INSURANCE OF BANK OBLIGATIONS IN SIX STATES

During the Period 1829-1866

by

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The Federal Deposit Insurance Corporation

1958

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INSURANCE OF BANK OBLIGATIONS IN SIX STATES DURING THE PERIOD 1829-1866

This is a study of the first attempts in the United States to protect bank creditors (depositors or noteholders or both) through use of the insurance principle. No comparable study of the insurance plans operated in six States prior to 1866 has ever been made, and only one of these has been previously analyzed. The authors have drawn, for almost all of their information, on original source material, much of which was unknown or discovered after having been thought lost for nearly a century. It is believed that in addition to providing a detailed account of the forerunners of Federal deposit insurance, the study makes a significant contribution to American banking history.

Among the highlights of the study are the following:

A description of the purpose of bank-obligation insurance, as viewed by the men who first considered such a plan in this country in 1829. (Ch. II, pp. 6-10.)

An account of the origins of modern bank examination procedures and their relationship to insurance. (Ch. II, pp. 13-18.)

The role of bank supervision in the operation of Indiana's mutual guarantee insurance plan--the most successful of all such plans operated during this period. This includes instructions to examiners and extracts from the private correspondence of supervisory officials. (Ch. IV, pp. 16-28. See first the third paragraph on p. 4 of Ch. I.)

A description of the short-lived insurance program operated in Michigan and its collapse after the panic of 1837; and an account of the extraordinary difficulties encountered by bank examiners in Michigan in the 1830's. (Ch. V. pp. 18-27 and 27-33.)

The development of the deposit assumption technique for the protection of insured creditors of Ohio banks; and an appraisal of the vital role played by insurance in enabling insured Ohio banks to survive the panic of 1857 without a single failure, including an account, taken from private correspondence, of actions by supervisory authorities. (Ch. VI, pp. 25-30. See first the third paragraph on p. 4 of Ch. I.)

A summary of the important lessons taught by the early insurance plans. (Ch. VIII, pp. 2 and 3.)

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This study of insurance of bank obligations in six States prior to 1866 is the outgrowth of a larger project which was begun in 1934 shortly after the Division of Research and Statistics was established. Under the direction of Mr. Mortimer J. Fox, the first chief of the Division, Miss Florence Helm and Mrs. Ethel Bastedo began to collect material on the experience of States with deposit insurance. Within a few months they had obtained considerable information on the character of the deposit guaranty legislation in eight States during the quarter of a century preceding establishment of the Federal Deposit Insurance Corporation, and had become familiar with references to the New York and Vermont "safety funds" in a report of the National Monetary Commission and Knox's History of Banking.

In October 1934, Mr. Clark Warburton was placed in charge of the survey of previous experience with insurance of bank obligations, with Miss Helm continuing for a time to work on statistical data and Mrs. Bastedo on the legislation in the eight States with deposit guaranty systems. By the end of that year enough work had been done to report: "Surveys have been made of State plans for the guarantee of bank deposits." 1/ However, it was realized that more exhaustive studies were desirable than these brief surveys, and a comprehensive project was outlined, of which a description was published in an inventory of current research on financial problems prepared at the National Bureau of Economic Research in cooperation with government agencies, universities, and other organizations. 2/

During the next few years progress on the studies was slow for several reasons. Collection of statistical data on the deposit guaranty funds, and on bank failures was found to be far more difficult than had been anticipated. It was also found that bank-obligation insurance or mutual guaranty systems had been in operation in four States, besides New York and Vermont, prior to establishment of the national banking system, that almost nothing had been published regarding them, and that the published accounts of the experience of New York and Vermont were inadequate for appraisal of their degree of success, their deficiencies, and the reasons for their discontinuance. In addition, Mr. Warburton's time soon became preoccupied with work more closely related to current operations of the Corporation and with other research projects, notably a study of bank failures and losses to depositors in the United States from 1865 to 1933, with attention to the reasons for the great waves of bank failures that were concentrated in certain years.

It was not until 1941 that Mr. Warburton was again able to devote a sizable portion of his time to the history of bank-obligation

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1/ Annual Report of the Federal Deposit Insurance Corporation for 1934, p. 29.

2/ A Program of Financial Research, Volume Two (National Bureau of Economic Research, 1937), pp. 157-58.

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insurance. During the next two years he reviewed the material that had been obtained on the eight systems of deposit guaranty established between 1907 and 1917, collected and analyzed additional information, and prepared reports on three of these systems. In addition, considerable information was collected by two assistants, Miss Carol Colver and Miss Wilhelmina Sharpe, on legislation pertaining to the six systems of bank-obligation insurance established between 1829 and 1858, and on the operations of four of them. But early in 1943, because of various circumstances partly associated with the war effort, all work on the project was suspended indefinitely.

Work on the project was resumed in 1952. It was decided to give first attention to the pre-1866 experience, with Mr. Carter H. Golembe responsible for preparation of reports on each of the six systems. Mr. Warburton has had general direction of the studies, suggesting facets that needed exploration and providing editorial comments. Mr. Golembe has been assisted by Miss Helen Thompson; and Mrs. Dorothy O'Gwynn, Mrs. Eileen Payne, and Mrs. Hazel Shea have given stenographic and clerical service. Miss Jeanette Karp and Mr. David Cole have read the manuscript and made many valuable editorial suggestions. Mr. Golembe and Mr. Warburton are jointly responsible for the final results as they appear in this book.

Edison H. Cramer, Chief
Division of Research and Statistics

January 1958

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CHAPTER I

INTRODUCTION

During the first thirty years after organization of the Federal government in 1789, banks were chartered by special acts of State legislatures or the Congress, usually for a limited number of years. For two-thirds of this period there were no bank failures; but in the last third many failures occurred and great controversies developed about the operations of banks and their place in the economy. In consequence, the next forty years was a period of development of banking codes and experimentation with various types of banking systems. During this time six States inaugurated systems of bank-obligation insurance.

The States which adopted insurance programs for the protection of bank creditors during this period were New York, in 1829; Vermont, in 1831; Indiana, in 1834; Michigan, in 1836; Ohio in 1845; and Iowa in 1858.[1] All of the systems, except that of Michigan, operated with varying degrees of success until banks were no longer eligible to participate in insurance. In Indiana, Ohio, and Iowa, this was because of their conversion to national banks between 1863 and 1866; in New York and Vermont because of expiration of the charters of the participating banks, with continuation of banking operations under national charters or under State laws which had not provided for the insurance of bank obligations.

In the debates which preceded establishment of the Federal Deposit Insurance Corporation in 1933 reference frequently was made to State deposit guaranty systems adopted by several States between 1907 and 1917. Little attention was paid to the bank-obligation insurance systems which operated prior to establishment of the national banking system, notwithstanding the fact that a few of the States had a remarkable record in this field and all of them pioneered in the development of some of the basic principles of present day deposit insurance.

Extent and Character of the Insurance Plans

In many details the early bank-obligation insurance systems differed from those adopted by individual States in the first decades of the twentieth century and by the Federal government in 1933. This was a consequence both of the characteristics of banking during this earlier period and of the fact that the plans were experimental procedures in providing protection for bank creditors.

1/ Because bank liabilities during the period covered in this study usually consisted of circulating notes plus deposits it has been found more convenient to use the single word "creditors" when referring to the owners of these obligations, rather than the phrase "depositors and noteholders". Similarly "bank obligations" has been used in place of "deposits and circulating notes."

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Approximately one-half of the nation's bank-supplied circulating medium before 1860 was composed of the notes issued by individual banks. This was because banks commonly extended credit in the form of circulating notes as well as deposits. In the less developed areas of the country bank credit was largely in the form of circulating notes; in the eastern cities, chiefly in the form of deposits. After 1865 all circulating banknotes were guaranteed by the Federal government, so that later bank-obligation insurance proposals were usually limited to deposits.

Another difference between the early insurance systems and those adopted after 1900 related to the function of bank capital. In addition to serving as ultimate security for the protection of bank creditors, bank capital was more extensively used as a tool for the limitation of bank operations than is the case today. In the early decades of the nineteenth century restrictions on the amount of bank lending, or on the creation of obligations, were often expressed in terms of multiples of capital rather than, as at present, in terms of required reserves against deposits.

Table 1 summarizes the provisions of the six plans adopted between 1829 and 1858.

Function of bank-obligation insurance. Bank-obligation insurance was a major banking reform and, as is often true in such cases, the motives which actuated proponents of the insurance legislation are not readily distinguishable after the passage of more than a century. In general, it appears that bank-obligation insurance was advocated and adopted for two reasons: to protect the community from severe fluctuations of the circulating medium due to bank failures; and to guard against loss to individual bank creditors, particularly those of limited means.

The available evidence indicates that the first of the above mentioned functions, i.e., to prevent severe fluctuations in the circulating medium, was the more important. Much of the evidence pointing to this conclusion relates to the New York insurance system and is discussed in Chapter II. However, it is also indicated by the fact that although there were differences among the six States in the types of obligations insured, in none of the States was there a limitation on the amount of insurance provided each individual bank creditor.

Obligations insured. In the first four plans adopted, all debts of the participating banks, i.e., circulating notes and deposits primarily, were covered by insurance. In New York, the insurance legislation was later amended to restrict insurance to circulating notes and this same restriction was also included in the last two plans adopted. However, as noted above, in none of the six State plans was there a limitation on individual coverage.

Limitation of insurance to circulating notes in three States reflected a belief, then current but by no means universal, that banks affected the amount of circulating medium only through the issuance of banknotes. Also, there was the belief that depositors could "choose" their banks, whereas noteholders were more likely to be persons of modest means who had no choice but to receive the banknotes in the form of wages.

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Table 1. Principal Provisions of Bank-Obligation Insurance Plans Adopted by Six States, 1829-1858

State	Obligations insured	Banks participating	Assessments; size of fund	Payment of bank creditors
New York	1829-42, all debts 1/ 1842-66, circulating notes 2/	All banks established or rechartered subsequent to passage of act 3/	Annually 1/2 of 1% of capital stock to maximum of 3%. If fund reduced, annual assessment not to exceed above rate until fund restored to maximum	After completion of liquidation of failed bank; beginning in 1837 immediate payment from fund to holders of circulating notes authorized
Vermont	All debts 1/	All banks established or rechartered subsequent to passage of act 4/	Annually 3/4 of 1% of capital stock to maximum of 4 1/2%. If fund reduced, annual assessments not to exceed above rate until fund restored to maximum	After completion of liquidation of failed bank
Indiana	All debts 1/	Branch Banks 5/	No specific amount; special assessments as necessary	Within one year after failure, if liquidation proceeds and stockholder contributions insufficient
Michigan	All debts 1/	All banks established or rechartered subsequent to passage of act	Annually 1/2 of 1% of capital stock to maximum of 3%. If fund reduced annual assessments not to exceed above rate until fund restored to maximum	After completion of liquidation of failed bank
Ohio	Circulating notes	Branch Banks 5/	Single assessment prior to opening of bank: 10% of amount of circulating notes. Thereafter assessments at above rate applicable only to additional circulating notes, if any, issued by bank	Immediately, through special assessments on solvent Branch Banks. Assessments to be repaid from insurance fund, and fund repaid from proceeds of liquidation of assets of failed bank
Iowa	Circulating notes	Branch Banks 5/	Single assessment prior to opening of bank: 12 1/2% of amount of circulating notes. Thereafter assessments at above rate applicable only to additional circulating notes, if any, issued by bank	Immediately, through special assessments on solvent Branch Banks. Assessments to be repaid from insurance fund and fund repaid from proceeds of liquidation of assets of failed bank

1/ Included circulating notes, deposits, and miscellaneous liabilities; excluded capital accounts.
2/ Act of April 12, 1842.
3/ Free banks, which were authorized in 1838, did not participate in insurance.
4/ Free banks, which were authorized in 1851, did not participate in insurance. In 1842 participating banks were authorized under specified conditions to withdraw from insurance.
5/ Branch Banks were essentially independent banks which possessed their own officers, distributed earnings to their own stockholders, and collectively constituted the "State Bank" in these States.

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Table 2 summarizes significant data relating to coverage of, and participation in, bank-obligation insurance systems adopted prior to 1860.

Membership. The first three insurance plans adopted were intended to include, immediately or eventually, all operating banks. In New York, Vermont, and Michigan the law applied to all banks organized subsequent to passage of the act, with provision that existing banks must join at the time their charters were extended or renewed. Michigan went even further and specifically provided what may have been intended in New York and Vermont: that an already existing bank could join at its option prior to a renewal or extension of its charter.

In Indiana, Ohio, and Iowa membership in the insurance system was limited to the Branch Banks of the respective State Bank Systems. It is important that these Branch Banks not be confused with present day branches of operating banks. The Branch Banks of Indiana, Ohio, and Iowa were what would now be called unit or independent banks, each with its own stockholders, board of directors, and officers. The Branch Banks collectively constituted the "State Bank," of which there was a Board of Directors, or Board of Control, composed of representatives of the Branch Banks, or in part of such representatives and in part of appointees by the State legislature. The Board, i.e., the State Bank, did not itself engage in any banking operations; it was a bank supervisory agency which had functions somewhat similar to the combined functions of bank supervision within the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System.

In all but one of the six States the insurance systems did not include free banks. The "free banking" movement began in the late 1830's, before any of the insurance systems had been thoroughly tested by experience, its primary purpose being to permit the organization of any bank meeting stated requirements. The goal of the "free banking" movement was to curb monopolistic tendencies thought to be inevitable in banking under special charters, and associated with this goal was a method of providing protection for holders of circulating banknotes through the posting with State officials, by each bank, of bonds or mortgages in an amount equal to the bank's total issues of such notes. Sponsors of "free banking" claimed that bank depositors were capable of protecting their interests and, consequently, in the free banking systems neither insurance nor posting of collateral was required for the protection of depositors. Many States passed "free banking" legislation - including all of those States which also made use of the insurance principle - and free banks were excluded from insurance except in Michigan. Consequently the insurance systems did not become as universal in coverage as had been anticipated, and in the two States where bank-obligation insurance had been first introduced - New York and Vermont - the number of banks participating decreased as charters expired and stockholders reorganized their banks under the "free banking" laws.

Table 2 shows the maximum and minimum numbers of banks participating in insurance in each of the six States.

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Table 2. Extent of Bank-Obligation Insurance in Six States, 1829-1866

Item	New York	Vermont	Indiana	Michigan	Ohio	Iowa
Period of operation	1829-1866	1831-1866	1834-1865	1836-1842	1845-1866	1858-1865
Number of participating banks:						
Minimum (year)	2 (1865)	3 (1831)	10 (1834-35)	1 (1840)	8 (1865)	7 (1858)
Maximum (year)	91 (1839)	13 (1841-48)	20 (1857-64)	44 (1838)	41 (1849-51)	15 (1864-65)
Percent of all banks in State participating:						
Minimum (year)	2.0% (1865)	9.8% (1858)	12.5% (1855)	14.3% (1840)	51.4% (1846)	100.0% (1858-65)
Maximum (year)	90.7 (1837)	81.3 (1843)	100.0 (1834-51)	84.6 (1838)	79.1 (1864)	100.0 (1858-65)
Obligations covered by insurance or guaranty (in thousands):						
Minimum (year)	$ 721 (1865)	$ 307 (1858)	$2,182 (1842)	$ 22 (1840)	$1,576 (1845)	$ 5 (1858)
Maximum (year)	70,090 (1836)	1,936 (1847)	7,898 (1862)	1,423 (1838)	8,460 (1851)	1,526 (1863)
Percent of all bank obligations covered:						
Minimum (year)	1.2% (1865)	8.3% (1858)	25.5% (1854)	2.4% (1840)	17.3% (1845)	2.9% (1858)
Maximum (year)	90.6 (1840)	78.3 (1845)	100.0 (1835-51)	61.5 (1838)	55.1 (1857)	46.1 (1862

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Types of insurance systems. Insurance of bank obligations was provided by three methods: 1) establishment of an insurance fund, commonly referred to at the time as a "Safety Fund", 2) a requirement that the participating banks mutually guarantee each other's obligations, and 3) a combination of the first and second methods.

Reliance upon an insurance fund alone was the case in New York, Vermont, and Michigan. As indicated in Table 1, the fund was established through assessments levied on capital stock of participating banks, reflecting the relationship between capital and bank obligations previously noted. The cost of administering the insurance systems, including salaries and expenses of Bank Commissioners, was charged against the funds.

While New York's insurance system was adopted by Vermont and Michigan, Indiana developed in 1834 an alternative plan which required that all participating banks mutually guarantee the liabilities of a failed member bank. This obligation became effective when a failure occurred, and no provision was made for an insurance fund. Administrative expenses of the Board of Directors of the State Bank were met by special assessments on the participating banks.

Insurance systems adopted by Ohio in 1845 and by Iowa in 1858 apparently reflected a conscious effort to incorporate the essential portions of the two methods, with major reliance on the Indiana precedent. As shown in Table 1, protection for bank creditors in Ohio and Iowa was dependent upon the mutual guaranty provision, with the insurance fund available for reimbursement of the contributing banks. This was probably due in part to evident success of the Indiana system by 1845 as contrasted with the difficulties experienced in New York and the depletion of the fund in Michigan. The method of paying administrative expenses of the Ohio and Iowa systems was similar to that of Indiana.

In each of the five States having insurance funds, custody of the fund was given to the supervising authority, but ownership, directly or indirectly, remained with the banks.

Method of paying creditors of failed banks. Immediate payment of insured obligations was effectively provided for in only two of the six States during this period. The systems of Ohio and Iowa provided that the necessary amounts would be made immediately available through special assessments levied on the sound participating banks in proportion to their note circulation. This represented an improvement over systems adopted earlier. In New York, Vermont, and Michigan, creditors had to wait until liquidation of the failed bank had been completed, and the deficiency determined, before receiving payment from the insurance fund. Indiana required that its insurance plan become operative only if liquidation of the assets of the failed bank proved insufficient to meet the claims of bank creditors within one year.

Supervision of Banks Participating in Insurance Systems

The development of bank supervision was one of the notable features of bank-obligation insurance systems operated in six States

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prior to 1866. Before the adoption of the first bank-obligation insurance system in 1829 bank supervision, when it existed at all, was characterized by inadequate condition reports and sporadic, ineffective bank examinations.

Condition reports were not required of many banks during th first few decades of banking in this country. When they were required, it was usually because the State was a stockholder and it was felt that reports should be made to the State--either to the governor or to the legislature--as to any other stockholder. However, the only information provided was a simple breakdown of assets and liabilities. It was not until after about 1800 that some States began to require more detailed information from banks. But as late as 1829, the year the first insurance plan was adopted, some banks still submitted no condition reports and many others did so only at irregular intervals.

Bank examination also had its origin, in many States, in the stockholder relationship between State and bank. As late as 1837, several Louisiana banks refused to be examined, claiming that the State held no stock and therefore had no authority to examine them. Prior to the 1830's, bank examinations were rarely made except in cases where it was suspected that the condition report was incorrect or it was believed that a bank was insolvent. In such cases the legislature or governor would usually appoint one or several prominent citizens to inquire into the condition of the bank and submit a report. It was considered essential that the person or persons so chosen occupy a respected and substantial position in the community, as it was thought to involve great risk to the bank and its customers if an ordinary businessman were to look at the books of the bank.

