EXCERPTS FROM THE INAUGURAL ADDRESS OF THE GOVERNOR OF IOWA, HONORABLE JOHN HAMMILL, TO THE FORTY-SECOND GENERAL ASSEMBLY, DELIVERED AT DES MOINES, IOWA, JANUARY 13th, 1927.

BANKING

"Accordingly I recommend:

(a) That proposed subscribers to capital stock of State banks must furnish a financial statement showing they are worth at least two times, over and above their exemptions, in unincumbered property the amount of their stock subscriptions; the Banking Department to be required not only to investigate the financial circumstances of subscribers to stock, but to determine whether or not they are the character of men who have and will hold the respect and confidence of the community as bankers. Subsequent statements of financial conditions of stockholders to be furnished semi-annually and filed with the Banking Commissioner.

(b) The stockholders should be required to deposit with the Banking Department securities defined by law to insure the prompt and full payment of any assessment which they may be called upon in the future to pay. This requirement should be made effective at once on any NEW banks or TRANSFER of stock in old banks, stockholders in existing banks to receive not to exceed six per cent annual dividends until this assessment liability is put up in approved securities as aforesaid, which assessment liability requirement might be met either by the stockholder himself or by the bank from its future earnings, acting in his behalf.

(c) Good banks should be made out of going banks rather than of closed banks. The laws of some states and the proposals that have been submitted, proceed from the starting point which has to do with closed banks. We should give our attention to studying the situation as regards live, active institutions, and those yet to be formed giving, however, due regard to the liquidation requirements of closed banks.

(d) I recommend that the entire capital of a bank be paid in before a bank can transact business; that the capital requirements be raised to $25,000.00 for cities of 3,000 or less, $50,000.00 for cities of 6,000 or less, and $100,000.00 for cities having a population over 6,000. Such capital must be paid in full before the transaction of business, together with an additional subscription of 10 per cent to cover organization expenses, etc., which it is unlikely immediate earnings of a new bank may meet. No dividend should be declared until a surplus of 20 per cent has been built up, and thereafter 20 per cent of the net earnings each year should be set aside until a 50 per cent surplus has been created. A requirement this drastic is not common in banking statutes, and is for the purpose of preventing distribution of earnings as dividends until proper reserves have been set up to protect against unforeseen contingencies. Experience has shown

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that in times past some banks have been too prone in prosperous years to declare dividends to the full earning capacity, without regard to the possibility of less prosperous periods, during which losses might be incurred.

(e) Officers and particularly directors should give greater attention to the business of the bank. Directors should be held personally liable for any losses resulting from unlawful acts in the management of the bank which they have in any sense approved or ratified. We should surround the operations of the State Banking System with such safeguards and resolutions as will promote better banking, solely without regard to the conveniences and likes or dislikes of the bankers, as they are semi-public servants, but not to so couch the terms of the law as will result in unnecessarily hampering legitimate business transactions to the detriment of the public interest. Iowa industry, agriculture and livestock pursuits must function. Iowa capital must be conserved and made available for the development and operation of Iowa's resources. Remove the present facilities of the State banking system, without a sufficient substitute, and these industries, on which so many depend, could not continue.

(f) That the ratio of capital to deposits is also sufficient to provide a reasonable margin of safety to depositors.

After making a survey of the conditions surrounding some failed banks, it is my opinion that one of the local causes of bank failures is the fact that officers of the bank have been interested in side ventures and have either borrowed or loaned funds of the bank in cases where they were directly or indirectly financially interested. This practice has occurred in many instances with the managing officer of the institution. The first thought is to restrict the operations of the managing officer of a banking institution to the business of the institution which he represents. Restraint to this extent may be unconstitutional. We should, therefore, reach this situation by restricting the loans, the advances that may be made by a banking institution in such cases, and it should be made unlawful for a bank in this State to loan to a director, officer, or employee thereof, or for a director, officer or employee thereof to borrow from the bank any of its funds, except subject to the following limitations:

1. The indebtedness of an officer, other than a director or an employee, shall not exceed five per cent of the paid-up capital stock and surplus of the corporation.
2. No such loan shall be made without first being approved by a majority of the board of directors at a meeting in the minutes of which such approval shall be recorded in detail. Every such loan shall be acted upon in the absence of the applicant.
3. The combined indebtedness of directors, officers and employees shall not exceed forty per cent of the paid-up capital stock and surplus of the corporation.
4. No officer who is actively engaged in the management of any bank, or any employee, shall BORROW any amount whatever from or discount any note or other commercial paper with the bank by whom employed, except upon good

collateral, or other ample security or endorsement; and no such loan or discount shall be made until after it has been approved by a majority of the directors or a committee of the board of directors authorized to act.

