may then be turned over to the depositor. But if the "run" occurs at the same moment (as in July, 1893) on practically every deposit bank of the given community and of the whole country, then conversion of assets into cash, in time to meet the rightful demands of the depositor, becomes impossible. It is to guard against such contingencies that the law of deposit banks requires a certain percentage of deposit liabilities to be at all times kept on hand. So plain is the possibility of sudden insolvency in the lack of such provision that savings banks, from which, in order to grant the largest profits to depositors, no such reserve of idle money is required, are granted the discretionary right of requiring a two-months' notice of withdrawal.

All this is a very elementary statement of banking practice. It is well, however, to make it; because the trust company, under the new conditions governing it, has become a deposit banking institution, on precisely the footing of the regular deposit banks, but without the slightest restriction in the matter of cash reserves. From the foregoing summary of the statute governing these institutions, it is clear that not a word is said in regard to a cash reserve which must be kept in hand. On the other hand, Section 44 of the New York bank law, dealing with state deposit banks, provides that

every bank or individual banker shall at all times have on hand in lawful money of the United States an amount equal to at least

fifteen per cent of the aggregate amount of its deposits, if its principal place of business is located in any city of the state having a population of eight hundred thousand and over; and an amount equal to at least ten per cent of the aggregate amount of its deposits, if its principal place of business is located elsewhere in the state.

One-half of such lawful money reserve may consist of moneys on deposit, subject to call, with any bank or trust company in this state having a capital of at least two hundred thousand dollars and approved by the superintendent of banks as a depository of lawful money reserve. If the lawful money reserve of any bank or individual banker shall be less than the amount required by this section, such bank or banker shall not increase its liabilities by making any new loans or discount otherwise than by discounting bills of exchange payable on sight, or making any dividends or profits until the full amount of its lawful money reserve has been restored. The superintendent of banks may notify any bank or individual banker whose lawful money reserve shall be below the amount herein required to make good such reserve; and if it shall fail for thirty days thereafter to make good such reserve, such bank or individual banker shall be deemed insolvent and may be proceeded against as an insolvent moneyed corporation.

Similarly, Section 5191 of the U. S. Revised Statutes provides that a national bank in any one of sixteen specified cities "shall at all times have on hand, in lawful money of the United States, an amount equal to at least twenty-five per centum of its deposits"; that every other national bank shall hold at least fifteen per cent; and that, whenever cash reserves fall below such percentage, contracting of new liabilities otherwise than by discounting sight bills shall be prohibited. Out of the fifteen per cent reserve of country banks in the national system, three-fifths may consist of balances on deposit in other specified institutions. Such are the public restrictions on deposit banks. The trust company section of the statute ignores the point entirely.

We have seen already why, with the legislature's theory of the trust company's business, this familiar safeguard was omitted. To require an authorized fiscal agent, executor or trustee to keep idle in a safe five, fifteen or twenty-five per

cent of the funds expressly entrusted to it for investment, would be a foolish handicap to the usefulness of its labors. It is only now, when the trust company is departing, in the greater share of its business, from the original purposes of the institution, that the question has arisen: Is the system safe?

Let us, to begin with, see exactly what proportion the so-called "general deposits" of the trust companies, whose status is the same as that of bank deposits, bear to the "deposits in trust" which the law originally contemplated. I subjoin the returns, as of January 1 in each year, from the reports of the banking department of New York State:

| | *1898* | *1899* | *1900* | *1901* |
|---|---|---|---|---|
| Deposits in trust . | $185,099,694 | $197,664,749 | $213,484,885 | $245,367,995 |
| General deposits . | 198,229,029 | 269,519,509 | 310,056,684 | 392,753,774 |
| Total deposits . . | $383,328,723 | $467,184,258 | $523,541,569 | $638,121,769 |

In other words, the deposits obtained on the basis of ordinary banking, and subject to all the risks of an ordinary bank deposit, make up more than sixty-one per cent of the trust companies' total deposit liabilities and nearly half of all liabilities, including capital. Nor is this all: the table just presented shows that, while trust deposits, for the use of which this form of corporation was created, have increased only 24½ per cent in the last two years, the increase in general deposits during the period has been forty-six per cent. The trust companies' deposits are likely to increase quite as rapidly in the future, because of the readiness with which they pay interest of two to five per cent on current deposits. The banks have of late years paid no interest to individual depositors, taking the ground that the granting of facilities for clearing checks and for drawing upon or remitting to distant points is sufficient return of service. But the trust companies, since their invasion of the deposit banking field, do all this. As depositors in the clearing-house banks, they require of such banks extension of all exchange facilities, and they pay interest in addition — this being easily practicable, since at the worst they receive an equal interest themselves from their depositaries.