There were a few instances when examinations were provided for under conditions other than those specified above. For example, the charter of the first bank to be established in Massachusetts (in 1784) provided that an agent of the State could examine into the condition of the bank at any time and be given full access to bank records. However, this was unusual for the time, as is indicated by the fact that Massachusetts made no use of this power until much later. In general, when examination was permitted it was only with the understanding that the examiner would not be allowed to do much more than verify the condition report which had been submitted to the State. Rarely was he given unrestricted access to bank records.

With the introduction of bank-obligation insurance legislation the supervisory picture was dramatically changed. In each of the six States regular examination by paid examiners, authorized to look thoroughly into the condition of the banks, was either written into the law or became accepted practice. In addition, condition reports were required in greater detail and with more regularity. It is not too much to say that modern bank supervisory procedures were effectively introduced to the American banking scene through bank-obligation insurance legislation.

Table 3 summarizes the principle supervisory provisions of the various insurance laws.

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Table 3. Principle Provisions Relating to Supervision of Banks Participating in Bank-Obligation Insurance Systems, Six States, 1829-1866

State: Period of bank-obligation insurance	Supervisory agency	Bank examination	Condition reports	Enforcement powers of supervisory officials
New York 1829-1866	1829-37. Three Bank Commissioners; one appointed by Governor; two by banks. 1837-43. Three Bank Commissioners appointed by Governor. 1843-51. State Comptroller. 1851-66. Banking Department; superintendent appointed by Governor.	1829-43. Each bank three times per year; additional examinations if requested by three participating banks. 1843-66. Examination only when bank was believed to be insolvent or to have submitted false condition report.	1829-43. Annually to Bank Commissioners. 1843-66. Quarterly to Comptroller; Superintendent of Banking Department. Content expanded.	If bank insolvent or had violated law could apply to court of chancery for injunction against continued operation.
Vermont 1831-1858	1831-37. Three Bank Commissioners; one appointed by legislature; two by banks. 1837-58. One Bank Commissioner appointed by legislature.	Each bank once per year; additional examinations if requested by a stockholder or bank debtor.	Annually to Bank Commissioners.	If bank insolvent or had violated law could apply to court of chancery for injunction against continued operation.
Indiana 1834-1865	1834-55. Board of Directors of the State Bank of Indiana; President and four directors appointed by legislature; one director by each Branch Bank.	Each bank twice per year; additional examinations if requested by directors of a bank.	Monthly to Board.	If bank insolvent, had violated law, or was mismanaging its affairs could close bank. Could regulate dividend payments. 1/
	1856-65. Board of Directors of the Bank of the State of Indiana; four directors appointed by legislature; one director by each Branch Bank; president by Board.			Could establish ratio of loans and discounts to capital for any or all banks between limits 1.25 to 1.00 - 2.50 to 1.00. Loan of deposited funds exempted.
Michigan 1836-1842	1836-37. One Bank Commissioner appointed by Governor. 1837-40. Three Bank Commissioners appointed by Governor. 1840-42. Attorney General.	1836-40. Each bank three times per year; additional examinations if requested by three participating banks. 1840-42. Whenever requested by Governor.	Annually to Bank Commissioners; Attorney General.	If bank insolvent or had violated law could apply to court of chancery for injunction against continued operation.

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Table 3. Principle Provisions relating to Supervision of Banks Participating in Bank-obligation Insurance Systems, Six States, 1829-1866

State: Period of bank-obligation insurance	Supervisory agency	Bank examination	Condition reports	Enforcement powers of supervisory officials
Ohio 1845-1866	Board of Control of the State Bank of Ohio; one member appointed by each Branch Bank; president by Board from outside its membership.	Left to discretion of Board; policy was to examine each bank once per year.	Quarterly to Board, policy was to require monthly reports to Board.	If bank insolvent, had violated law, or any order of Board, could close bank. Could regulate dividend payments. Could order any bank to reduce its circulation or liabilities to whatever level was deemed safe. Could determine proportion of reserve to be in vault cash. 1/
Iowa 1858-1866	Board of Directors of the State Bank of Iowa; three directors appointed by legislature; one director by each Branch Bank; president by Board.	Left to discretion of Board; policy was to examine each bank twice per year.	Monthly to Board.	If bank insolvent, had violated law, or any order of Board, could close bank. Could regulate dividend payments. Could order any bank to reduce its circulation or liabilities to whatever level was deemed safe.

1/ Not stipulated in law but assumed by agency.

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Function of supervision under insurance plans. In considering the relationship between supervision and bank-obligation insurance it should be remembered at the outset that both were reforms aimed at protecting the public against bank failures. This problem did not become serious until about the time of the war of 1812; indeed, the first failure had not occurred until 1809, more than a quarter century after banking began in this country. Proposals for supervision and insurance reflected a growing awareness that, since banks create circulating medium, the public has a deep interest in a stable banking system.

In view of the evident concern for establishment of banking systems which would protect the public against the consequences of bank failures, it would appear that one explanation for the adoption of insurance and supervision at the same time was simply the convenience of incorporating a number of reforms into one piece of legislation. In each of the six States here under consideration the circumstances at the time of adoption were such that far reaching changes in the respective banking structures were both feasible and necessary.

Notwithstanding the possibility of independent development of these two reforms, it is probable that many people saw bank supervision as a necessary adjunct to insurance, for two reasons: it would make insurance practicable and also make it acceptable. The new techniques of bank supervision which were being advocated prior to 1829 were a recognizable extension of already existing supervisory practices and might well have been adopted on their own merits. Bank-obligation insurance, on the other hand, was new to the American banking scene and hardly could have been placed into operation without accompanying supervisory legislation.

The need for some control over the risk to which the various insurance systems, i.e., the participating banks, would become exposed was clearly recognized by the proponents of insurance. It was not maintained that supervision would prevent all loss to the insurance system, but rather that the early exposure of financial difficulties would reduce both the number of failures and the amount of loss which nevertheless occurred in those failures. For example, Joshua Forman, the author of the New York plan, pointed out that examination, plus other authority given supervisory officials, would:

> prevent mismanagement and ... secure the prosperity of the failing banks before mismanagement has progressed to its consummation ... If [some banks] should succeed in breaking through all restraints, and consummate their ruin, the losses would be comparatively small, and within the means of the fund to meet them. 1/

1/ New York Assembly Journal, 1829, p. 178.

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Improved supervision was also thought to be the answer to the charge that insurance would penalize the sound banks for the benefit of the creditors of the badly managed banks. Clearly, there had to be some assurance given the well-managed banks that their assessments would not be dissipated as a consequence of unsound banking practices which, in the absence of any check, might be stimulated by the knowledge that losses were covered by insurance. Probably the best demonstration of this role of supervision is found in the fact that all but one of the supervisory systems originally provided for the selection of most or all of the supervisory officials by the participating banks.

Composition and selection of supervisory staffs. Two types of supervisory agencies were established in the six States. In New York, Vermont, and Michigan all supervisory operations were conducted by individuals known as Bank Commissioners. No provision was made for subordinate staff members. In Indiana, Ohio, and Iowa the supervisory structures were more complex. Overall policy and final authority were given to banking boards in each State but supervisory operations were conducted by officers or executive committees of these boards, and occasionally by specially appointed agents.

In general, supervisory officials in States relying primarily upon an insurance fund for bank creditor protection (New York, Vermont, and Michigan) were appointed by the Governor or legislature, while in States with a mutual guaranty system (Indiana, Ohio, and Iowa) all or most of the members of the banking boards were chosen by the banks. Selection of supervisory officials by participating banks was authorized in the original laws of New York and Vermont but was soon abandoned.

The typical term of office for a supervisory official in the six States was one or two years. No official, whether a Bank Commissioner, member of a State Board, or official of a State Bank, was given a longer term than two years, except the president of the State Bank system in Indiana. The term of that office was five years until 1856, at which time it was reduced to one year.

The salaries provided for supervisory officials by the various acts were generally sufficient to assure the full-time services of the respective individuals. Only the Vermont schedule was on a per diem basis, indicating that the Bank Commissioner may not have been expected to devote all of his time to supervisory tasks. In Ohio and Iowa salaries were determined by the banking boards and were comparable with salaries established by statute in the other States.

Examination and condition reports. Regular examination of banks participating in the insurance system was required by the original insurance law in four of the States; but in the two in which it was not required (Ohio and Iowa) regular examination was ordered by the respective banking boards. The only States which later restricted this practice were Michigan, in 1840, and New York, in 1843.

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Condition reports to supervisory officials were required in all six of the insurance laws. Their frequency and content varied. Those of New York, Vermont, and Michigan appear to have been fairly limited as to detail. However, significant improvement was made in this regard in New York beginning in 1843.

In the second group of States, i.e., Indiana, Ohio, and Iowa, the frequency and content of condition reports were to a significant extent determined by the respective supervisory agencies. This was true whether or not the law dealt with such matters, reflecting the broader authority of the banking boards as contrasted with the Bank Commissioners. In general, these reports were much more detailed than those of Vermont and Michigan.

Enforcement powers of supervisory officials. Supervisory officials in each of the States with bank-obligation insurance systems were clothed with authority considered sufficient to implement their operations and functions. In actual fact, however, this authority in some States was not sufficient to permit the most effective supervision, while in others it went beyond what are today considered normal supervisory powers. It is again convenient to consider the States in two groups: New York, Vermont, and Michigan, each of which had an insurance-fund type of insurance system, and Indiana, Ohio, and Iowa, each of which depended primarily upon mutual guaranty ~~for~~ the protection of creditors of failed banks.

In the States of the first group ultimate authority of the Bank Commissioners rested upon their right to apply for an injunction against the continued operation of any bank found to be insolvent or operating in violation of the law. The effect of such an injunction was to place the bank in a position under which receivers could be appointed and, if necessary, disbursements made from the insurance fund.

In Indiana, Ohio, and Iowa a bank participating in the insurance program could be closed by supervisory officials because of discovery of insolvency or of illegal operation. More important, it could be closed if it refused to comply with an order by supervisory officials. Since the officials were charged with safeguarding the interests of the entire system such orders could well relate to unsafe and unsound banking practices, regardless of the legality of such practices or of the solvency of the bank. As a matter of fact, the Indiana act went so far as to make it the "duty" of supervisory officials to suspend the operations of any bank "mismanaging its affairs, whereby the interest of the other [banks] is endangered." 1/

In addition to giving supervisory officials the right to use the suspension power in circumstances other than illegal or insolvent operation, States having the mutual guaranty type of in-

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1/ An Act to establish a bank with branches, January 28, 1834, section 39.

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surance system provided such officials with less severe penalties to be applied to banks operating in an unsafe and unsound manner. These included authority to prohibit or regulate dividend payments and the power to compel a bank to contract the amount of its assets and liabilities.

It is not known whether the various State legislatures intended that the provisions relating to the contraction of assets and liabilities should be used only in the cases of individual banks or, on at least some occasions, in the cases of all or most of the banks at the same time. The Ohio and Iowa laws seem to reflect the former interpretation, the Indiana law possibly the latter. However that may be, it is clear that on those occasions when the power was used to apply equally and at the same time to all or most of the banks, it had ceased to be a weapon in the supervisory arsenal and had become, instead, a device characteristic of a central bank, whereby the result of its use would be either contraction or expansion of the volume of bank liabilities, i.e., of the major segment of the money supply.

Protection of Creditors of Banks Participating in Insurance System

The record of protection accorded creditors of banks participating in bank-obligation insurance plans prior to 1866 is exceptionally good. In three of the States no insured creditor suffered any loss as a consequence of bank failure, and in two others a substantial portion of losses that would otherwise have been borne by creditors was covered by insurance payments. In five of the States insurance ended only because participating banks had become national banks or were otherwise ineligible to continue in their respective systems.

Banks in financial difficulties. In all six insurance systems under discussion one or more participating banks became involved in serious financial difficulties. In Michigan all but one of the participating banks closed within three years. In other States the number of banks in financial difficulty in any one year was small, although one or a few banks which failed constituted in some cases a sizable percentage of the banks participating.

For the six States combined during the insurance periods failures of participating banks were fewer than those of nonparticipating banks both in actual number and in proportion to number. In each of four States the number of failing nonparticipating banks exceeded the number of participating banks in financial difficulties. The greatest difference occurred in Indiana where of a total of 70 cases of bank difficulty, 69 were nonparticipating banks. Only in Michigan were there more failures among participating banks than among those not operating under insurance. In Iowa, where all banks participated in insurance, there was one case of a bank in serious financial difficulty.

Methods used to protect creditors of banks in financial difficulty. The measures taken in some of the States by insurance authorities to protect the creditors of failed banks, and of banks in imminent danger of failing, were not wholly contemplated by

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insurance legislation. Such measures were developed in an attempt to provide better coverage or to meet emergencies not foreseen at the time insurance was adopted. In general, they represented improvements on the original plans and some are similar to those used today by the Federal Deposit Insurance Corporation.

In New York it was discovered at an early date that depositors and noteholders of a distressed bank could, in some cases, be better protected by restoring the bank to solvency than by allowing it to go into receivership. Consequently, disbursements for the former purpose were successfully made in a number of cases. Also, a borrowing power was given to administrators of the New York system when it became apparent that insurance assessments might be sufficient to cover loss but not to provide a sufficiently large fund for the needed disbursements at time of bank failures.

The question of whether to place a distressed bank in receivership and pay insured creditors or to arrange for its continued operation arose in several cases handled by insurance authorities in Ohio. In these cases, receivership would have deprived the respective communities of needed banking services and, in addition, it was feared that the failures would adversely affect the credit of the other participating banks. It was therefore decided to prevent if possible the closing of the banks. The procedures which were used resemble, in some respects, those used by or available to the Federal Deposit Insurance Corporation today.

Indiana and Iowa had only one case of a participating bank involved in serious financial difficulty and in each instance the bank was kept from closing through action taken by the insurance authority. Little information is available on the precise techniques which were used but it appears that financial aid was granted, either in the form of a loan or a subordinated deposit, by some or all of the sound participating banks.

Disbursements to protect creditors of distressed banks. Insurance disbursements made on behalf of creditors of participating banks in financial difficulties and the degree of protection achieved thereby are shown in Table 4. In the six States combined, more than 85 percent of insured obligations in failing banks were made available to creditors either through direct payments by the insurance systems and receivers or through rehabilitation of distressed banks by insurance disbursements. In individual States the degree of protection provided ranged from 100 percent in Indiana, Ohio, and Iowa to zero in the case of Michigan.

It will be noted that in some cases claims against the respective insurance systems were considerably less than the obligations insured at or near time of failure. Four of the insurance plans--New York, Vermont, Indiana, and Michigan--provided that insurance payments need not be made until the receivers of the failed banks had an opportunity to dispose of at least some of the assets and declare a dividend. In the other two States, Ohio and Iowa, creditors of failed banks were to be paid immediately, but in practice there was sufficient time between the failure of the bank and the return of circulating notes for redemption to realize upon

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Table 4. Insurance Disbursements and Bank Creditor Protection, States with Bank-Obligation Insurance Systems, 1829-1866
(Amounts in thousands)

State and year of bank difficulty	Participating banks in serious financial difficulties		Banks placed in receivership				Banks rehabilitated with insurance aid:	Protection of insured creditors: Percentage of insured obligations	
			Payments to insured creditors by receiver 2/	Claims against insurance system	Payments to insured creditors by insurance system				
	Number	Insured obligations 1/			Amount	Percent of claims	Disbursements	Made available to creditors 3/	Not paid 4/
Total six States	74	$ 9,900	$ 2,548	$ 4,260	$ 3,151	74.0%	$ 494	86.7%	13.3%
New York, total	21	$ 6,485 5/	$ 2,123	$ 2,813	$ 2,813	100.0%	$ 147	97.9%	2.1%
1837	5	1,550 6/	101	36	36	100.0	147	100.0	...
1840	2	696 7/	241	446	446	100.0	...	98.7	1.0
1841	4	2,392 7/	640	1,724	1,724	100.0	...	98.8	1.2
1842	5	1,027	474	532	532	100.0	...	98.0	2.0
1848	1	186 8/	186	...	...	...	...	100.0	...
1854	1	125	20	75	75	100.0	...	87.7	12.3
1857	3	509	461						
Vermont, total	2	$ 157	$ 26	$ 65	$ 47	72.3%	...	46.5%	53.5%
1839	1	74	10	34	34	100.0	...	59.5	40.5
1857	1	83	16	31	13	41.9	...	34.9	65.1
Indiana, total	1	$ 78	...	...	...	...	9/	100.0%	...
1843	1	78	...	...	...	...	9/	100.0	...
Michigan, total	39	$ 1,091	...	$ 1,091	...	...	...	...	100.0%
1838	16	449 10/	...	449 10/	...	...	...	...	100.0
1839	18	424 10/	...	424 10/	...	...	...	...	100.0
1840	5	218 10/	...	218 10/	...	...	...	...	100.0
Ohio, total	10	$ 1,994	$ 399	$ 291	$ 291	100.0%	$ 327	100.0%	...
1850	2	432	...	...	...	...	190	100.0	...
1852	1	179 11/	6	173	173	100.0	12/	100.0	...
1854	3	511	393	118	118	100.0	81 13/	100.0	...
1857	4	872	...	...	...	...	56	100.0	...
Iowa, total	1	$ 95	...	...	...	...	20	100.0%	...
1860	1	95 14/	...	...	...	...	20 14/	100.0	...

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Table 4. Insurance Disbursements and Bank Creditor Protection, States with Bank-Obligation Insurance Systems, 1829-1866 (continued)
(Amounts in thousands)

1/ At time of failure or last report prior to failure.

2/ Amounts for New York in 1840, 1841, and 1842, and Vermont in 1839 and 1857, represent reported receivers' collections. The amounts of receivership expenses charged against these sums, if any, are not known.

3/ Through payments by receivers and payments on claims in receivership cases, and through rehabilitation of the bank in other cases.

4/ In New York and Vermont chiefly because claims were not presented.

5/ Circulating notes and deposits through 1842; circulating notes only 1848, 1854, and 1857. Deposits of two banks which failed in 1842, after passage of the law restricting insurance to circulating notes, are included because of recognition of the liability of the insurance fund for their deposits by an act passed in 1845. Miscellaneous liabilities are unavailable for some banks and are probably included with deposits in other cases; such liabilities at time of failure were probably very small.

6/ Circulation at time of closing plus estimated deposits. Deposits estimated by assuming that average decline in circulation between reporting date and dates of failure was matched by a similar decline in deposits. Four of these banks were enabled to resume operations because of insurance aid.

7/ Includes obligations fraudulently issued and not shown on books at last reports prior to failure.

8/ Records conflict as to circulation outstanding at time of failure, $192,000 being given in some reports.

9/ Amount of disbursements, presumably in the form of loans, made to rehabilitate bank not known.

10/ Partially estimated.

11/ Includes, as of date just prior to failure, notes in circulation of $156,000 plus $23,000 carried under liabilities as "sundires The latter sum probably represented circulating notes held as security by other Branch Banks for amounts previously advanced to sustain the failing bank.

12/ Excludes the $23,000 mentioned in note 11 because the circulating notes presumably held as security by the other participating banks are assumed to be included among those redeemed by the payments to insured creditors.