5. No officer who is actively engaged in the management of any bank, or any employee, SHALL MAKE ANY LOAN for the bank by whom employed in which said officer or employee is personally or financially interested, directly or indirectly, for his own account, for himself, or as the partner or agent of others, except upon good collateral, or other ample security or endorsement, and no such loan shall be made until after such personal interest shall have been disclosed to the board of directors and that fact shown by the minutes of the meeting of the board of directors, and the loan approved by a majority of said board of directors.

It should also be provided that if the directors of any bank permit any of the directors, officers or employees thereof to borrow its funds, or discount notes on commercial paper, in violation of the foregoing recommendation or in an excessive amount, or in a dishonest manner, or in a manner incurring great risk or loss to such bank, any director who participated in or assented to the same should be liable personally for all damage which the bank or its shareholders may sustain by reason of such loan.

The bank failures in the state have brought forth the question of a compulsory guarantee of bank deposits. I know of no model bank guaranty law. Only eight states out of the Union have ever attempted such a law. No state has passed such an Act since 1917. All such laws were put to the test when the general period of deflation set in in 1920. Since that time the failure of at least half a dozen or more of them has been calamitous. Whatever the cost of thoroughly competent and efficient bank examinations, it is a proper charge against banks. Whatever laws are devised to make sure that banks are given this sort of supervision, they will have economic justification. Adequate examination and control encourage good banking and discourage bad banking. Bank guaranty laws work contrariwise.

I am inclined to the belief that the soundest and most effective safeguard to bank deposits is a mutual examination system similar to the one devised by the Chicago Clearing House Association. This system has been in effect in Chicago for a number of years and has been accepted by the banks thereof, and while there have been occasional failures, no depositor of a member bank has ever lost a dollar since the examination system was established. I believe it is feasible to divide the State into districts and to organize the banks in each district into a mutual examination association, which can make use of the clearing house system effectively. Once institute such an organization and the strong banks would get in for the possible advantage that it would offer. Then competition would force other banks to become strong enough to warrant membership.

The bankers and the bank depositors of each State should make sure that the bank examinations department is efficiently managed and amply provided with men and money. As the banks themselves pay all the costs of the department, the public cannot object to this. In my judgment if they would do this, they would set up the soundest and most effective instrument of safeguarding deposits yet devised.

Our own Banking Department needs more men and money to hire still more competent men. The head of the department should be able to earn and he should be paid as much as the president of a good sized bank. Under such conditions we should have no epidemic of bank failures and no demand for a guaranty law. Iowa should adopt a banking policy that is sound, that will make each banker stand for a policy that will protect his own bank and the depositors therein.

Let us apply ourselves to develop and encourage better bankers, more careful examination of banks and require banking laws to be more rigidly enforced. The responsibility of the poor banker and the fraudulent banker should not be charged to the honest and efficient banker or the public in general.

Let us be fair and remember again that the economic conditions through which we have been passing have been unprecedented. Borrowers, whether business, professional men or farmers representing in normal times some of our financially strongest and best citizens, have, due to existing conditions become financially embarrassed or "gone broke." Credit has been extended to them legitimately and in good faith. These borrowers have been unable to pay their notes or interest. The stockholders of banks throughout the State have been making up those losses so far as they could and in a vast number of instances have themselves GIVEN THEIR ALL in the effort to make up those losses caused by legitimate borrowers, in order that their banking institution might survive and their depositors be protected.

Proper experience, proper financial ability, proper business integrity on the part of the banker, has, does now, and always will safeguard the depositors' funds. The essential thing, the paramount necessity, is that legislative action should enhance rather than nullify the necessity for such, as all of the banking experiences of the country in all these years have demonstrated the soundness of this contention and the futility and the danger of banking sedatives.

Affirmative legislative specifications concerning investment of a bank's funds are dangerous and offer an opportunity for unsound banking, while broad general restrictions as to investment of any and all of the funds of the bank, provide a feasible and necessary protection to depositors.

With these indispensable qualities our financial institutions should and will attain adequate strength and be best able to serve the fundamental interests of the commonwealth."