Under such circumstances it is hardly surprising that depositors have more and more tended to confide their moneys to the trust companies.

Now let us see the practical result. Not to weary the reader with particulars, it should be noticed that the state banks of New York hold in reserve, against their deposit liabilities, a cash fund amounting on the average to thirteen per cent. By the comptroller's returns at the close of 1900, the national banks of New York State, outside of the larger cities, held in their vaults, in actual specie and legal tenders, 12¾ per cent of their deposits, while the New York City banks alone held twenty-six per cent. The trust companies of the state, by their report of January, 1901, had deposit liabilities of $638,121,769, against which they held, in actual cash, $9,365,171, which is less than 1½ per cent. Even if, for the sake of more exact comparison, all deposits strictly in trust are excluded from the reckoning, we shall find that against the $392,753,774 deposits on a simple banking footing, and subject to demand, the cash in the companies own vaults is only 2⅜ per cent.

The trust company, however, will answer readily that what they lack in actual cash on hand they have in abundant measure in the shape of demand deposits with other institutions. The "country bank" of the state or national system is allowed by law, as we have seen, to count as part of its minimum reserve a specified proportion placed on deposit with other banks. Of the fifteen per cent reserve exacted from smaller national banks, three-fifths may be thus transferred; of the ten per cent minimum of the New York State bank, one-half. If the trust company includes its re-deposits with its cash on hand, its position seems materially better. As against the $9,365,000 held in cash in their own vaults, last January, by the fifty-seven trust companies of the state, they report ten times as much, or $96,337,000, as "cash on deposit in banks or other moneyed institutions." Their total reserve fund, computed on this basis, amounts to 26⅞ per cent of "general deposits" only or to 13¼ per cent of all such liabilities.

Either percentage is larger than the minimum of the state or national country bank. It is, moreover, larger than the savings bank reserve. Against their $947,129,000 deposits, the New York savings banks held, last January, $9,742,000 cash on hand and $62,865,000 deposited in other institutions. This is a total available cash reserve of only 7½ per cent. On the mere face of things, therefore, the trust company seems to be the best-guarded institution of the four.

There are, however, several reasons why this is not so. The savings banks are restricted by law, with the utmost care, as to the securities and mortgages in which the deposits may be invested. In regard to stock and bond investments, outside of federal, state and municipal obligations, the lines are drawn very narrowly. As to mortgages, the proportion of a savings bank's deposits to be thus invested is definitely limited. So with the state deposit bank. Such a bank may earn its revenues (Section 43) "by discounting and negotiating promissory notes," *etc.*; "by buying and selling exchange, coin and bullion; by loaning money on personal security." It may "become the owner of any stocks or bonds or interest-bearing obligations of the United States, or of the state of New York, or of any city, county, town or village of this state, the interest of which is not in arrears." But this is all. Real property the bank is explicitly forbidden to "purchase, hold, or convey" for any purpose, except for "its immediate accommodation in the convenient transaction of its business," or when the realty "shall be mortgaged to it in good faith, by way of security for loans" made by the bank, or when it shall be conveyed in satisfaction of previously contracted debts or acquired by purchase "under judgments, decrees or mortgages" held by the institution.

These are plain rules, and their necessity is obvious to any one who reflects on the history of the numerous mortgage institutions in our own and foreign countries. Now let us turn back to the law, above cited, regulating the business of trust companies. We shall find that these institutions are empowered "to loan money on *real* or personal security" — not,

like the banks, on personal security alone — and "to lease, hold, purchase and convey any and all real property" coming into their hands under such conditions. They may "purchase, invest in, and sell stocks," with no limitation, as in case of the banks, to securities issued by the United States or by the state, counties or municipalities of New York. It needs but a glance to see the vastly wider opportunity here, not necessarily for bad investments, but for investments which cannot be readily converted into cash. These broader powers of investment were a necessary incident of the trust side of the operations of these companies, where the nature of the business differed radically from that of a simple deposit bank. But let us picture a national or state bank suddenly empowered to deal in railway stocks and real estate. Probably this would be criticised as an invitation to "wild-cat banking." Yet it is precisely this condition which exists in the larger part of the business done by the trust companies.

Again, as regards the matter of reserves. Here we must notice, as regards the savings bank, that its deposits are not strictly payable on demand.

> The sums thus deposited shall be repaid to such depositors . . . after demand, in such manner, and at such times, and after such previous notice, and under such regulations, as the board of trustees shall prescribe [New York banking law, Section 113].

This is the authority for the well-known "sixty-day notice" proviso, rarely applied except in time of panic, but then a safeguard to the whole community. Without that recourse, as employed in the run on the savings banks in midsummer, 1893, it is an absolute certainty that one of two catastrophes must then have happened — suspension of the savings banks, as Western savings banks, lacking the safeguard, suspended, or stoppage of payments at the deposit banks whose surrender of the savings bank accounts had crippled them.