13/ Disbursement made to one of the banks prior to failure in an unsuccessful effort to prevent its closing. The amount advanced in this case was apparently not recovered by the contributing banks.

14/ Estimated.

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a portion of the assets of the bank involved.

Better protection of creditors of banks involved in financial difficulties was achieved by the systems with mutual guaranty than by the simple insurance fund systems. Full payment was made to the insured creditors of four banks which had been placed in receivership in Ohio, but there may have been some loss to depositors, who were not protected by insurance. In the case of eight other distressed banks--six in Ohio and one each in Indiana and Iowa--insurance disbursements made possible the continued operation of either the bank involved or a successor bank. In Ohio and Iowa, where only circulating notes were protected by insurance, this had the incidental effect of providing full coverage for depositors. On the other hand, no payments were made from the insurance fund to creditors of failed Michigan banks, and only partial protection was given Vermont creditors. Although all claims against the insurance fund were paid in New York, payment was delayed in some cases for considerable periods of time.

Adequacy of insurance funds and assessments. Measures of the adequacy of the insurance funds and rates of assessment in the five State systems embodying an insurance fund are shown in Table 5. It will be noted that in three States the funds and assessment rates were sufficient to cover all insurance costs, although as was pointed out earlier, they were not sufficient in New York to cover all disbursements at the time such were needed.

The average ratios of the insurance funds to total and to insured obligations varied considerably from State to State. Michigan's insurance fund average one-twentieth of one percent of insured obligations, while the funds in Ohio and Iowa were 12 and 19 percent respectively of insured obligations. It should be noted, however, that in Vermont, Ohio, and Iowa, and in New York prior to 1840, most of the income derived from investment of the insurance funds was returned to the participating banks in proportion to their contributions.

All of the assessments paid by participating banks were on capital stock or insured obligations and were intended to be made for a limited number of years. However, to provide a basis for comparison with rates under Federal deposit insurance, the equivalent average annual rates on total obligations are shown in Table 5. It will be seen that the rate most closely approximating the present statutory rate of one-twelfth of one percent under Federal deposit insurance was Michigan's one-tenth of one percent per year. Other rates were substantially higher, ranging from one-fifth of one percent in New York and Vermont to about two percent in Iowa.

Included in Table 5 are the assessment rates which would have been necessary to cover the insurance costs. Because of the relatively small surplus and liability in New York and Vermont respectively, such rates in those States are approximately the same as those actually paid. In both Ohio and Iowa, the rate could have been considerably smaller so far as the ultimate cost of insurance was concerned. On the other hand, to have been successful in the short and disturbed period in which it operated, Michigan's insurance system would have required a tremendously high assessment rate.

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Table 5. Insurance Funds and Assessments, States with Bank-Obligation Insurance Systems, 1829-1866 1/
(Amounts in thousands)

Item	New York (1829-1866)	Vermont (1831-1866)	Michigan (1836-1842)	Ohio (1845-1866)	Iowa (1858-1865)
Insurance funds:					
Average size	$190 2/	$ 21	$ 0.4	$ 759	$ 171
As percent of:					
Average total obligations	0.6%	1.9%	.05%	7.7%	7.2%
Average insured obligations	0.9	1.9	.05	11.6	18.6
Balance or deficiency at close of system	$ 13	$ -18	$-1,091	$ 815 3/	$ 309 3/
Assessments and fund income:					
Assessments and income available for insurance operations:	$3,413	$ 99	$ 3	$1,649	$ 349
Assessments paid	3,105	62	3	1,649 4/	349 4/
Interest received	308	36	--	5/	5/
Insurance disbursements	2,961	47	--	642	20
Other costs 6/	439	36	3	100	20
Refunded to banks or State	13	18	--	907	309
Assessments necessary to cover insurance costs 7/	3,092	65	1,094	400 8/	30 8/
Equivalent average annual rate of assessments on total obligations:					
Paid	0.2%	0.2%	0.1%	0.8%	2.1%
Necessary to cover insurance costs	0.2	0.2	39.1	0.2	0.2

1/ Excludes Indiana, whose insurance system was one of mutual guaranty, with no fund.

2/ Balance in fund at end of each year. Average size of fund computed by taking into account balances only during years when fund was immediately available to protect insured creditors was $379,000; or 0.9 percent of total obligations and 1.0 percent of insured obligations.

3/ Amount in fund in last year of full operation of insurance system.

4/ Maximum in insurance fund plus total of special assessments used to redeem notes of failed banks or rehabilitate operating banks, plus supervisory costs estimated at $100,000 for Ohio and $20,000 for Iowa.

5/ Not available.

6/ Includes (when applicable) supervisory salaries, interest paid on borrowings, dividends to banks from investment income, and miscellaneous expenses, less recoveries and miscellaneous receipts. In Ohio and Iowa, includes only estimated supervisory costs.

7/ "Insurance costs" includes disbursements to creditors of failed banks or in aid of operating banks, supervisory expenses, interest on borrowings, and miscellaneous expenses, less recoveries, interest income retained in fund, and miscellaneous receipts.

8/ Estimated by assuming approximately 50 percent recovery on disbursements, plus estimated supervisory costs.

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The differences between actual rates and computed necessary rates in Michigan, Ohio, and Iowa do not depend solely on the claims made by creditors of failed banks. For example, Michigan's computed rate is very high because of the small number of years during which the necessary amounts would have been contributed. The computed necessary rate would have been much lower for Michigan if its system had started earlier, or had experienced a decade or two of prosperous years before encountering a wave of failures, and if it had had power to borrow funds to meet claims as they arose.

Appraisal of the Insurance Systems

The six insurance and mutual guaranty plans adopted during the period under discussion provided creditors of failing banks with a degree of protection previously unknown in American banking and, as has been indicated, three of them were wholly successful in preventing losses to holders of insured obligations. In the chapters to follow, each of the State systems will be described in detail and an appraisal made of its operations. However, some general comparisons can be made at this point.

All of these pioneer systems operated under handicaps that were inherent in the insurance plans or resulted from external pressures. The most serious defect was in the systems of New York, Vermont, and Michigan, where there was neither mutual guaranty nor provision for an original fund or for borrowing power. In Michigan and Vermont, the first failures came before a sufficient fund had been accumulated, and these were so serious in the former State that the system collapsed. In New York the fund was provided with borrowing power only after insurance operations had temporarily broken down.

A handicap common to all six of the insurance plans, associated with the lack of borrowing power, was the pressure for rapid liquidation arising out of the regulations governing the payment of insured creditors. Liquidation under pressure usually results not only in smaller recovery, but also tends to adversely affect values in a market likely to be already depressed. In New York, Vermont, and Michigan such pressure came from creditors who, under most circumstances, could not be paid until the liquidation of the failed banks had been wholly or substantially completed. Indiana's insurance plan was also subject to the same handicap although the problem never arose in practice. In Ohio, and inherent in the Iowa plan, pressure for rapid liquidation came from the participating banks because the assessments necessary to make prompt payments to creditors could be lessened, or even avoided, if sufficient funds were secured from the receiver.

In two of the six States, Ohio and Iowa, sizable insurance funds were provided immediately upon organization of the systems. In these States participating banks were required to make the major portion of their insurance contribution prior to opening for business. Consequently, it is probable that confidence in the safety of insured obligations was more widespread among creditors, and was achieved more quickly, than was the case in New York, Vermont, and Michigan. Also, the assessment rates in Ohio and Iowa, as computed on an equiva-

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lent annual average, were much higher than in the other States.

Banking and business developments during the early years of the insurance systems were also an important factor in their success or failure. This is particularly evident when the Michigan experience is compared with that of Ohio or Iowa. The Michigan system was started at a time when the nation was on the verge of a deep and prolonged depression. In Ohio, the system was established after recovery from that depression was under way; and in Iowa, after the panic of 1857. In each of these cases there was a subsequent and fairly prolonged period characterized by general prosperity and relatively few bank failures.

The influence of supervision is reflected in the record of all of the State systems. As a factor in the successful operation of insurance it was most important in the case of Indiana, Ohio, and Iowa. However, it must be remembered that supervision in these States included activities on the part of supervisory authorities which are today the function of the central bank. In Indiana, which must be reckoned as the most successful of all systems in terms of minimization of banking difficulties over a prolonged period of time, it is difficult to attribute the success of the system to anything other than the excellence of supervision, for it was subject to some of the handicaps described above. The Indiana system had neither an original nor accumulated fund upon which to draw; and had been in operation only a short time before the panic of 1837 and the long depression of the late 1830's and early 1840's.

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CHAPTER II

INSURANCE OF BANK OBLIGATIONS IN NEW YORK, 1829-1866

New York was the first State to use the insurance principle in providing for the protection of bank creditors. The plan was adopted in 1829 and went into full operation in 1831. It became inoperative in 1866, when the charters of the last of the participating banks expired.

Review of New York Banking History to 1866

New York banking history to 1866 can be divided into three periods by the following events: establishment of the Bank of New York in 1784; institution of the insurance system in 1829; 1/ and passage of the Free Banking Act in 1838. To provide background information for the sections to follow, New York's banking history during each of the periods delineated by these events is briefly sketched below.

Banking from 1784 through 1828. Banking in New York began three years after establishment of the nation's first bank in Philadelphia. In 1784 the Bank of New York, formed under articles of association drawn up by Alexander Hamilton, opened for business. However, because an earlier act of the State legislature (1782) prohibited all banking in the State except that conducted by an agency of the Philadelphia bank (the Bank of North America), it was not until 1791 that the Bank of New York was able to secure a charter from the State legislature. This marked New York's entrance into a period of banking by special charter which was not seriously altered until 1829, and during which 43 banks were chartered with an authorized capital of over $30 million.

Provisions of charters granted in New York State after 1791 varied. The earlier charters were clearly patterned upon those of the Bank of England and the first Bank of the United States, whereas the later charters began to reflect the banking experience which was steadily accumulating. In general, the charters consisted of restrictive and prohibitory clauses and it was not until 1825 that the first specific grant of banking powers was made by the legislature. 2/ Typical among the provisions of bank charters were limitation of capital stock, prohibition of dealings in real estate or other merchandise, and restriction of bank debts to a given multiple of capital.

1/ The insurance system was popularly known as the "Safety Fund" system, and is so referred to in most of the literature.

2/ Specific banking powers were stipulated for the first time in charters granted to the Commercial Bank of Albany and the Dutchess County Bank.

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Passage of a special act by the State legislature was needed to secure a bank charter. As the demand for bank facilities grew the value of a charter naturally increased, particularly after passage of several restraining acts which prohibited banking by unauthorized corporations. As a result, legislators were under heavy pressure to grant new bank charters and it was inevitable that political considerations often appeared dominant in their deliberations.

There was no effective supervision of banks during this period. Examinations were rarely made, usually only after a bank was known to be insolvent. Until 1824 reports from banks were irregular and scattered. Those which were published gave little information on the actual condition of the banks concerned. The banking privilege was therefore frequently abused. Among the charges leveled at banks were: organization without the necessary capital, dishonest management, maintenance of fictitious credit by making unearned dividends, sale of worthless stock, excessive rates of interest, failure to observe limitations upon the issue of circulation, and unwarranted expansion and contraction of circulation.

Despite the probable existence of the unsafe banking practices noted above, the first bank failure in New York did not occur until 1819, thirty-five years after banking began in the State. During the next decade seven additional banks failed, resulting in severe losses to bank creditors in some cases.

Most bank charters granted during this period were due to expire in the early 1830's. As that time drew near it became clear that the legislature would only renew the charters if there was a thorough revision of the banking system. Consequently, when a new administration came to power in 1829 the way was open for the introduction of banking reforms.

Banking from 1829 through 1837. In the fall of 1828 Martin Van Buren was elected Governor of New York. His first message to the legislature devoted considerable space to the problem presented by the impending expiration of many bank charters. After dismissing suggestions ranging from the aboliton of all banking to the establishment of a State Bank with branches Van Buren gave the first official indication that a proposal entirely new to banking would soon be made:

> My own reflections ... have derived much assistance from a sensible and apparently well considered plan that has been submitted to me, and which will, in due season, be laid before you ... It proposes to make all the banks responsible for any loss the public may sustain ... 1/

1/ State of New York, Messages from the Governors, Charles Z. Lincoln, editor, (Albany: 1909), III, 243.

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Three weeks later, on January 26, 1829, Van Buren sent to the Assembly the detailed plan of the man who first conceived bank-obligation insurance, Joshua Forman. The plan provided for the establishment of an insurance fund, to which all banks would be required to contribute as a condition of charter renewals, the appointment of a board of commissioners to regularly examine the banks, and the compulsory investment of bank capital in State bonds or well-secured mortgages.

Except for minor changes, the first two provisions became law on April 2, 1829. The proposal having to do with the investment of bank capital was rejected, but at a later date, and in slightly different form, became part of the Free Banking Act and, still later, of the National Banking Act.

Passage of the insurance law was effected over the bitter opposition of New York City banks, and only after the Albany banks were mollified by repeal of a restriction limiting them to six percent on discounts. Oppostion to the law was based primarily on the argument that well-managed banks should not be made responsible for the errors of poor bankers and, secondly, that the supervisory powers granted in the act were impossible of being carried out and would be ruinous to the banks.

So strong was the oppostion of the New York City banks that at first they refused to accept charters under the law and threatened to cease operations. However, this extreme position was soon abandoned and by 1832 most of the banks chartered prior to 1829 were operating under the law. In addition, new banks were authorized, so that by 1837 a total of 88 banks had been either chartered or rechartered under the provisions of the 1829 act.

Banking from 1838 to 1866. Support for the insurance law of 1829 was based in part upon the belief that it would eliminate some of the more objectionable features of chartered banking. When it became evident that neither the existence of mutual responsibility nor the visits of bank examiners was sufficient to prevent mismanagement of some of the banks antagonism towards chartered banks was revived. The result was passage of New York's pioneering Free Banking Act in 1838. 1/

Basically, this new legislation was designed to throw open the business of banking to all persons who could meet certain minimum requirements. The number of banks was not limited and, of course, it was no longer necessary to secure a charter by virtue of having a special act passed by the legislature. There had been some discussion of making the new banks subject to the insurance law but in the bill which finally emerged protection of holders of circulating notes was provided for by having each bank deposit securitie

1/ Although Michigan preceded New York by one year in passing such an act, credit for the step must remain with the latter since Michigan merely passed a version of the bill then under consideration in the New York legislature.

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(State bonds or mortgages) with the State government to the full value of notes issued.

The introduction of free banking came hard upon the heels of the panic of 1837 and just prior to the severe depression 1839-42. Failures among both free and chartered banks were numerous during these years. However, enthusiasm for free banking was unchecked while opposition to chartered banking was, if anything, intensified. Thus the era of banking by special charter was finally ended. As charters expired, banks reorganized under terms of the Free Banking Act. In 1866 the charter of the last bank participating in the insurance system expired, leaving banking in New York (except for two banks with perpetual charters) within the province of free banks and the new national banks being organized.

Character of the Insurance Plan

During the first fifteen years of its operation substantial alteration was made in New York's insurance plan, but there was no change at any time in its basic character. The plan centered on a fund, created from assessments levied on participating banks, which was to stand as a guaranty for the obligations of failed participating banks. Most of the changes were a consequence of experience gained during the banking difficulties of 1837 and the early 1840's. In describing the development of the principal provisions of the insurance plan, details of the operational history of the insurance system will be touched upon occasionally. However, the major part of the latter story is left to a later section of this chapter.

Obligations insured. Under the original act of 1829 insurance applied to "such portion of the debts, exclusive of the capital stock, of any of the said corporations which shall become insolvent, as shall remain unpaid, ..." 1/ Nowhere in the act was "debts" further defined so that for thirteen years the word "debts" was interpreted literally, i.e., to mean all bank obligations to the public, the most important of which were deposits and circulating notes.

In 1842, when the claims of noteholders and depositors of failed banks had exceeded the amount available from the fund, the law was amended to make insurance apply only to circulating notes. The new provision required that the insurance fund "after paying the liabilities already charged upon [it], shall be inviolably appropriated and applied to the payment and redemption of such portion of the bank notes, outstanding or in circulation, of any of the said banking corporations subject to contribute to said fund ..." 2/

While the language of the amendment seems to clearly exclude deposits from insurance protection, and has been so understood by

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1/ An Act to create a fund for the benefit of the creditors of certain monied corporations, and for other purposes, April 2, 1829, section 4.

2/ Amendment adopted April 12, 1842, chapter 247, section 5.

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most modern writers, this was not the interpretation of the New York State Comptroller. In his 1848 report Millard Fillmore lamented the fact that the amendment simply gave preference to noteholders and that a surplus could still be used to pay depositors. According to Knox, he desired that the fund be "sacredly devoted to the bill holder" but such further amendment, if necessary at all, was never adopted. 1/

Insurance fund. The fund out of which payments were to be made to insured bank creditors was created by requiring each participating bank to pay annually to the State Treasurer an assessment equal to one-half of one percent of paid-in capital stock. 2/ Payments were to continue until each bank had paid a total of three percent of its capital stock. The State Comptroller was charged with management of the fund but ownership remained with the participating banks, each of which was to share in the fund's net income, proportionate to the bank's contribution. 3/

Maximum size of the fund was set at three percent of paid-in bank capital (less any held by the State). 4/ In other words, each bank had to make only six full payments to meet its quota, assuming no increase in its capital stock. The 1829 legislation required that assessments, at rates determined by the Comptroller but not to exceed the regular rate, be resumed whenever the fund was reduced as a consequence of insurance payments. The special assessments were to continue until the fund was restored to the maximum amount. 5/

The provision for special assessments was substantially modified in an 1841 amendment. There was often a considerable passage of time betwen the date a bank failed and the date at which payments were actually made from the fund. Under the 1829 law, it was not until such payments were made and a loss to the fund resulted that special assessments could be levied. The amendment made any allocation of the fund for the protection of creditors of a failed bank, regardless of actual expenditures or the creation of a loss, a reduction in the fund by definition, therefore giving the Comptroller the right to levy special assessments almost immediately upon failure of a bank. 6/

1/ John Jay Knox, History of Banking in the United States, (New York: Bradford Rhodes and Company, 1900), p. 412.

2/ An Act to create ..., section 2. The first payment of a bank in operation less than one year was in proportion to the portion of year it had operated. Stock held by the State, if any, was not included in the assessment base.

3/ Ibid., section 6; section 7. Salaries of Bank Commissioners were a prior charge against earnings of the fund.

4/ Ibid., section 4.

5/ Ibid., section 8.

6/ Amendment passed 1841, chapter 292, section 5.

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Method of paying creditors of failed banks. Under the 1829 law creditors of failed banks could not be reimbursed from the fund until liquidation was completed and a court order was secured directing the State Treasurer to pay the necessary amount out of the insurance fund. Since long periods of time were often required to liquidate a bank, this provision constituted a serious defect in the plan. Bank creditors, particularly noteholders, being unable to wait for payment, might be forced to dispose of their claims at heavy discounts.

Fortunately, the law was amended in time to deal with the first cases in 1837. The Comptroller was authorized to make immediate payments out of the fund, under such arrangements as he thought best, to holders of circulating notes, so long as the amount due, i.e., the excess of liabilities over assets of the failed bank, did not exceed two-thirds of the insurance fund. 1/ The method adopted, according to Root, was to pay noteholders immediately, leaving depositors to be paid out of bank assets. After payment of depositors and other creditors, remaining assets were taken by the Comptroller and, if they were insufficient to cover earlier payments to noteholders, the deficiency was made up through renewed assessments on the participating banks. 2/

Participation of banks. It was the original intention of the State legislature to make the insurance system general. This is clear from the first sentence of the 1829 law: "Every moneyed corporation having banking powers, hereafter to be created in this State, or whose charter shall be renewed or extended, shall be subject to the provisions of this act." 3/ Since all banking was done under special charter in 1829, this provision contemplated the eventual inclusion in the insurance system of every bank in the State except the two which held perpetual charters. No provision was made for the entry of other than chartered banks nor did an operating bank have the right to withdraw.

In 1838 the concept of an insurance system for all banks was abandoned. The Free Banking Act of that year did not require banks formed under its provisions to participate in the insurance program. In fact, such a provision was expressly voted down prior to passage of the bill. 4/ This action stemmed primarily from political motives and apparently had little to do with displeasure over the operation of the insurance system to that time. Nevertheless, it signaled the eventual end of bank-obligation insurance in New York State.

Purpose of the Insurance Legislation

The fact that New York was the first State to adopt bank-obligation insurance, and did so after almost a half-century of banking

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1/ Amendment dated May 8, 1837, chapter 350, section 1.

2/ L. Carroll Root, "New York Bank Currency", Sound Currency (February, 1895), p. 5.

3/ An Act to create ..., section 1.

4/ Robert E. Chaddock, The Safety-Fund Banking System in New York State, 1829-1866, (Washington: National Monetary Commission, 1910), p. 379.

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experience, has resulted in a more complete record of the discussion preceding and following passage of the 1829 law than is the case for any other State. The arguments stated or implicit arguments of a number of the leading participants in the debate over the insurance legislation are worth examining. It is probable that most of the views described here were later reflected in debates preceding adoption of bank-obligation insurance plans in other States prior to the Civil War.

Objectives of the 1829 act. The various objectives sought by (or attributed to) proponents of bank-obligation insurance may be broadly described as follows: 1) to guard the State against destruction of circulating medium caused by bank failures, 2) to protect the bank creditor of limited means against loss, 3) to achieve a political goal for which bank-obligation insurance served simply as a means to an end. The first two objectives were those stated by advocates of the 1829 legislation, with protection of the circulating medium clearly of dominant importance. The third was that attributed to the authors and supporters of the plan by its critics.

Most of the advocates of the 1829 law were motivated, in whole or in part, by a desire for a stable circulating medium, although some saw the insurance provisions of the law as accomplishing a much more limited objective. Perhaps the clearest expression of the former position was by Joshua Forman in the letter to Van Buren which first set forth his bank-obligation insurance plan:

> ... The object to be attained, is of incalculable importance to the prosperity, happiness, and moral character of this highly commercial and growing state--to secure them a sound, well regulated currency, which shall not only be in the hands of the receiver of the value it purports to be, but shall be so adapted to the necessities of business, as to insure to regular, well directed business, the support and protection necessary to preserve its well earned profits, and depress and restrain that adventurous, speculating business, which causes those convulsions in the money market, baffling all calculation, and defeating the best arranged plans of business ... 1/

Most of Forman's accounts of the purpose of his plan, as did that quoted above, had reference to all of its parts, i.e., creation of an insurance fund, establishment of an examination system, and the requirement of investment of bank capital in securities. While it is difficult to determine with precision Forman's concept of the function of the insurance fund itself, he apparently felt that it would contribute to the stability of the circulating medium in two ways: first, by maintaining public confidence in the banks and replacing circulating medium lost as a consequence of bank failures; 2/ second, by preventing overexpansion of the circulating medium which, inevitably in Forman's view, led to contraction "demoralizing in its effects

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1/ New York Assembly Journal, 1829, p. 175.

2/ " ... the safety fund [will] prevent panic runs and pay real losses ...", Ibid., p. 184.

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upon society." 1/ This last function was possible because each bank would "be kept in check by the others, now more interested in their welfare than before." 2/

Interestingly, it was the latter effect which was more important to Forman. "In times of reducing the circulation from a redundant to an ordinary one," the banks exert a "tremendous effect" on business. "Great as has been the evil and loss from the failure of banks, they dwindle into insignificance, compared with the public injury occasioned by the irregular and injudicious management of the solvent banks." 3/

The relationship between the insurance plan and the stability of circulating medium was also sensed by other advocates of the 1829 law, but not expressed as clearly as by Forman. Van Buren, in his first message to the legislature, noted that the "stability of /bank/ paper, is the principal and almost the only point, in which the public has much interest." 4/ This view was echoed by the legislative committee which prepared the first draft. 5/ In a similar vein, the son of Alexander Hamilton, a Van Buren supporter, saw as the primary goals to be achieved by new legislation in 1829 "the stability of the currency of the country; and, second, the security of the depositors and holders of the notes of the banks ..." 6/

The more limited objective of protecting the bank creditor of modest means against loss due to bank failure was also sought by most advocates of the 1829 law; and for several of its advocates was the only important objective. Although both Van Buren and the legislative committee evidenced a desire for a stable circulating medium in their discussions of the 1829 law, in their statements regarding the specific function of the insurance provisions the safety of the small creditor was of primary importance. At a later time Van Buren gave as his reason for considering a bank-obligation insurance plan his desire, "to protect the most helpless against losses by /bank/ failures ..." 7/ Although this statement was made some thirty years after the act was adopted, it is supported by his message to the legislature accompanying the original insurance plan:

> /The insurance/ fund is to be raised gradually, and in a manner little burthensome to the banks; to be at all times kept good by them, and instead of going into the public treasury for the general benefit, is to be applied to the protection from actual loss of those of our constituents who would otherwise suffer by the failure of banks improvidently chartered by the state, or unskilfully managed by those to whom they were so granted; and whose paper, in the unavoidable state of our currency, our citizens can hardly be said to have the option to take or refuse... 8/

1/ Ibid., p. 184.
2/ Ibid., p. 178.
3/ Ibid., p. 184, and 174. Emphasis in original.
4/ State of New York, op. cit., p. 242.
5/ New York Assembly Journal, 1829, p. 437.
6/ James A. Hamilton, Reminiscences, (New York: 1869),pp.82-8
7/ Martin Van Buren, Autobiography, (Washington: Government Printing Office, 1920), p. 221.
8/ New York Assembly Journal, 1829, p. 173.

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Similarly, the committee reported that:

> The loss by the insolvency of banks, generally falls upon the farmer, the mechanic and the laborer, who are least acquainted with the condition of banks, and who, of all others, are most illy able either to guard against or to sustain a loss by their failure. The protection and security of this valuable portion of our population, demands from us, in their favor, our most untiring exertions; and our time and talents cannot be more beneficially employed, than when we are legislating for their indemnity. 1/

An event which throws light on the relative importance of the two objectives described above was the 1837 amendment to the insurance law, authorizing the Comptroller to take necessary measures for the immediate payment of the notes of any insolvent bank. Under the 1829 Act, the requirement that creditors of failed banks would be reimbursed from the insurance fund only after liquidation of the assets was completed suggests that the problem of ultimate loss to the individual creditor was paramount in the minds of those persons drafting that particular section. However, virtual abandonment a few years later of this procedure for paying creditors indicates that restoration of the circulating medium, or solvency of the banks, or both, was the primary goal. In other words, it was desired not merely to reimburse the insured noteholder for the difference between his original claim and receivers' dividends, collected perhaps over a period of years; but also to make his notes immediately acceptable or convertible into other means of payment. Whether this was considered at the time as the original intent of the 1829 Act is not known.

The significance of the 1837 amendment, so far as the purpose of insurance of bank obligations is concerned, is that it is important for the objective of guarding against destruction of circulating medium, but unimportant for protection of the bank creditor of modest means against loss. The difference between receiving immediate payment of insured obligations and receiving payment over several years is small, consisting of the foregone interest on unavailable funds. However, the first method has the important advantage of providing for the immediate restoration of purchasing power within the affected community, either because insured notes are immediately replaced or because the distressed bank is sufficiently strengthened by having its notes circulate at par to continue in operation.

It is to be expected that opponents of the insurance legislation saw, or professed to see, objectives much less praiseworthy than protecting the individual bank creditor or guarding the circulating medium. Probably the most frequent charge was that the plan was designed to give control over the banks to the administration. Exponents of this view were consequently more concerned with the examination requirements of the act than the provision for insurance.

1/ *Ibid.*, p. 439.

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Typical of such attacks was the following:

> The bank safety fund law, first conceived by a visionary speculator, is undoubtedly one of the most gigantic schemes of political power, and moneyed monopoly, ever devised and brought into operation in any country. The plan, as is believed, was first unfolded by the projector, to Mr. Van Buren, then Governor of the State of New York, who discovered in it at once, a mighty engine of political power. The capital of all of the banks in the state, amounting to 30 millions of dollars, with the privilege to issue bills to the amount of seventy-five millions, subject to the control of the Commissioners of the right political stamp, empowered to examine books and papers -- administer oaths to the officers and clerks--enter their vaults and handle their treasures, stop their discounts, and restrain their issues, opened to the aspiring, an avenue to political advancement, more favoured than any ever before contemplated. In the suppressed language of General Root, on the floor of the Assembly, it conferred a power, greater than that wielded by Philip of Macedon. 1/

It is, of course, entirely possible that Van Buren and some of his followers in the legislature were more than a little interested in the political implications of the plan. Abijah Mann, without whose skillful manipulation the bill could not have passed the legislature, was apparently uninterested in the principles of insurance and of bank examination. The great accomplishment, as he saw it, was that "the banks had for the first time yielded to conditions prescribed by the Legislature." 2/ What conditions, he indicated, were of no concern to him. 3/ Nevertheless, it is probable that this particular objective was not of great consequence to most supporters of the act and it is at least possible that even to the politicians it was not the most important objective.

Conception of circulating medium. A large part of the difficulty encountered in determining the objectives of the 1829 law stems from the fact that there were varying concepts of circulating medium. While it is clear that the idea that deposits were part of the money supply was accepted at an early date in this country there were still many in 1829 who either did not accept, or were not even aware of this fact. 4/ To the latter, circulating medium consisted of specie, i.e., gold and silver coin, plus banknotes. Since banknotes far exceeded specie in amount, the terms "circulating banknotes" and "circulating medium" could be used interchangeably by these persons.

1/ R. K. Moulton, Legislative and Documentary History of the Bank of the United States, (New York: 1834), p. 67. Emphasis in the original.

2/ A. C. Flagg, Banks and Banking in the State of New York, (Brooklyn: 1868), p. 39.

3/ Ibid., pp. 37-39.

4/ Henry E. Miller, Banking Theories in the United States before 1860, (Cambirdge: Harvard University Press, 1927), p. 110.

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The different concepts of circulating medium become important to a determination of the objectives of the 1829 law when it is remembered that it was also believed that holders of circulating notes were unwilling creditors of a bank. Contrariwise, it was felt that depositors were deliberate creditors, i.e., they had surplus funds to deposit and were in a position to choose their bank. As a result, once it is determined that a proponent of the safety fund felt or believed that insurance protection should be restricted to noteholders, instead of applying to all bank creditors including depositors, it is still not clear whether he believed the primary objective was protection of the circulating medium, imperfectly understood, or the safety of the "small" creditor, i.e., the noteholder.

Several of the key personages connected with the 1829 legislation felt that protection was being offered only to noteholders. Joshua Forman, the originator of the plan, apparently used the terms "circulation" and bank "debts" interchangeably in his original presentation of the plan and there is no evidence to show that he ever considered whether deposits would or would not be insured. 1/ Similarly, the Assembly committee reporting the bill stated:

> ... the committee flatter themselves that something can be formed out of it, which will effectually indemnify the bill-holder from every possible loss that can in any event be sustained by the insolvency of banks ... 2/

Among others holding this view were: Enos Throop, lieutenant governor of New York in the Van Buren administration:

> .... It is worthy of consideration, whether the law of last winter, creating a safety fund, and a board of visiting and examining commissioners, does not afford all the guarantee for the soundness of bills, which it is in the power of legislation to devise. 3/

Albert Gallatin, financier:

> .... with a laudable intent to protect the community against partial failures, a "safety fund" has since been established by law, consisting of a tax of one-half per cent. on the capital of every bank, and which is applicable to the payment of the notes of any that may fail ... 4/

1/ New York Assembly Journal, 1829; pp. 174-86.
2/ Ibid., p. 438.
3/ January 5, 1830. State of New York, op. cit., p. 311.
4/ Albert Gallatin, "Considerations on the Currency and Banking System of the United States:, American Quarterly Review (December 1830) in The Writings of Albert Gallatin, edited by Henry Adams, (Philadelphia: 1879), III, 317.

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and Abijah Mann who managed passage of the bill through the Assembly:

> The Safety Fund law therefore required a contribution of three per cent ... to constitute the Safety Fund, to be applied for the redemption of currency issued by the weak and broken banks ... 1/

To those who believed that only circulating notes were insured the 1842 amendment which specifically restricted protection to circulating notes merely clarified the language of the original act and was not a departure from the objectives of the authors. This interpretation of the 1842 amendment was held by no less authority than the New York Bank Commissioners in 1841. In their report of that year the Commissioners claimed that most people had not understood the phrasing of the section dealing with insured obligations. They stated flatly that the 1829 act had been "primarily designed to secure bank note holders, and not depositors or other creditors."2/

Of those quoted above, Forman was the only one of whom it may be fairly said that his apparent belief that only circulating notes would be insured was due to lack of understanding that circulating medium consisted of both circulating notes and deposits - rather than to any desire to limit the objectives of his plan. 3/ So far as the others are concerned, it is only clear that they thought circulating notes alone were insured. For what reason they advocated or believed this is not known.

Although several modern accounts of the New York insurance system have accepted the thesis that the intent of the law's formulation was to insure circulating notes only, there is substantial evidence pointing to the fact that many contemporary observers had always advocated (or assumed) that both depositors and noteholders were insured. 4/ This suggests, of course, that these observers could scarcely have felt that the primary purpose of the act was to protect the "small" bank creditor. As noted above, James A. Hamilton, writing to Van Buren while the legislation was still being considered, specifically mentioned "the security of the depositors and holders of the notes ..." 5/ In an anonymous pamphlet published in 1829 the act was severely criticized because it allegedly favored the bank creditor and discriminated against the stockholder. The bank creditors who were to receive the benefits of this act were identified as "the bill holder and depositor." 6/ Similarly, Redlich points to the fact that an amendment to the Vermont act, which act copied that of New York, clearly recognized that both deposits and notes were intended to be covered. 7/ Redlich dismisses the 1841

1/ Flagg, op. cit., pp. 37-38.

2/ "Annual Report of the Bank Commissioners," January 25, 1841, New York Assembly Documents, document number 64, pp. 16-17.

3/ This judgment of Forman's view can also be found in Fritz Redlich, The Molding of American Banking, (New York: Hafner Publishing Company, 1951), I,91.

4/ See, for example, Chaddock, op. cit., p.272: Miller, op. cit., p. 151.

5/ Hamilton, op. cit., p. 173. Emphasis added.

6/ An Examination of some of the Provisions of the Act ... passed April 1829, anonymous, (New York: 1829), p. 6.

7/ Redlich, ~~op. cit.~~, p. 264.

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statement of the Bank Commissioners regarding the purpose of the act with the flat assertion: "the commissioners were uninformed on the history of the act." 1/

Another piece of evidence is the act itself. If the legislators actually confused the words "debts" and "circulating notes" it might be assumed that the words were used interchangeably in the act. Yet, at each place where it was necessary to refer to the obligations to be insured the legislature carefully used the term "debts". In one section it gave clear indication that by debts it meant "liabilities": the fund was "to be inviolably appropriated and applied to the payment of such portion of the debts, exclusive of the capital stock ..." 2/ On the other hand, in those parts of the act where it was necessary to refer to circulating notes the legislature had no difficulty in using precisely that term. 3/

Finally, it is of interest that the committee which drafted the 1829 act referred in its report to the banks' "debts, amounting to nearly 30 millions of dollars." 4/ Thirty million dollars was probably about equal to the sum of circulating notes plus deposits in 1829, and apparently far exceeded either item alone. 5/ It is unlikely that the committee would have used the term "debts" to mean both circulating notes and deposits in its report, but to mean only circulating notes in the act itself.

Statutory Provisions Relating to Supervision and Regulation of Participating Banks

New York's act creating an insurance fund was notable not only because it introduced the insurance principle for protection against bank failures but also because it made significant contributions in the area of bank supervision. This section surveys those provisions of the law, and later amendments or changes, dealing with supervisory activities and with the operations of participating banks.

Supervisory agency. The supervisory department established by the 1829 act was of modest size, consisting of only three persons, with no allowance for staff or quarters mentioned in the act. Each was designated as "Bank Commissioner", with a salary of $1,500 per annum to be paid out of the insurance fund. 6/ Term of office was two years, with Commissioners removable by the governor for cause. 7/

It was originally provided that two of the three Commissioners would be chosen by the banks (one by banks located in New

1/ Ibid..
2/ An Act to create ...., section 4.
3/ Ibid., section 27.
4/ New York Assembly Journal, 1829; p. 441.
5/ There are no available bank data for New York in 1829. However, data for other years indicate this was the probable order of magnitude of the items.
6/ An Act to create ..., sections 7 and 26.
7/ Ibid., section 23.

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York City and one by so-called "country" banks) and one by the Governor, with the advice and consent of the Senate. 1/ However, in 1837 an amendment to the act placed all appointments in the Governor's hands.

It is evident that in providing an annual salary of $1,500, roughly equivalent to $7,000 today, the intent of the authors of the 1829 act was that these be full-time positions. Curiously, it was just this intention which drew strong criticism from opponents:

> We think ... they /the Commissioners/ will be men, with whom the salary ... will be an object of some importance; for, it can not be supposed, that gentlemen, in easy circumstances, will be induced to accept an appointment, the duties of which, if performed as they ought to be, will require so much of their time and attention. 2/

This criticism reflects the practice of that period of appointing prominent individuals to examine particular banks, when the situation appeared to warrant, as a public service. To the critics it was inconceivable that competent personnel could be secured if the salary, however adequate, was to be a major consideration.

In 1843 the offices of Bank Commissioner were abolished and many of their duties transferred to the Comptroller. 3/ This arrangement lasted for eight years, after which time it was recognized that the duties of bank supervision were too numerous to be handled by the already overburdened Comptroller. Accordingly, in 1851 a "separate and distinct department which shall be charged with the execution of the laws ... in relation to the banks ..." was established by the legislature. 4/

The chief officer of the newly created department was to be appointed by the Governor for a term of three years, at an annual salary of $2,500. He was given the title, "Superintendent of the Banking Department", and authority to employ a staff sufficient to handle the department's work. The Banking Department thus established was retained during the remainder of the insurance period and to the present day.