The trust company's case, then, is not analogous to that of the savings bank. For two other reasons it is not analogous to the country bank's position. In the first place, most of

the six hundred millions of trust company deposits are not held by country institutions but by city companies with enormous liabilities. There are trust companies in the largest cities of New York, which, with four to seven millions in deposits, keep cash on hand of only three to ten thousand dollars. A "country bank" would be allowed no such privilege under any system, and a city bank, be its charter national or state, would be forced to dispense wholly with the re-deposit of reserves. While the reserve requirements for a country deposit bank are low, — five per cent in cash on hand and ten per cent on hand and on deposit, — the requirement is at any rate absolute. It is a minimum below which no bank must allow its reserve to fall. But for the trust company's reserve no minimum is prescribed. There are companies in New York City carrying on hand or in other institutions cash in the ratio of twenty per cent of their general deposits; but there are also companies — chiefly in smaller cities — which carry a total reserve hardly exceeding five per cent. So far as the statute is concerned, they need not have kept that. With the broadest powers for investment of deposits enjoyed by any institutions is combined an absolute immunity from the safeguards thrown by law about the depositors in other banks. The instinct of prudent banking on the part of its managers and the manner in which its banking agents and associates insist on proper business practices are the real protection to the depositor in trust. It is, then, not surprising that the New York clearing-house has by resolution required the trust companies, which are allowed to clear checks through it, to submit frequent and detailed statements of their operations.

There is reason to believe that, as a class, the trust companies are wisely and prudently managed. Whether this fact, under present conditions, is or is not enough to warrant dispensing with ordinary legal safeguards and restrictions, must be judged in the light of banking history. The answer to such an appeal would, I think, be promptly in the negative. The simple truth of the matter is, that either the state and national banks are unreasonably restricted, or else the

precautions surrounding trust companies are extremely loose. There is, I think, no escape from the second of these conclusions. How the situation arose we have already seen. Circumstances have led the companies into a line of business never contemplated by the authorizing act, and the act has not been changed. The bank and clearing-house precautions at New York will do very much to obviate trouble; but who is to watch the trust company of the country districts? Every one knows what has happened to banks, in times of financial strain, between the visits of the bank examiner.

But it is not at all necessary to assume that trouble will come through dishonest or reckless management. There is a broader question lying behind the whole problem of the trust companies. The phenomenal rise of these institutions has occurred in a series of years of great prosperity. No institution or system can be pronounced entirely safe which has not been "tried by fire" in a financial crisis, and the trust company system, as now conducted, has not been thus tried.

It is possible that the American money market will never again witness the destructive phenomena of 1893. But this consummation, however devoutly to be wished, is very far from certainty. In 1880 it was plausibly argued that we should never witness another 1873; in 1871 the recurrence of 1857 seemed in the highest degree unlikely. It is true, indeed, that no one of these three years of crisis duplicated the events of its predecessor. But there were some phenomena which were repeated on each occasion with unerring accuracy, and one of those phenomena was a sudden and general demand for their funds by bank depositors. There is room to argue that America's altered position on international exchange, turning it from a debtor nation into a creditor, will prevent in future the worst of former panic disasters. But if this be conceded, it is very far from proving that our banking institutions will never be subjected to another sudden strain, and it is the part of prudent banking legislation to keep in view the gravest possibilities while framing its safeguards. The experience of 1893 sufficiently proved the system of

re-depositing bank reserves in other banks, subject to demand, to be, as Professor Amasa Walker described it many years ago, the most explosive element in American banking.

Eight years ago the general banking collapse was directly brought about by the demand of country bank depositors for their funds, followed by urgent recall by these banks of their deposits in city institutions which could not spare the money. Yet every dollar of the ninety-six millions deposited in bank by the trust companies is an addition to this explosive fund. The trust company, under its present status, is as much subject to a run of depositors as was the country bank in 1893; the average ratio of its cash reserves to deposits is less than half that of the country banks of the panic year; and it is quite at liberty to keep no reserve at all. Yet a run of its own depositors would force the trust company to recall its funds from the deposit bank, and at a time when a run might be in progress on that bank as well. The extraordinary pace at which these accounts are increasing and the lack of requirement for liquid investment of their funds we have seen already. It is not easy to avoid the conclusion that, however plain may be the sailing of the companies to-day, the present status of the law constitutes an element of the greatest danger for the future. The banking law, in my judgment, ought unquestionably to be amended so that institutions doing a simple deposit banking business under another name shall be required to erect the safeguards demanded of the banks.

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