Bank examination. As pointed out in Chapter I, the roots of bank examination are to be found in the provisions of early bank charters which required, usually because the State was a stockholder, that banks make reports of condition to the legislature and that agents of the legislature or the Governor be permitted to visit banks when necessary. However, it was not until 1829, when New York adopted its insurance law, that the fundamental principles of modern examination procedures were adopted. The important provisions of the law which related to bank examination were:

1/ Ibid., sections 20 and 21.

2/ An Examination of some of the Provisions ..., pp. 30-31.

3/ An Act to abolish the office of Bank Commissioner, and for other purposes, April 18, 1843.

4/ An Act to organize a Bank Department, April 12, 1851.

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> Three persons, to be styled "the Bank Commissioners of the State of New York," shall be appointed in the manner hereinafter provided; whose duty, or the duty of one of whom it shall be, once at least in every four months, to visit every moneyed corporation upon which the provisions of this act shall be binding; and thoroughly to inspect the affairs of the said moneyed corporations; to examine all the books, papers, notes, bonds, and other evidences of debt of said corporations; to compare the funds and property of said corporations with the statements to be made by them as hereinafter provided; to ascertain the quantity of specie the said corporations have on hand; and generally to make such other inquiries as may be necessary to ascertain the actual condition of the said corporations, and their ability to fulfil all the engagements made by them. 1/
>
> The said commissioners, or either of them, shall have power to examine upon oath, all the officers, servants, or agents of said corporations, or any other person, in relation to the affairs and condition of said corporations; which oath the said commissioners, or either of them, are personally authorized to administer. 2/

In addition to requiring three examinations in each year for each bank, special examinations were to be made when requested by any three participating banks. 3/ It was also provided that examiners make annual reports to the legislature of their activities. 4/

To modern eyes these provisions would scarcely seem exceptional, but contemporary observers immediately noted three significant departures from tradition: First, examinations were no longer to be made sporadically, under a specific direction of the legislature, but instead were to be regular and frequent; second, the position of bank examiner was to be on a full-time basis and carry adequate compensation; third, and perhaps most important, examiners were to have complete access to bank records.

So far as the third point is concerned, in most States prior to 1829 it had generally been assumed that examinations, when necessary at all, should be confined to verifying the accuracy of statements of condition. Rarely was the examiner shown a detailed schedule of bank assets or permitted to ascertain or question the value of individual items in the loan portfolio. Tentative steps toward thorough examination policies may well have been taken prior to 1829 in the cases of individual banks, but it appears that the

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1/ An Act to Create a fund for the benefit of the creditors of certain moneyed corporations, and for other purposes, April 2, 1829, section 15.
2/ Ibid., section 17.
3/ An Act to create ..., section 16.
4/ Ibid., section 19.

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New York law was the first to set out such a policy in specific terms, applicable to an entire banking system.

The novelty of this concept of bank examination is best illustrated by the criticism it attracted. One example, characterizing the examination provision as "one of the most gigantic schemes of political power, and moneyed monopoly, ever devised and brought into operation in any country." has been cited above. 1/ More restrained but not less adamant opposition was contained in an anonymous pamphlet circulated in New York City soon after passage of the law. 2/ Intended as an attack on all provisions of the law, the largest part of the argument was directed at those relating to bank examination. Among the comments were:

> The powers granted these commissioners are such, as never ought to be placed in the hands of any three men, be their qualifications what they may, or their characters ever so pure and unsullied ...
>
> If the proposed law shall go into effect, the fiscal affairs of every man must be laid bare to the view of these commissioners ...
>
> We have reason to believe, there are few men, at least such as the public would have confidence in, that will accept an office, requiring every moment of their time, both summer and winter, to be devoted to its duties ...
>
> It is surely improper, that spies and inquisitors should be commissioned to look after the conduct and actions of those who have conducted well, and thus fasten on them, oblique [sic] and mistrust, not merited or warranted by their acts ...

The appearance of two fundamental banking innovations in the same act, i.e., insurance of bank obligations and regular bank examination, was more than coincidence. Although each was sought for its own sake there was a strong relationship between them. Regular bank examination was the answer to those who charged that insurance would place a premium on reckless banking. Contrariwise, the existence of mutual responsibility made the new mode of examination, if not welcome, at least more palatable to participating banks.

It is also significant that the introduction of these innovations was considered as the effective answer to demands for State participation in banking, i.e., for the end of an independent banking system. Among the proposals for banking reform current in 1829 was one calling for a State-owned bank with branches throughout the State. To this, Joshua Forman answered that with the introduction of the insurance principle and of bank examination:

1/ See above, p. II-10.

2/ An Examination of some of the Provisions ..., pp. 18, 28-30.

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> The whole body of banks would constitute a kind of community something after the model of our federal union, in which each in its proper sphere would have the same freedom of action, separate patronage and individual benefit or loss from good or bad management, they now possess - with a supervision over the whole, as perfect and more beneficial for the public than that of a general /State-owned/ bank over its branches - and a common fund for the common security, which, under the operation of the principle of inspection to prevent mismanagement, and the power to secure the property of the failing banks before mismanagement has progressed to its consummation ... is on the whole a more ample security to the public than that of a general bank with branches ... 1/

When the duties of the Bank Commissioners were transferred to the Comptroller in 1843 the examination power was drastically curtailed. Instead of regular examination, the act provided that the Comptroller could only examine "whenever he shall have good and sufficient reason to suspect the condition of any bank, or the correctness of its quarterly report." 2/ No change was made in this regard when the office of Superintendent of the Banking Department was created so that, for that part of the insurance period from 1843 to 1866 there was no regular examination of participating (or nonparticipating) banks.

Condition reports. New York's insurance law of 1829 did not introduce any major advance in requiring condition reports from banks. Two years before, in 1827, all banks had been required to report regularly to the State Comptroller. 3/ Prior to that time, reports had been regularly submitted only by those banks whose charters included such a requirement. However, the insurance law did require that reports previously made to the Comptroller would now be made to the Bank Commissioners so that, for the first time in any State, condition reports were directed to persons giving their full time to bank supervision.

Condition reports submitted to the Bank Commissioners were made annually, as of the first day of each year. Only three items - loans and discounts, circulation, specie - were reported for two dates, July 1st and January 1st.

With the removal of the Bank Commissioners in 1843, and the transfer of their powers to the Comptroller, it was apparently felt that more frequent and detailed information was necessary. Consequently participating banks, as well as those not included in the insurance system, were required to report quarterly to the Comptroller.

1/ Letter from Joshua Forman, New York Assembly Journal, 1829, p. 178.

2/ An Act to abolish ..., section 6.

3/ This applied only to banks receiving charters (or renewals of charters) on or after January 1, 1828. Thus while it would eventually have applied to all but two chartered banks at the outset it applied to none.

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In addition, improvements were made in the content of the reports. This was particularly true of the "loans and discounts" item which, before 1843, had lumped together nearly every debt due a bank with the exception of deposits in other banks and securities. Beginning in 1843 "loans and discounts" was broken down to show, for example, loans and discounts to directors as distinguished from other borrowers, brokers' loans, loans on real estate, and overdrafts. Although there were some changes in the description of deposit items after 1843, in general there was a fairly detailed breakdown during the entire period 1829-1866.

During the course of the insurance period some improvement was also made in the matter of reporting dates. The annual reports made to 1843 and the quarterly reports made until 1848 were as of dates announced prior to the preparation of such reports. Consequently, some reporting banks could so adjust or alter various items that there was uncertainty as to the correctness of the totals. Beginning in 1848 reporting dates were chosen as of a date already past and it is believed that this, along with some additional safeguards adopted later, resulted in more accurate tabulations.

Enforcement powers of supervisory officials. The authority possessed by supervisory officials in New York, whether the Commissioners, Comptroller, or Superintendent of the Banking Department, stemmed from their right to secure an injunction against the continued operation of any bank found to be insolvent or operating in violation of the law. 1/ The various laws did not provide additional, and less drastic, pieces of authority, such as to determine the form of condition reports or take certain steps against a bank in hazardous condition but not yet insolvent. The consequences of this arrangement are discussed in a section to follow. 2/

Bank operations. The insurance act contained relatively few provisions dealing with bank operations. This was because each of the banks subject to the law operated under individual charters granted by the legislature and most operating regulations were included in them.

The most important limitations placed on the banks by the 1829 law related to circulating notes and to loans and discounts. Following the then common practice of using capital as a regulatory tool, circulating notes could not exceed twice, nor loans and discounts twice and a half, the amount of capital "paid in and actually possessed". 3/ It is likely that somewhat similar provisions were found in many of the individual bank charters and that the 1829 law merely brought all the banks under the same rule. In effect, the law required a capital ratio on the order of twenty to forty percent, a not uncommon ratio for banks of that period.

1/ An Act to create ..., section 18.
2/ See below, pp. II-72-73.
3/ An Act to create ..., section 27.

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Aside from the requirement that interest on loans not exceed "the legal interest" (which at that time was 7 percent for loans maturing in more than 64 days, and 6 percent for the shorter term loans) the remaining restrictions also dealt with circulating notes. 1/ All notes were payable on demand, i.e., post-notes were prohibited. 2/ An amendment of May 16, 1837, tightened the restriction on circulating notes and also established a schedule whereby the larger the capital of the bank the smaller was the proportion of notes allowed it. Thus banks with as little as $100,000 capital were allowed circulating notes to a maximum of $150,000 while banks with $2,000,000 capital were only allowed a volume of circulating notes equal to $1,200,000.

Another amendment in 1843 required a reduction of circulation to the proper proportion with capital if the latter became impaired or was reduced. In 1848 the circulation-capital relationship was eased by an amendment permitting banks with capital of more than $200,000 to issue notes up to the additional amount. However, these notes had to be secured in the same fashion as those of free banks, i.e., by the posting of State bonds or mortgages.

Number and Obligations of New York Banks, 1829-1866

During the 37 years of operation of New York's insurance system a wide variety of banks existed in the State. The discussion below deals only with commercial banks operating under provisions of various State banking laws. It therefore excludes private banks (except those banks designated as "individual" banks and operating in accordance with the terms of the Act of 1838), savings banks, and national banks organized in the final few years of the period.

Number of operating banks. As described earlier, it was originally intended to include in the insurance system all banks except two. The two exceptions were the Bank of the Manhattan Company and the New York Dry Dock Company, each of which had a perpetual charter.

Table 6, which contains a distribution of banks by insurance status for each year in the insurance period, shows that during the first nine years of insurance (1829-1837) this objective was nearing realization. At the close of 1829 slightly more than half of the banks were subject to the insurance law. As the banks not participating in insurance renewed their charters they automatically came into the insurance system, so that by the end of 1837 about 91 percent of the New York banks were included.

With the formation of free banks (which did not participate in insurance) beginning in 1838, the conception of an all-embracing insurance system died. In addition, it apparently became settled policy in New York to cease chartering (or rechartering), so that as charters expired banks reorganized under the provisions

1/ Ibid., section 33.
2/ Ibid., section 35.

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Table 6. Number and Percentage Distribution of Operating Banks, by Insurance Status, New York, 1829-1866 1/

End of year	Number of banks: Total	Number of banks: Participating in insurance 2/	Number of banks: Not participating in insurance: Chartered 3/	Number of banks: Not participating in insurance: Free 4/	Percentage distribution: Total	Percentage distribution: Participating in insurance 2/	Percentage distribution: Not participating in insurance: Chartered 3/	Percentage distribution: Not participating in insurance: Free 4/
1829	43	23	20	--	100.0	53.5	46.5	--
1830	49	29	20	--	100.0	59.2	40.8	--
1831	63	51	12	--	100.0	81.0	19.0	--
1832	69	58	11	--	100.0	84.1	15.9	--
1833	79	69	10	--	100.0	87.3	12.7	--
1834	86	76	10	--	100.0	88.4	11.6	--
1835	87 5/	77	10	--	100.0	88.5	11.5	--
1836	100 5/	90	10	--	100.0	90.0	10.0	--
1837	97 5/	88	9	--	100.0	90.7	9.3	--
1838	114 5/	89	9	16 6/	100.0	78.1	7.9	14.0
1839	174 5/	91	7	76 7/	100.0	52.3	4.0	43.7
1840	154 8/	89 9/	7	58 10/	100.0	57.8	4.5	37.7
1841	132 8/	85	7	40 10/	100.0	64.4	5.3	30.3
1842	133 8/	81	6	46 10/	100.0	60.9	4.5	34.6
1843 11/	136 12/	80	6	50	100.0	58.8	4.4	36.8
1844 11/	148	80	3	65	100.0	54.1	2.0	43.9
1845 11/	148	78	3	67	100.0	52.7	2.0	45.3
1846 11/	150	77	3	70	100.0	51.3	2.0	46.7
1847 11/	167	77	2	88	100.0	46.1	1.2	52.7
1848 11/	182	76	2	104	100.0	41.8	1.1	57.1
1849	190	75	2	113	100.0	39.5	1.0	59.5
1850	209	71	2	136	100.0	34.0	.9	65.1
1851	243	69	2	172	100.0	28.4	.8	70.8
1852	276	67	2	207	100.0	24.3	.7	75.0
1853	322	57	2	263	100.0	17.7	.6	81.7
1854	333	52	2	279	100.0	15.6	.6	83.8
1855	286	42	2	242	100.0	14.7	.7	84.6
1856	312	40	2	270	100.0	12.8	.7	86.5
1857	294	32	2	260	100.0	10.9	.7	88.4
1858	301	30	2	269	100.0	10.0	.7	89.3
1859	303	28	2	273	100.0	9.2	.7	90.1
1860	306	25	2	279	100.0	8.2	.7	91.1
1861	302	24	2	276	100.0	7.9	.7	91.4
1862	308	17	2	289	100.0	5.5	.7	93.8
1863	309	10	2	297	100.0	3.2	.7	96.1
1864	284	6	2	276	100.0	2.1	.7	97.2
1865	99	2	2	95	100.0	2.0	2.0	96.0
1866	77	13/	2	75	100.0	--	2.6	97.4

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Table 6. Number and Percentage Distribution of Operating Banks, by Insurance Status, New York, 1829-1866 1/ (continued)

Sources: New York Assembly Documents, Annual Reports of the Bank Commissioners, 1831-1843; 1831 number 59, 1832 (70), 1833 (69), 1834 (102), 1835 (74), 1836 (80), 1837 (78), 1838 (71), 1839 (101), 1840 (44), 1841 (64), 1842 (29), 1843 (34); Annual Reports of the Comptroller, 1844-1851: 1844 (4), 1845 (25), 1846 (25), 1847 (5), 1848 (4), 1849 (5), 1850 (8), 1851 (9); Annual Reports of the Superintendent of the Banking Department 1852-61, 1864-67; 1852 (9), 1853 (6), 1854 (15), 1855 (10), 1856 (4), 1857 (5), 1858 (4), 1859 (5), 1860 (3), 1861 (3), 1864 (3), 1865 (4), 1866 (3), 1867 (4); New York Senate Documents, Annual Reports of the Superintendent of the Banking Department, 1862-63; 1862 (32), 1863 (3) L. Carroll Root, "New York Bank Currency," op. cit..

1/ Excludes private banks, savings banks, branches of operating banks, and, for 1863-66, national banks.

2/ Banks chartered in accordance with terms of Act of 1829 or whose charters were renewed following passage of that Act.

3/ Banks chartered prior to Act of 1829, including two banks with perpetual charters.

4/ Banks organized in accordance with provisions of Act of 1838.

5/ Differs from total published in 1953 Annual Report of the Federal Deposit Insurance Corporation, p. 60, because of inclusion of banks in operation but for which no reports are available. In the report for the year ending 1838 the Commissioners remarked in a footnote that they excluded from the count the Dry Dock Company and the Delaware and Hudson Canal Company, although "it is understood ... that both are doing business under their charters." The data for 1838 were therefore adjusted and, since the number of chartered banks not participating could not, under the 1829 law, increase, the data for 1835-37 were also adjusted under the assumption that one (1835) or both (1836-37, 1839-43) banks had not been counted by the Commissioners in these years.

6/ As shown in Sound Currency, February 1, 1895, p. 17, which also reports 48 applications made to date. A count of individual banks by the writer indicates that as many as 22 may have been in operation.

7/ In operation on December 1, 1839, as reported in Sound Currency, February 1, 1895, p. 17. A count of individual banks by the writer shows only 66 in operation at end of year.

8/ Differs from totals published in 1953 Annual Report of the Federal Deposit Insurance Corporation, p. 60, primarily because of improved estimates of number of free banks. Also see notes 5/ and 10/.

9/ Excludes Wayne County Bank which failed near close of year but was included in Bank Commissioners' report.

10/ Estimated. Total was arrived at by listing the opening and closing dates of every free bank known to have been started in or prior to this year. These dates were taken from William H. Dillistin, Historical Directory of the Banks of the State of New York, (New York: New York State Bankers Association, 1946). Banks which went into voluntary liquidation during this year were estimated from information provided in Sound Currency, op. cit., p. 18.

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Table 6. Number and Percentage Distribution of Operating Banks, by Insurance Status, New York, 1829-1866 1/
(continued)

11/ November dates.

12/ Differs from total published in 1953 Annual Report of the Federal Deposit Insurance Corporation, p. 60, because of inclusion of two chartered banks not participating in insurance and now assumed not to have been included in official reports. See note 5/.

13/ The charters of the last two participating banks expired before the end of 1866.

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of the Free Banking Act or, after 1863, under those of the National Banking Act. Thus in 1840 the number of banks participating in insurance began a steady decline, ending in 1866 with the expiration of the charters of the last two participating banks.

Free banks, on the other hand, increased rapidly in number, primarily because of banks newly organized but also because of the conversion of banks previously participating in insurance. In 1847 slightly more than half of all New York banks were operating under provisions of the 1838 act and during the final years of the period almost all of the banks in New York, aside from newly organized national banks, were free banks.

Bank obligations. Bank obligations are defined here to include deposits, circulating notes, and miscellaneous liabilities; and to exclude capital stock and other capital items. Table 7 shows the amount and percentage distribution of total bank obligations for all operating banks in New York State, with the banks grouped by insurance status.

Fluctuations in economic activity in the State, as well as in the nation, are reflected in the all-bank data. For example, the panic of 1837 is clearly evident in the decline from $83 million of bank obligations at the end of 1836 to less than $50 million at the end of 1837. Similarly, the deep depression which began about 1839 and ended in 1842, the decline of 1854, the panic of 1857, and the inflation of the war years are all reflected in the data.

As was the case with the number of banks, obligations of banks participating in insurance became of increasingly greater importance between 1830 and 1838. By the latter year approximately nine-tenths of all bank obligations in the State were attributable to participating banks. However, there was an almost unbroken decline beginning about 1840, with the result that within a decade less than half of all bank obligations were those of participating banks and by 1860, less than one-tenth.

Chartered banks not participating in insurance had a relatively large share of all bank obligations during the early 1830's, but this share naturally declined as such banks became participating banks in the years prior to 1838, or free banks after about 1840. They became of greater relative importance only in the last two years of the period, as a consequence of the marked decline in the number of free banks after passage of the National Bank Act.

The obligations of free banks increased almost as rapidly as the number of such banks. As shown in Table 7, these banks had more than four-fifths of total bank obligations by 1855 and more than nine-tenths in the early 1860's.

Chartered banks, whether or not participating in insurance, were of larger average size than free banks. This can be seen from a comparison of Table 7 with Table 6. It will be noted that in most instances the proportion of bank obligations of either group

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Table 7. Amount and Percentage Distribution of Bank Obligations, Operating Banks by Insurance Status, New York, 1829-1866 1/
(Amounts in thousands of dollars)

End of year	Amount of obligations 2/: All banks	Banks participating in insurance	Banks not participating in insurance: Chartered	Free	Percentage distribution: All banks	Banks participating in insurance	Banks not participating in insurance: Chartered	Free
1829	3/	3/	3/	--	--	--	--	--
1830	37,740	11,142	26,598 4/	--	100.0%	29.5	70.5	--
1831	33,466	26,160	7,306 4/	--	100.0	78.2	21.8	--
1832	39,095	31,093	8,002 4/	--	100.0	79.5	20.5	--
1833	47,652	39,047	8,605 4/	--	100.0	81.9	18.1	--
1834	56,722	47,303	9,419 4/	--	100.0	83.4	16.6	--
1835	73,847	59,666	14,181	--	100.0	80.8	19.2	--
1836	82,623	70,090	12,533	--	100.0	84.8	15.2	--
1837	49,690	42,732	6,958	--	100.0	86.0	14.0	--
1838	57,674 5/	50,784	6,890	3/	100.0	88.1	11.9	--
1839	39,932 5/	32,673	5,259	3/	100.0	86.1	13.9	--
1840	45,600 5/	41,334	4,266	3/	100.0	90.6	9.4	--
1841	43,764 6/	33,338	4,180	6,246 6/	100.0	76.1	9.6	14.3
1842	45,355	33,162	3,805	8,388	100.0	73.0	8.4	18.5
1843	64,101	47,131	5,502	11,468	100.0	73.5	8.6	17.9
1844	71,375	49,866	3,124	18,385	100.0	69.9	4.4	25.7
1845	72,539	50,587	2,998	18,954	100.0	69.7	4.2	26.1
1846	69,618	47,311	2,734	19,573	100.0	68.0	3.9	28.1
1847	82,927	54,250	1,985	26,691	100.0	65.4	2.4	32.2
1848	70,317	54,655 7/	2,000 4/	13,662 4/	100.0	77.7	2.9	19.4
1849	83,872	53,959 7/	2,000 4/	27,913 4/	100.0	64.3	2.4	33.3
1850	110,775	51,232 7/	3,000 4/	56,543 4/	100.0	46.2	2.7	51.1
1851	94,297	49,806 7/	4,000 4/	40,491 4/	100.0	52.8	4.3	42.9
1852	143,541	48,753 7/	4,000 4/	90,788 4/	100.0	34.0	2.8	63.2
1853	138,560	36,735 7/	4,000 4/	97,825 4/	100.0	26.5	2.9	70.6
1854	126,056	27,419 7/	4,000 4/	94,637 4/	100.0	21.7	3.2	75.1
1855	154,043	24,188	5,465	124,390	100.0	15.7	3.5	80.8
1856	163,900	24,080	4,088	135,732	100.0	14.7	2.5	82.8
1857	131,044	13,493	3,973	113,578	100.0	10.3	3.0	86.7
1858	176,933	16,923	4,662	155,348	100.0	9.6	2.6	87.8
1859	165,906	15,555	4,290	146,061	100.0	9.4	2.6	88.0
1860	182,151	14,601	6,473	161,077	100.0	8.0	3.6	88.4
1861	211,178	18,481	6,929	185,768	100.0	8.7	3.3	88.0
1862	299,341	21,002	8,976	269,363	100.0	7.0	3.0	90.0
1863	314,829	20,060	6,785	287,984	100.0	6.4	2.1	91.5
1864	353,350	13,751	7,723	331,876	100.0	3.9	2.2	93.9
1865	61,018	721	8,035	52,262	100.0	1.2	13.2	85.6
1866	47,879	8/	8,557	39,322	100.0	--	17.9	82.1

Sources: See Table 6.

1/ For types of banks included and excluded see Table 6, note 1. No adjustment has been made for individual banks which may not have reported on a given date.

2/ Includes deposits, circulation, and miscellaneous liabilities. Totals may therefore differ slightly from those published in 1953 Annual Report of the Federal Deposit Insurance Corporation, pp. 62-63.

3/ Not available.

4/ Estimated.

5/ Incomplete.

6/ Probably incomplete.

7/ Partially estimated.

8/ The charters of the last two participating banks expired before the end of 1866.

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of chartered banks was larger than the proportion of their number of all operating banks. For example, in 1844 banks participating in insurance were 54 percent of the number of all operating banks but held 70 percent of the obligations of all operating banks; and chartered banks not participating in insurance constituted only two percent of all operating banks but held well over four percent of all bank obligations. Similar relationships can be observed for many of the later years in the period, when almost all banks in the State were free banks.

The larger average size of chartered banks as compared with free banks was due to the fact that many of the chartered banks had been started early in the State's history and none had gone into operation later than the 1830's. Consequently they had a longer time to develop a banking business and, in addition, tended to be located in the larger cities.

Obligations of participating banks. Because of their insured status, somewhat more importance attaches to the types of obligations in insured banks than to those of banks not participating in insurance. Table 8 shows total obligations of participating banks, broken down into major categories.

In the first year (1830) for which data are available circulating notes of participating banks comprised the largest type of obligation. Thereafter, deposits exceeded circulating notes, the difference between the two items tending to become larger as the period progressed. During the 1830's and 1840's deposits were typically twice, and in the late 1850's and early 1860's approximately three times, the amount of circulating notes.

Among the deposit items, that classified as "individual, partnership, and corporation deposits" in this table predominated in most of the years included in the insurance period. Such deposits were almost entirely demand deposits.

"Government deposits" in participating banks consisted, at various times, of deposits of the State Treasurer, of the Commissioners of the Canal Fund, and of the Treasurer of the United States. United States deposits were of importance only during the earlier years, before the establishment of the Independent Treasury and when the Federal government followed the policy of keeping its very substantial surplus deposited in selected State banks. Beginning in 1837 the Federal surplus was distributed among the State governments but its importance prior to that date is reflected in the large volume of "Government deposits" in participating banks in 1835-36. 1/

"Interbank deposits" were relatively important during the entire period. They were particularly large prior to 1840, and in several of these earlier years actually exceeded in amount

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1/ U. S. Government deposits in participating banks were $6,049,699 at the end of 1835, and $7,833,039 at the end of 1836.

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Table 8. Obligations of Banks Participating in Insurance, by Type of Obligation, New York, 1829-1866
(thousands of dollars)

End of year	Total obligations 1/	Circulating notes 2/	Deposits: Total	Deposits: Individual partnership, and corporation 3/	Deposits: Government 4/	Deposits: Interbank 5/	Miscellaneous liabilities 6/
1829	7/	7/	7/	7/	7/	7/	7/
1830	11,142	5,871	4,826	1,702	1,615	1,509	445
1831	26,160	12,001	13,434	5,964	2,135	5,335	725
1832	31,093	12,216	18,162	8,059	2,767	7,336	715
1833	39,047	15,403	22,327	8,545	5,060	8,722	1,317
1834	47,303	14,464	32,470	14,555	3,658	14,257	369
1835	59,666	18,956	39,840	14,271	9,138	16,431	870
1836	70,090	22,065	44,188	15,186	11,270	17,732	3,837
1837	42,732	11,556	29,644	12,954	3,340	13,350	1,532
1838	50,784	17,680	32,104	15,427	2,776	13,901	1,000
1839	32,673	9,937	21,991	13,560	2,276	6,155	745
1840	41,334	14,321	26,655	15,242	1,875	9,538	358
1841	33,338	11,418	21,566	12,571	1,291	7,704	354
1842	33,162	8,926	23,934	13,868	836	9,230	302
1843	47,131	13,050	33,779	19,744	2,860	11,175	302
1844	49,866	14,890	34,517	20,602	3,413	10,502	459
1845	50,587	15,547	34,598	21,824	3,394	9,380	442
1846	47,311	15,767	31,120	20,388	1,392	9,340	424
1847	54,250	16,809	36,875	23,677	1,395	11,803	566
1848	54,655	20,420	33,735 8/	7/	7/	7/	500 8/
1849	53,959	20,570	32,889 8/	7/	7/	7/	500 8/
1850	51,232	19,464	31,368 8/	7/	7/	7/	400 8/
1851	49,806	18,658	30,743 8/	7/	7/	7/	400 8/
1852	48,753	18,610	29,843 8/	7/	7/	7/	300 8/
1853	36,735	14,559	21,376 8/	7/	7/	7/	300 8/
1854	27,419	8,000	19,219 8/	7/	7/	7/	200 8/
1855	24,188	7,525	16,481	12,495	837	3,149	182
1856	24,080	6,771	17,152	13,710	438	3,004	157
1857	13,493	4,127	9,309	7,466	181	1,662	57
1858	16,923	4,862	12,027	9,406	118	2,503	34
1859	15,555	4,984	10,542	8,339	143	2,060	29
1860	14,601	3,973	10,600	8,490	116	1,994	28
1861	18,481	4,186	14,265	10,286	135	3,844	30
1862	21,002	3,863	17,112	11,283	351	5,478	27
1863	20,060	2,256	17,804	14,138	345	3,321	2
1864	13,751	1,160	12,591	11,037	--	1,554	--
1865	721	401	320	272	--	48	--
1866	9/	9/	9/	9/	9/	9/	9/

Sources: See Table 6.

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Table 8. Obligations of Banks Participating in Insurance, by Type of Obligations, New York, 1829-1866
(thousands of dollars)
(continued)

1/ Differs in some years from totals published in 1953 Annual Report of the Federal Deposit Insurance Corporation, pp. 62-63, because of minor adjustments in deposit tabulations and inclusion of miscellaneous liabilities. Data are for reporting banks and no adjustments have been made for banks which may not, on any one date, have been included in official reports.

2/ For some years the sum of "Bank Notes issued and in circulation" and "Registered Notes issued and in circulation."

3/ Includes "individual deposits," (sometimes described as "individual depositors," "deposits," "due depositors on demand," or "deposits, individual") and "deposites to apply on debts," (sometimes described as "deposits on debts," or "amounts due not shown under other heads"). Excludes "dividends unpaid," (sometimes described as "due individuals," or "due individuals and corporations other than banks and depositors").

4/ Deposits of United States Government, and of New York State, including deposits of Commissioners of Canal Fund.

5/ Includes deposits of brokers in some earlier years; excludes deposits of branches in parent banks, 1830-33. This item was not reported separately beginning in 1834 and may be included in interbank deposits beginning with that date.

6/ Includes unpaid dividends, which are presumed to have represented dividends declared but not paid (as distinct from paid but not called for) and therefore not properly a deposit item.

7/ Not available.

8/ Estimated.

9/ The charters of the last two participating banks expired before the end of the year.

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each of the other deposit categories. As the number of chartered banks began to decline, and particularly as those in New York City left the insurance system and reorganized under the Free Banking Act, "Interbank deposits" became relatively less important.

"Miscellaneous liabilities", consisting largely of dividends which, it is assumed here, had been declared but not yet paid, comprised a minor proportion of the total obligations of participating banks.

Relative size of participating banks. In a preceding section it was pointed out that, on the average, participating banks were larger than free banks during the insurance period. However, there were also marked size differences among the participating banks themselves. Table 9 shows participating banks grouped by size (as measured by the amount of deposits plus circulating notes) for three dates: December 31 of 1834, 1842, and 1855.

Seven size groupings are used. The first two, representing less than $200,000 of deposits and circulation, include what might be termed small banks. The next two size groupings, ranging from $200,000 to $800,000 of deposits and circulation, contain medium sized banks, while the other three groupings, $800,000 or over contain the large banks in the insurance system.

When the data for the three dates are compared one major difference among the distributions of banks is evident. In both 1834 and 1855 the largest number of participating banks had from $200,000 to $400,000 of deposits plus circulation, but in 1842 by far the largest number of participating banks had between $100,000 and $200,000 of such obligations. This is undoubtedly a reflection of the severe depression which began about 1839 and reached its bottom in 1842.

The effects of the depression of 1839-1842 may also be observed in the fact that in 1842 sixteen banks, or about 20 percent of all participating banks, fell in that size group while in 1834 there were no banks in the smallest size group (less than $100,000) and in 1855 only one bank in that group.

Larger size banks (those with more than $800,000 of deposits and circulation) constituted about 15 percent of all participating banks on each of the three dates. As would be expected, they were a slightly larger proportion of all participating banks in 1834 and in 1855 than in 1842.

With banks grouped by size it is possible to measure the degree of concentration of risk to which the insurance system was exposed. It will be seen from Table 9 that in 1834 a sizable proportion of the risk to the New York system was located in relatively few banks. For example, two banks, constituting less than three percent of all participating banks, had more than 20 percent of insured deposits plus circulation. The 13 largest size banks on that date were only 17 percent of all participating banks but had about 60 percent of insured obligations.

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Table 9. Number, Deposits, and Circulation of Banks Participating in Insurance, by Size of Bank, New York 1834, 1842, 1855
(amounts in thousands)

Size of bank	December 31, 1834				December 31, 1842				December 31, 1855			
	Number of banks	Deposits and circulation			Number of banks	Deposits and circulation			Number of banks	Deposits and circulation		
		Total	Deposits	Circulation		Total	Deposits	Circulation		Total	Deposits	Circulation
Number or amount - total 1/	76	$46,934	$32,470	$14,464	81	$32,651	$23,725 2/	$8,926	43	$24,006	$16,481	$7,524 2/
Banks with deposits plus circulation (in thousands of dollars) of:												
Less than 100	--	--	--	--	16	1,274	451	822	1	88	33	54
100 to 200	21	3,414	879	2,535	33	4,587	1,819	2,767	8	1,440	398	1,042
200 to 400	27	7,393	2,775	4,618	14	3,928	2,279	1,649	20	5,727	2,579	3,148
400 to 800	15	8,166	5,247	2,919	8	4,960	3,848	1,112	8	4,136	2,351	1,786
800 to 1,600	7	8,570	7,242	1,329	5	5,106	4,094	1,012	3	3,471	2,859	612
1,600 to 3,200	4	9,840	7,957	1,884	4	9,314	8,072	1,242	2	5,304	4,609	696
3,200 and more	2	9,550	8,372	1,179	1	3,484	3,163	322	1	3,840	3,652	187
Percent distribution - total 1/	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Banks with deposits plus circulation (in thousands of dollars) of:												
Less than 100	--	--	--	--	19.8	3.9	1.9	9.2	2.3	.4	.2	.7
100 to 200	27.6	7.3	2.7	17.5	40.7	14.1	7.7	31.0	18.6	6.0	2.4	13.9
200 to 400	35.5	15.7	8.5	31.9	17.3	12.0	9.6	18.5	46.5	23.8	15.6	41.8
400 to 800	19.8	17.4	16.2	20.2	9.9	15.2	16.2	12.5	18.6	17.2	14.3	23.7
800 to 1,600	9.2	18.3	22.3	9.2	6.2	15.6	17.3	11.3	7.0	14.5	17.3	8.1
1,600 to 3,200	5.3	21.0	24.5	13.0	4.9	28.5	34.0	13.9	4.7	22.1	28.0	9.3
3,200 and more	2.6	20.3	25.8	8.2	1.2	10.7	13.3	3.6	2.3	16.0	22.2	2.5

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Table 9. Number, Deposits, and Circulation of Banks Participating in Insurance, by Size of Bank, New York, 1834, 1842, 1855 (continued)
(amounts in thousands)

Sources: "Annual Report of the Bank Commissioners," January 22, 1835, New York Assembly Documents, 1835, document number 74; January 30, 1843, New York Assembly Documents, 1843, document number 34; "Annual Report of the Superintendent of the Banking Department," January 7, 1857, New York Assembly Document, 1857, document number 5.

1/ Components may not add to totals because of rounding.

2/ Differs slightly from amounts shown in Table 8 because of rounding and because of discrepancies in original reports. Table 8 amounts were taken from published summary statements while totals here were computed from statements of individual banks.

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The degree of concentration of risk changed markedly after 1841 as a result of the exclusion of deposits from insurance. In 1842 the ten largest banks, constituting about 12 percent of all participating banks, had 29 percent of insured obligations. Had insurance coverage not been changed, the same banks would have had 55 percent of insured obligations. In 1855 there were only six banks with deposits plus circulation of more than $800,000. Although these banks constituted 14 percent of all participating banks they only had about 20 percent of the total circulation. These same banks had more than half of the deposits plus circulation of participating banks and more than two-thirds of the total deposits.

Insured obligations. As more and more chartered banks came into the insurance system during the early and middle 1830's the proportion of bank obligations which was insured in New York State increased. Thus by the end of 1837 more than 85 percent of the obligations of all banks were protected by insurance. Table 10 shows that the proportion went even higher during the next three years but it should be recalled that for these years free bank data were not available and the figures thus overstate the extent of insurance coverage. For example, in 1841, the first year for which at least partial information was available on the obligations of free banks, there was 100 percent coverage of participating bank obligations but this represented only about 75 percent coverage of all bank obligations.

Even without a change in the type of obligation covered by insurance, the proportion of all bank obligations insured would have gradually declined during the remainder of the period as a consequence of the increasing number of free banks and the abandonment of the policy of granting or renewing individual bank charters. However, this decline was enormously accelerated by the withdrawal of insurance coverage from deposits and miscellaneous liabilities, as can be seen in Table 10. In 1841 there had been complete coverage of the obligations of participating banks, which represented fairly substantial coverage of the obligations of all banks in the State. One year later less than 30 percent of the obligations of participating banks, and less than 20 percent of the obligations of all banks, were insured. The proportion of all bank circulation which was insured obviously did not decline to the same degree.

During the remainder of the 1840's and into the early 1850's insurance portection was important only in so far as it related to circulating notes. 1/ As late as 1851 more than 70 percent of the circulating notes of all banks were insured, and there had been relatively little change in the proportion of total obligations, either of participating banks or of all banks, which were insured.

For the remainder of the insurance period, i.e., from about the middle 1850's through 1865, insurance protection accorded to bank

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1/ After 1845 all payments into the insurance fund were required by law to be used, or held, for the retirement of the fund's debt and could only become available for insurance payments after February 1, 1866. References to "insurance coverage" in this and the paragraph to follow should be read with this in mind.

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Table 10. Insured Obligations and Insurance Coverage, New York, 1829-1866

End of year	Insured obligations (thousands of dollars) 1/	Insurance coverage - percent: Participating banks: total obligations	All banks 2/ Total obligations	Deposits 3/	Circulation
1829	4/	4/	4/	4/	4/
1830	$11,142	100.0%	29.5	4/	4/
1831	26,160	100.0	78.2	4/	4/
1832	31,093	100.0	79.5	4/	4/
1833	39,047	100.0	81.9	4/	4/
1834	47,303	100.0	83.4	4/	4/
1835	39,666	100.0	80.8	76.9	89.7
1836	70,090	100.0	84.8	81.0	91.2
1837	42,732	100.0	86.0	83.0	93.0
1838	50,784	100.0	88.1 5/	86.0 5/	90.8 5/
1839	32,673	100.0	86.1 5/	82.8 5/	93.5 5/
1840	41,334	100.0	90.6 5/	88.9 5/	94.0 5/
1841	33,338	100.0	76.1	74.9	78.4
1842	8,926	27.0	19.7	--	74.2
1843	13,050	27.7	20.4	--	75.8
1844	14,890	29.9	20.9	--	73.9
1845	15,547	30.7	21.4	--	72.7
1846	15,767	33.3	22.6	--	70.8
1847	16,809	31.0	20.3	--	64.1
1848	20,420	37.4	29.0	--	88.0
1849	20,570	38.1	24.5	--	85.1
1850	19,464	38.0	17.6	--	69.7
1851	18,658	37.5	19.8	--	71.3
1852	18,610	38.2	13.0	--	55.7
1853	14,559	39.6	10.5	--	44.7
1854	8,000	29.2	6.3	--	28.3
1855	7,525	31.1	4.9	--	23.5
1856	6,771	28.1	4.1	--	20.2
1857	4,127	30.6	3.1	--	17.3
1858	4,862	23.7	2.7	--	17.1
1859	4,934	32.0	3.0	--	16.6
1860	3,973	27.2	2.2	--	14.1
1861	4,186	22.6	2.0	--	13.7
1862	3,863	18.4	1.3	--	9.9
1863	2,256	11.2	.7	--	6.1
1864	1,160	8.4	.3	--	3.7
1865	401	55.6	.7	--	4.5
1866 6/	--	--	--	--	--

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Table 10. Insured Obligations and Insurance Coverage, New York, 1829-186
(continued)

Sources: See Table 6.

1/ All obligations of participating banks, 1830-1841; circulating notes of participating banks, 1842-1865. Differs slightly from data published in 1953 Annual Report of the Federal Deposit Insurance Corporation, pp. 64-65 because of minor adjustments in deposit items and inclusion of miscellaneous liabilities.

2/ Excludes the types of banks described in Table 1, note 1.

3/ Deposits, excluding miscellaneous liabilities, in participating bank as percentage of deposits, excluding miscellaneous liabilities, in all operating banks.

4/ Not available.

5/ Exceeds actual degree of coverage because of absence of free bank data.

6/ The charters of the last two participating banks expired before the end of the year.

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creditors declined until it became almost negligible. It is true that approximately 20 to 30 percent of the obligations of participating banks were covered by insurance during most of this time. However, the number of such banks and their relative importance in the State's banking structure was continuously declining. By 1860, for example, 27 percent of the obligations of participating banks were insured but this coverage represented only two percent of the obligations of all banks in the State. Even the proportion of circulating notes covered by insurance became of minor importance. By 1855 less than one-fourth of the circulating notes issued by banks in the State were insured; by the early 1860's this proportion had fallen to less than 10 percent.

History of Operation of Insurance System

When bank-obligation insurance terminated in New York in 1866 the record showed that the claims of all creditors of participating banks in serious financial difficulties had been paid and that a small surplus remained in the insurance fund. This had been accomplished only after substantial change had been made in the operating procedures of the insurance system and at the cost of serious inconvenience and loss to some creditors.

Participating banks in serious financial difficulties. During the insurance period there were 21 cases of participating banks which either became insolvent and suspended operations or were in such serious danger as to warrant disbursements from the insurance fund to protect their creditors. The 21 cases involved a total of 18 banks, three of which were in financial difficulties on two different dates. Table 11 lists the banks concerned and provides information on the causes of their difficulties and the amount of their obligations.

All of the cases except one occurred during years of economic crisis and depression. There were five cases during the panic year of 1837, 11 cases during the depression years of 1840-42, one case during the 1854 depression, and three cases in the panic year of 1857. The remaining case occurred in 1848, a year of recovery which followed a brief downturn in 1847. Because of the concentration in depression years, "asset deterioration" was a principal cause of difficulty in many of the 21 cases. However, in almost every case it was found that there were additional causes, the most important of which were unsafe banking practices, violations of law, and defalcations.

The 21 distressed banks had total obligations substantially in excess of $7 million and insured obligations of over $6 million on the last reporting dates prior to their closing or difficulty. The yearly totals, as given in Table 11, show that the insurance system suffered its most severe blow in 1841, when four banks with total obligations of more than $1.8 million failed. Although failures in 1837 involved five banks with almost the same amount of obligations as in 1841, the first four cases were banks which were restored to solvency (although three of these failed in later years) so that the burden on the insurance fund was light. These four 1837 cases were the only ones in which banks were restored to solvency; in the remaining 17 cases the banks concerned were placed in receivership.

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Table 11. Participating Banks in Serious Financial Difficulties, New York Insurance System, 1829-1866 1/
(Amounts in thousands of dollars)

Case number	Name and location of bank	Suspension or difficulty: Date	Suspension or difficulty: Principal cause 2/	Obligations at last report prior to suspension or difficulty: Total 3/	Deposits	Circulation	Size group classification 4/	Obligations per $100 of active participating banks
	21 cases - total	1837-1857	...	$7,267	$3,969	$3,298	3 (average)	$0.58 5/
	5 cases - total	1837		1,797	1,014	783		2.71
1	Bank of Buffalo, Buffalo	May, 1837	Violation of law; unsafe banking	493	311	182	4	...
2	Commercial Bank of Buffalo, Buffalo	May, 1837	Violation of law; unsafe banking	649	497	152	4	...
3	City Bank of Buffalo, Buffalo	May, 1837	Violation of law; unsafe banking	147	42	105	2	...
4	Sacket's Harbor Bank, Sacket's Harbor	May, 1837	Asset deterioration	287	48	239	3	...
5	Lockport Bank, Lockport	May, 1837	Asset deterioration	221	116	105	3	...
	2 cases - total	1840		618	230	388	...	1.94
6	City Bank of Buffalo, Buffalo	February, 1840	Violation of law; asset deterioration	438	169	269	4	...
7	Wayne County Bank, Palmyra	December, 1840	Violation of law; unsafe practices	180	61	119	2	...

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Table 11. Participating Banks in Serious Financial Difficulties, New York Insurance System, 1829-1866 1/
(Amounts in thousands of dollars)

Case number	Name and location of bank	Suspension or difficulty: Date	Suspension or difficulty: Principal cause 2/	Obligations at last report prior to suspension or difficulty: Total 3/	Obligations at last report prior to suspension or difficulty: Deposits	Obligations at last report prior to suspension or difficulty: Circulation	Size group classification 4/	Obligations per $100 of active participating banks
	4 cases - total	1841		$ 1,818	$ 1,038	$ 780	...	4.44
8	Commercial Bank of New York, New York	September, 1841	Defalcation	454	333	121	4	...
9	Bank of Buffalo, Buffalo	November, 1841	Asset deterioration; violation of law	445	249	196	4	...
10	Commercial Bank of Buffalo, Buffalo	November, 1841	Asset deterioration; violation of law	574	327	247	4	...
11	Commercial Bank of Oswego, Oswego	December, 1841	Asset deterioration; unsafe banking	345	129	216	3	...
	5 cases - total	1842		1,167	636	531	...	3.54
12	Watervliet Bank, Watervliet	March, 1842	Defalcation	260	145	115	3	...
13	Lafayette Bank, New York	February, 1842	Asset deterioration	165	93	72	2	...
14	Clinton County Bank, Plattsburg	April, 1842	Asset deterioration	319	151	168	3	...
15	Bank of Lyons, Lyons	September, 1842	Asset deterioration	246	165	81	3	...

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Table 11. Participating Banks in Serious Financial Difficulties, New York Insurance System, [illegible] 1/ (cont'd)
(Amounts in thousands of dollars)

Case number	Name and location of bank	Suspension or difficulty: Date	Suspension or difficulty: Principal cause 2/	Obligations at last report prior to suspension or difficulty: Total 3/	Deposits	Circulation	Size group classification 4/	Obligations per $100 of active participating banks
	5 cases - total (continued)							
16	Oswego Bank, Oswego	November, 1842 6/	Asset deterioration	177	82	95	2	...
	1 case - total	1848		947	708	239	...	1.76
17	Canal Bank of Albany, Albany	July, 1848	Defalcation	947	708	239	5	...
	1 case - total	1854		166	19	147	...	.46
18	Lewis County Bank, Martinsburgh	November, 1854	Violation of law; defalcation	166	19	147	2	...
	3 cases - total	1857		754	324	430	...	3.15
19	Bank of Orleans, Albion	August, 1857 5/	Asset deterioration; violation of law	292	138	154	3	...
20	Reciprocity Bank, Buffalo	August, 1857 6/	Asset deterioration	287	143	144	3	...
21	Yates County Bank, Penn Yan	August, 1857 6/	Asset deterioration	175	43	132	2	...

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Table 11. Participating Banks in Serious Financial Difficulties, New York Insurance System, 1829-[illegible] 1/ (continued)
(Amounts in thousands of dollars)

1/ "Serious financial difficulty" is used here to mean difficulty necessitating payments to insured creditors from the insurance fund, regardless of whether the bank was ultimately liquidated or restored to solvency.

2/ In almost all cases insolvency was due to a combination of causes, not all of which are known. Those listed here are "principal" in the opinion of the writer, based on available information.

3/ Excludes miscellaneous liabilities.

4/ Based on size groupings as shown in Table 4, with number 1 assigned to the smallest grouping (less than $100,000 of total obligations).

5/ Average annual rate for 36 years, 1830-65.

6/ Approximate dates.

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The serious nature of the 1841 failures, and to some extent of those in 1842, is shown in the Table 11 columns which reflect the size of the banks concerned. During the entire insurance period the typical distressed bank was of small to medium size, falling into the size group containing banks with $200,000 to $400,000 of total deposits plus circulation. In 1841, however, three of the four failures involved banks falling in a larger size group. Per $100 of obligations (deposits plus circulating notes) of active participating banks, the obligations of failing banks in 1841 were $4.44 and in 1842 were $3.54. Each of these ratios was larger than that for any other year during which participating banks failed and was considerably greater than the average annual ratio for the entire insurance period of $0.58 of failing bank obligations per $100 of obligations of all participating banks.

<u>Protection of bank creditors.</u> Creditors of a failed bank may be said to have been fully protected when their claims were paid in full within a reasonably short time after the bank closed for business. Table 12 shows the extent to which creditors of failing banks participating in New York's insurance system received payment for their insured claims and the paragraphs to follow describe the manner in which these claims were paid.

As shown in Table 12, failing participating banks in New York had insured obligations of approximately $6.5 million, of which $6.3 million, or 98 percent, was restored to the holders. About one-third of this latter amount was returned to insured creditors through the proceeds of liquidation, much of it probably within a reasonable time following closing of the banks concerned. The remaining two-thirds was either paid out of the insurance fund or made available to insured creditors by the restoration of bank solvency. The larger part of this portion was not immediately made available to insured creditors.

Table 12 shows that all claims against the insurance system were paid in full, even though two percent of insured obligations was not paid. This situation came about because some insured creditors did not present claims. Failure to make claim is expected of a very small proportion of potential claimants under any insurance system, but the amount involved here was undoubtedly higher than would normally have been the case, due to the manner in which claims were paid.

Insured creditors of the five banks which became involved in serious financial difficulties in 1837 were fully protected, in terms of the amounts received or made available to them and the time required for payment. In the first four cases disbursements from the insurance fund were sufficient to restore the banks to solvency, thus making available to insured creditors all of the amounts due them. In the fifth case the bank was liquidated but apparently all of the insured obligations were immediately paid by the receiver or from the insurance fund.

The 11 bank failures which occurred in the three years 1840-42 gave rise to a volume of claims of such magnitude that the insurance system was not able to make payment within a reasonable time.

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Table 12. Protection of Depositors and Noteholders, Participating Banks in Serious Financial Difficulties, New York Insurance System, 1829-1866 1/
(Amounts in thousands of dollars)

Year and case number 2/	Insured obligations at date of closing or difficulty	Banks placed in receivership: Payments to insured creditors by receiver 3/	Banks placed in receivership: Claims against insurance system	Banks placed in receivership: Payments to insured creditors by insurance system: Amount 4/	Banks placed in receivership: Payments to insured creditors by insurance system: Percent of claims	Banks restored to solvency with insurance aid: disbursements	Protection of insured creditors: Percent of insured obligations: Made available to 5/ creditors	Protection of insured creditors: Percent of insured obligations: Not paid
21 cases, total	$6,485	$2,123	$2,813	$2,813	100.0%	$ 147	97.9%	2.1%
1837	1,550	101	36	36	100.0	156	100.0	...
1	301 6/	...	...	...	...	22	100.0	...
2	747 6/	...	...	...	...	18	100.0	...
3	179 6/	...	...	...	...	24	100.0	...
4	186 6/	...	...	...	...	83 7/	100.0	...
5	137 6/	101	36	36	100.0	...	100.0	...
1840	696	241	446	446	100.0	...	98.7	1.0
6	484 8/	167	317	317	100.0	...	100.0 9/	...
7	212 10/	74	129	129	100.0	...	95.8	4.3
1841	2,392	640	1,724	1,724	100.0	...	98.8	1.2
8	589 11/	303	286	286	100.0	...	100.0 9/	...
9	668 11/	83	585	585	100.0	...	100.0 9/	...
10	813 12/	173	612	612	100.0	...	96.6	3.4
11	322 13/	81	241	241	100.0	...	100.0 9/	...
1842	1,027	474	532	532	100.0	...	98.0	2.0
12	230 11/	19	211	211	100.0	...	100.0 9/	...
13	165 14/	165	...	...	...	...	100.0 9/	...

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Table 12. Protection of Depositors and Noteholders, Participating Banks in Serious Financial Difficulties, New York Insurance System, 1829-1866 1/ (continued)
(Amounts in thousands of dollars)

Year and case number 2/	Insured obligations at date of closing or difficulty	Banks placed in receivership: Payments to insured creditors by receiver 3/	Banks placed in receivership: Claims against insurance system	Banks placed in receivership: Payments to insured creditors by insurance system: Amount 4/	Banks placed in receivership: Payments to insured creditors by insurance system: Percent of claims	Banks restored to solvency with insurance aid: disbursements	Protection of insured creditors: Percent of insured obligations: Made available to creditors 5/	Protection of insured creditors: Percent of insured obligations: Not paid
1842 (continued)								
14	$ 306 13/	$ 76	$ 228	$ 228	100.0%	...	99.3%	0.7%
15	149 13/	37	93	93	100.0	...	87.2	12.8
16	177 14/	177	...	...	...	...	100.0 9/	...
1848	186	186	...	...	...	...	100.0	...
17	186	186	...	...	...	...	100.0	...
1854	125	20)			100.0	...)		
18	125	20)			100.0	...)		
			75	75			87.7	12.3
1857	509	461)			100.0	...)		
19	200	190)			100.0	...)		
20	160	146)			100.0	...)		
21	149	125)			100.0	...)		

Sources: L. Carroll Root, "New York Bank Currency," Sound Currency, February 1, 1895; Robert E. Chaddock, The Safety Fund Banking System in New York, 1829-1866, (Washington: National Monetary Commission, 1910). See also sources listed for data presented in Table 6.

1/ Differences in amounts and percentages between this table and those shown in the 1953 Annual Report of the Federal Deposit Insurance Corporation, p. 53, are attributable to: a) inclusion of circulation fraudulently issued by some banks but nevertheless a valid claim on the insurance fund, b) adjustment in column 2 of all data to date of closing or difficulty, 3) other refinements of data.

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Table 12. Protection of Depositors and Noteholders, Participating Banks in Serious Financial Difficulties, New York Insurance System, 1829-1866 1/ (continued)
(Amounts in thousands of dollars)

2/ For names of banks see Table 11.

3/ Receivers' collections. Receivership expenses charged against these amounts, if any, are not known.

4/ Smaller than amount shown as "Payments to creditors of failed banks" in Table 8 because of exclusion from total in this table of payments on behalf of creditors of banks restored to solvency.

5/ In receivership cases the sum of receivers payments and payments by insurance system as percentages of insured obligations at date of failure.

6/ Circulation plus estimated deposits. Estimate made by assuming that the percentage increase or decrease in deposits between last reporting date and date of closing or difficulty was the same as the known percentage change in circulation between the same two dates.

7/ L. Carroll Root, op. cit., reports disbursements totaling $92,000 for this bank, making the total redemption for these four 1837 cases $156,000. However, insurance fund records show total disbursements for note redemption during 1837-39 as $183,000, or $9,000 less than the total of such redemptions for the five 1837 cases shown in this table if Root's figure is used. After examining each of these five cases it seemed probable that the difference was in case number 4 and was due to the fact that whereas $92,000 of the notes had been redeemed a portion had been redeemed by State agencies other than the insurance fund.

8/ Circulation reported at time of failure was $269,000 and deposits at last report prior to failure were $169,000. Since a total of $317,000 of circulation was redeemed from the insurance fund this is presumed to have been the actual circulation at date of failure. Deposits on the same date are not known but no claim was made on fund so that it is presumed that the receivers' collections of $167,000 were about equal to the amount of deposits.

9/ Amount of obligations not paid because of failure to make claim is not known but, if any, is presumed to have been small.

10/ Circulation at date of failure plus receivers' payments to creditors and deposits redeemed from insurance fund.

11/ Case similar to that described in note 8/, as circulation reported at date of failure was less than circulation redeemed.

12/ Consists of $388,000 circulation at time of failure and $425,000 deposits paid from insurance fund. Differs from case number 7 (see note 10) in that it appears that in this case receivers' collections were applied to payment of circulating notes.

13/ Estimate partially based on assumption described in note 12/.

14/ At last report prior to failure.

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When the Bank of Buffalo failed in November 1841, (case 9 in Table 7) the insurance fund had already been so far drawn down that the Comptroller hesitated to make provision for the payment of its insured creditors. He was particularly concerned because not all of the creditors of the three banks which had failed just prior to that time had been paid. When seven additional failures followed very soon after that of the Bank of Buffalo the insurance system appeared to have no recourse except to pay insured creditors as proceeds from liquidation of assets became available.

The situation described above was rectified in 1845 when the Legislature authorized the issuance of bonds, which could either be sold to secure sufficient funds or paid directly to creditors of failed banks. Such bonds were issued beginning in 1845 but it was not until 1851, or 9 years after the last of the above failures, that final payment was made to insured creditors. In the intervening time, of course, many creditors suffered serious inconvenience, while some others undoubtedly disposed of their claims for less than the full value, or lost them altogether. It will be noted in Table 12 that for those cases in which complete data are available (cases 7, 10, 14, and 15) insured obligations not paid ranged from less than 1 percent to more than 12 percent.

With the issuance of bonds to pay creditors of bank failures occurring in 1840-42, future contributions to the insurance fund by sound participating banks were to be used first to retire this debt. Consequently, the insurance system was not able to make immediate provision for the payment of insured creditors of banks failing after 1845. Fortunately, the first such failure, occurring in 1848, did not require any payment from the insurance fund. Insured obligations of this bank (case 17) were fully and speedily paid by the receiver.

The insured creditors of the last four participating banks which failed were not as fortunate. In 1854 the Lewis County Bank closed and it was found that a large proportion of its assets was entirely worthless. Receivers' payments to insured creditors were equal only to approximately one-sixth of the insured obligations outstanding on the date of failure.

The three banks which closed as a consequence of the panic of 1857 were in a relatively better position and receivers were able to reimburse insured creditors for more than four-fifths of the amount due them. However, in these cases, as well as in the case of the Lewis County Bank, such payments were apparently spread out over a considerable period of time.

With the retirement in 1866 of the last of the bonds issued on behalf of creditors of the 1840-42 bank failures payment of the insured creditors of the final four banks was started. All claims made by such creditors were paid by the insurance system. However, it will be seen from Table 12 that although approximately $150,000 of insured obligations was still outstanding in 1866 only about $75,000 was presented for payment. The remainder, most of which probably represented obligations of the Lewis County Bank, had apparently been thought worthless by the holders and long since lost.

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Insurance receipts and expenditures. During the course of the insurance period total receipts of the insurance system were $4,736,000 and expenditures were $4,724,000. The difference, approximately $13,000, was paid into the State treasury in 1867. Table 13 shows the sources and distribution of insurance income for each year in the period 1829-1866.

Assessments accounted for more than three-fifths of the total income of the insurance system. Approximately one-fifth represented proceeds of borrowings and the remaining income consisted largely of earnings on investments and receipts from the sale of assets of failed banks. Of total expenditures, about three-fifths represented payments to insured creditors of failing banks. The remainder consisted largely of payments on debt and operating expenses.

It will be observed from Table 13 that assessments were paid by most participating banks during each year of the insurance period, beginning in 1831. Although it had been originally contemplated that each participating bank would pay its entire assessment over a period of six years, the large losses suffered by the insurance fund as a consequence of the failures of the early 1840's resulted in the levying of deficiency assessments during the remainder of the insurance period.

Perhaps the most interesting fact shown by the data in Table 13 is that assessment income was more than sufficient, to cover all payments to creditors of failed banks, taking the insurance period as a whole. The difficulties in which the insurance system was placed in the middle 1840's were not due, basically, to an inadequate assessment rate but to the unfortunate timing of the various bank failures. In this connection it might be observed that New York's insurance system went into full operation only six years prior to the panic of 1837 and only eight years before the beginning of one of the three most severe depressions with which this country has been afflicted.

Earnings on investments were not a major source of income during the insurance period. Of the approximately $300,000 of such income, about half was returned to participating banks, in accordance with law. Such dividends were, of course, discontinued after 1841.

Recoveries by the insurance system on assets acquired from failed participating banks were only slightly in excess of $300,000. This was about 10 percent of the total amount paid to insured creditors. The low recovery rate was due to a number of factors, principal among them being the lapse of time which occurred between the first group of failures (1840-42) and the assumption by the insurance system of the various assets. It was the practice in the case of the 1840-42 failures for the receiver to begin immediate liquidation of the assets, using the proceeds to pay as many of the obligations of the failed banks as was possible. In 1845, when arrangements were made to borrow sufficient funds to pay the remaining creditors, the receipts from liquidation of failed bank assets were paid into the insurance fund. However, in many cases too long a time had elapsed to effect efficient liquidation.

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Table 13. Insurance Receipts and Expenditures, New York, 1829-1866
(Amounts in thousands of dollars)

Fiscal year 1/	Balance in fund at end of fis- 2/ cal year	Receipts						Expenditures				
		Total	Assess- ments 3/	Invest- ment in- come 4/	Recoveries 5/	Borrow- ings	Other	Total	Payment to creditors of failed banks 6/	Expenses 7/	Debt retire- ment	Other
1829-1866	$190 (average)	$4,736	$3,105	$ 308	$ 317	$1,001	$ 5	$4,724	$2,961	$ 707	$1,001	$ 55
1829	...	...	8/	...	...	...	...	...	...	...	...	...
1830	...	...	8/	...	...	...	...	...	...	...	...	...
1831	20	27	27	9/	--	--	--	7	--	6	--	1
1832	78	63	63	9/	--	--	--	5	--	4	--	1
1833	173	99	94	5	--	--	--	5	--	5	--	--
1834	283	115	105	10	--	--	--	5	--	5	--	--
1835	410	133	118	15	--	--	--	6	--	6	--	--
1836	545	151	132	19	--	--	--	16	--	16	--	--
1837	552	188	111	29	48	--	--	181	159	22	--	--
1838	725	228	92	31	105	--	--	55	23	32	--	--
1839	831	143	78	37	28	--	--	36	1	35	--	--
1840	572	87	53	34	--	--	--	345	315	30	--	--
1841	497	70	43	26	1	--	--	146	113	32	--	1
1842	347	387	362	25	--	--	--	537	525	6	--	6
1843	109	328	322	6	--	--	--	566	549	5	--	12
1844	145	36	33	3	--	--	--	9/	9/	--	--	--
1845	59	373	34	3	--	336	--	460	459	1	--	--
1846	13	476	27	3	15	430	1	522	483	34	--	--
1847	54	268	90	2	18	158	--	227	175	52	--	9/
1848	79	109	92	2	15	--	9/	84	--	61	23	--
1849	94	189	129	3	57	--	--	174	1	52	121	9/

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Table 13. Insurance Receipts and Expenditures, New York, 1829-1866 (continued)
(Amounts in thousands of dollars)

Fiscal year 1/	Balance in fund at end of fiscal year 2/	Receipts: Total	Receipts: Assessments 3/	Receipts: Investment income 4/	Receipts: Recoveries 5/	Receipts: Borrowings	Receipts: Other	Expenditures: Total	Expenditures: Payment to creditors of failed banks 6/	Expenditures: Expenses 7/	Expenditures: Debt retirement	Expenditures: Other
1850	$ 49	$ 213	$ 125	$ 8	$ 3	$ 77	--	$ 258	$ 78	$ 44	$ 136	--
1851	38	125	123	1	1	--	--	136	--	40	95	1
1852	36	126	124	1	1	--	--	128	9/	35	93	--
1853	66	122	120	2	9/	--	--	92	9/	31	61	9/
1854	92	100	89	4	7	--	--	74	9/	28	45	1
1855	146	82	79	3	--	--	--	28	9/	26	2	9/
1856	111	71	66	5	2	--	9/	106	--	23	83	9/
1857	151	62	61	1	1	--	--	22	9/	20	--	2
1858	44	55	45	10	--	--	--	162	9/	17	144	1
1859	34	58	44	2	12	--	--	68	--	11	56	1
1860	69	44	43	1	--	--	--	9	9/	9	--	9/
1861	29	42	41	1	--	--	--	82	9/	7	75	9/
1862	44	43	41	1	1	--	--	28	--	3	25	9/
1863	77	35	34	1	--	--	--	2	--	2	--	9/
1864	108	34	24	5	5	--	--	3	9/	3	--	9/
1865	134	29	21	6	--	--	2	3	--	3	--	9/
1866	13 10/	25	20	3	--	--	2	146	75 11/	1	42	28

Sources: See Table 6.

1/ Usually ending September 30. Totals will not add in all cases because of use of unrounded data.

2/ In cash or invested without adjustment for, debts outstanding but not yet payable. See Table 9 for condition of insurance fund after taking debt into consideration at end of each fiscal year.

3/ Includes regular and special assessments, as well as payments in notes of failed banks in lieu of assessments.

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Table 13. Insurance Receipts and Expenditures, New York, 1829-1866 (continued)
(Amounts in thousands of dollars)

4/ Includes profit arising from sale of bonds.

5/ Receipts from assets of insolvent banks but includes amounts recovered from, or paid by, banks restored to solvency or liquidated in 1837. See Table 12.

6/ Includes payment in cash or bonds to creditors of failed banks placed in receivership and cash disbursements and cash payments in 1837 to redeem notes of banks restored to solvency with insurance aid.

7/ Includes salaries of Bank Commissioners, interest on bonds issued, and dividends on investment income paid to participating banks.

8/ Assessments were paid beginning in 1831.

9/ Less than $500.

10/ Amount remaining after final settlement with creditors of last participating banks to fail was $13,144. However, final settlement was not actually completed until after 1866.

11/ Most of these payments were made after the close of fiscal 1866.

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Insurance fund and assessments. New York's insurance fund was available for the prompt protection of creditors of currently failing banks only during the first 14 years of insurance (1831-44) and at the close of the final year (1866). Since the first assessments were paid in 1831 there was no insurance fund during the first two years of insurance. In the period from 1845 to 1866 there was a balance in the fund in each year but for most of these years the debt was in excess of this balance and during all of these years payments from the fund on behalf of creditors of banks failing after 1845 were prohibited. Table 14 shows the condition of the insurance fund in each year during the insurance period, taking into account the indebtedness of the fund, and in addition shows the size of the fund relative to total and to insured obligations of participating banks.

During the years in which the insurance fund was immediately available for bank creditor protection, i.e., from 1831 through 1844, the average size of the fund was $379,000. 1/ It will be observed from Table 14 that the fund reached a peak in 1839, after which it decreased rapidly, becoming negative beginning in 1845.

It is interesting to observe that on the average during these first 14 years the insurance fund was about 0.9 percent of total obligations of participating banks and slightly over one percent of insured obligations. These ratios are not markedly different from comparable ratios for the present deposit insurance fund of the Federal Deposit Insurance Corporation. This fund was 0.8 percent of total deposits and 1.4 percent of insured deposits at the end of 1956. From its establishment in 1934 to date it has never exceeded 0.9 percent of total deposits and has only once (June 30, 1942) exceeded 2.0 percent of insured deposits. New York's insurance fund, on the other hand, was at one time as large as 2.5 percent of both total and insured obligations.

Table 14 also makes possible a comparison of the assessments paid by banks participating in New York's insurance system with assessments paid by banks participating in Federal deposit insurance today. The average annual assessment was $88,000 under the New York system, which was equal to 0.24 percent of total obligations and 0.43 of insured obligations. The statutory assessment rate today for banks participating in Federal deposit insurance is 0.08 percent and the effective rate, i.e., taking into account net assessment income credits, is less than 0.04 percent. Since the actual New York assessment rate was based on capital stock the equivalent average annual rates on total and insured obligations were not constants. New York assessments were as little as 0.06 percent and as high as 1.1 percent of total obligations. Thus in several years the rate was less than the statutory rate under Federal deposit insurance while in other years it was eight to twelve times larger.

1/ Although it was not until 1845 that the insurance fund was forbidden to be used for bank creditor protection until all bonds were retired, as a practical matter the fund was not immediately available to creditors after 1841 because of the large number of bank failures.

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Table 14, Insurance Fund and Insurance Assessments, New York, 1829-1866
(Amounts in thousands of dollars)

Fiscal year 1/	Condition of insurance fund: negative amounts in () 2/	Ratio of insurance fund to obligations of participating banks 3/: Total obligations	Insured obligations	Insurance assessments levied on bank capital: Amount	Equivalent average annual rate on: 3/ Total obligations	Insured obligations
Average	$ 379 4/	.87% 4/	1.03% 4/	$ 88	.24%	.43%
1829	...	...	...	5/	...	...
1830	...	...	...	5/	...	...
1831	20	.08	.08	27	.10	.10
1832	78	.25	.25	63	.20	.20
1833	173	.44	.44	94	.24	.24
1834	283	.60	.60	105	.22	.22
1835	410	.69	.69	118	.20	.20
1836	545	.78	.78	132	.19	.19
1837	552	1.29	1.29	111	.26	.26
1838	725	1.43	1.43	92	.18	.18
1839	831	2.54	2.54	78	.24	.24
1840	572	1.38	1.38	53	.13	.13
1841	497	1.49	1.49	43	.13	.13
1842	347	1.05	3.89	362	1.09	4.06
1843	109	.23	.84	322	.68	2.47
1844	145	.29	.98	33	.07	.22
1845	(277)	...	...	34	.07	.22
1846	(753)	...	...	27	.06	.17
1847	(869)	...	...	90	.17	.54
1848	(822)	...	...	92	.17	.45
1849	(685)	...	...	129	.24	.63
1850	(672)	...	...	125	.24	.64
1851	(588)	...	...	124	.25	.66
1852	(497)	...	...	124	.26	.67
1853	(406)	...	...	120	.33	.83
1854	(333)	...	...	88	.32	1.11
1855	(279)	...	...	79	.32	1.04
1856	(230)	...	...	66	.28	.98
1857	(191)	...	...	61	.45	1.47
1858	(153)	...	...	45	.27	.93
1859	(108)	...	...	44	.28	.88
1860	(72)	...	...	43	.29	1.08
1861	(38)	...	...	41	.22	.99
1862	2	.01	.05	41	.19	1.06
1863	35	.17	1.55	34	.17	1.51
1864	66	.48	5.69	24	.17	2.05
1865	92	12.76	22.94	21	2.88	5.17
1866	13	--	--	20	--	--

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Table 14. Insurance Fund and Insurance Assessments, New York, 1829-1866
(continued)
(Amounts in thousands of dollars)

Sources: See Table 6.

1/ Usually ending September 30.
2/ Balance in fund at end of year less debt outstanding.
3/ Ratios computed from data before rounding.
4/ Excludes 1845-66, when debt of insurance fund exceeded balance on hand (1845-61) and when fund could not be used for payment of creditors of failed banks (1861-66).
5/ Assessments were paid beginning in 1831.

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Appraisal of Supervision and Regulation of Insured Banks

As indicated in an earlier section, participating banks were supervised by three different agencies between 1829 and 1866. Until 1843 the three Bank Commissioners were charged with this duty. Supervision was vested in the State Comptroller from 1843 to 1851 and in the Superintendent of the newly formed banking department beginning in 1851.

Adequacy of examination, 1831-43. Regular examination of all participating banks was required by law until 1843; after that date examinations were made only when there was reason to believe that a bank was making false returns or was insolvent. On balance, it appears that examinations during the earlier period were inadequate, while those of the later period were thorough but of little help in preventing conditions which could lead to failure.

This judgment on bank examinations during the years to 1843 is based on indirect evidence; the actual reports on individual banks, if any were ever made, are not now available. Thus, adequacy of the examinations can be judged only from the fact that in the later years several of the bank failures disclosed the existence of long standing practices which should have been discovered by examiners.

The report of January 26, 1842 revealed that the Commercial Bank of Oswego, which failed in December 1841, had been "controlled by irresponsible persons, and ... its funds were to a large extent applied to the payment of the shares and otherwise appropriated to the private speculations of its managers" from the time of its organization in 1836. 1/ Similarly, the failure of the Commercial Bank of New York in September 1841 was attributed to "extravagant speculations" of officers and directors, starting in 1836. 2/

The Commissioners' report made in 1843 noted similar cases of long periods of mismanagement and fraud culminating in failures. Thus, investigation of the failure of the Watervliet Bank revealed "a series of gross frauds ... which had been carried on for several years" 3/ Similarly, the Clinton County Bank was found to have been grossly mismanaged during almost its entire period of operation, 4/ while three Buffalo banks, in a "fraud ... heretofore unprecedented in the history of banking in this State ...", were found to have issued about $425,000 in banknotes in excess of the legal limit. 5/

There may have been several reasons why cases of gross mismanagement apparently never drew the attention of the Bank Commissioners, at least so far as their published reports reveal. Un-

1/ "Annual Report of the Bank Commissioners," January 26, 1842, New York Assembly Documents, 1842, document number 29, p. 17.

2/ Ibid., pp. 13-14.

3/ "Annual Report of the Bank Commissioners," January 30, 1843, New York Assembly Documents, 1843, document number 34, p. 7.

4/ Ibid., pp. 14-15.

5/ Ibid., p. 21.

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doubtedly the most unfair explanation was advanced by Abijah Mann, who quoted a colleague: "bank commissioners ... were placed there like our dogs to watch a meat market, and were as easily subsidized by suitable food." 1/ There is, it should be remarked, no other evidence that the examiners were subject to bribery, nor is Mr. Mann considered a dispassionate commentator on the insurance law. 2/ Rather, it appears that proper examination before 1843 was prevented by: 1) the magnitude of the task, 2) the examiners' insufficient authority, 3) the lack of experience or ability of the examiners.

The 1829 law required that each bank be examined three times a year. During the first year in which the system was in operation there were 29 participating banks, thus requiring each of the three examiners, on the average during the year, to make about 30 examinations. At that date the number of examinations was probably not excessive (FDIC examiners today make about the same number per year), although it must be remembered that the three Commissioners were also charged with receiving reports from the banks and preparing an annual report to the legislature. However, by 1839 the annual number of examinations required of each examiner reached about 100; a number certainly beyond the capabilities of the most skillful examiner.

Equal in importance to the burden of work placed on the examiners was the fact that although they possessed sweeping investigatory powers they could not close a bank unless there had been a violation of law. As the 1843 report pointed out:

> Its /the bank's/ administration may exhibit the most dangerous improvidence, its discounted debt may be distributed in such large sums to particular individuals, or so inadequately secured as to render its collection extremely doubtful, the officers of the bank may be found to be the principal borrowers, and everything conspire to cause a well grounded belief that its managers are seriously hazarding or impairing its capital ... But so long as a bank does not violate any law, it is usually placed beyond the reach of the Commissioners.... 3/

Both the limitation of authority to close a bank and the fact that so many banks had to be examined fail to explain why the Commissioners did not at least call attention in their published reports to specific cases of mismanagement. There were, it is true, many instances in which the Commissioners warned against stockholder laxity. Nevertheless, one cannot but feel that part of the explanation was lack of experience, and perhaps ability, of these first bank examiners.

1/ Flagg, op. cit., p. 39.

2/ See, for example, Redlich, op. cit., pp. 94, 265.

3/ "Annual Report of the Bank Commissioners", January 30, 1843, op. cit., p. 9.

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Adequacy of examination, 1844-65. The elimination of regular bank examination after 1843, for which was substituted special examinations by the supervisory authority for banks reporting falsely or believed to be in serious difficulty, meant in effect almost no examination. In the few instances in which the supervisory authority did make an examination the work was extraordinarily thorough. 1/ Nevertheless the examinations could only serve to explain how a bank had been brought to the point of failure since they came far too late to enable preventive action by the supervisory authority.

No accurate tabulation is available of the number of bank examinations made between 1844 and 1865. It could scarcely have been large; and was probably less for the entire 21 years than the number of examinations conducted by the Bank Commissioners in any single year from 1831 to 1843. Between 1845 and 1854 statements indicating that 10 banks had been examined were noted by the writer. In each of five of these cases examination was followed by failure or closing. In the others corrections were made, although one bank eventually failed, or the information which prompted the examination proved to have been faulty.

That the situation was a considerable source of irritation to the supervisory authorities is evident from several annual reports. In his report for the year 1848 the Comptroller requested that the law be changed to permit annual examination of the participating banks, pointing out that "whatever might have been the object, ... the effect of the [present] law is to prevent examinations that might be useful." 2/

In even more bitter language the Superintendent of the Banking Department assailed the law in 1859:

> It confers a power utterly useless in its operative effect as to the public safety, and leaves upon the minds of the people an impression that the Superintendent can exercise some power and control over our banks, beyond that connected with the currency they issue. It is true he can enter upon the examination of the affairs of a bank which he suspects of making an incorrect or imperfect quarterly report, or is in an unsound or unsafe condition; but all experience teaches us that an insolvent bank never exposed that insolvency, or any danger of such a result, in its quarterly report. Figures and affidavits are never made by bank officers to expose insolvency or defalcations. They, the figures, are most useful adjuncts to conceal the real condition of affairs, and the law is keeping the

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1/ See, for example, the report of examination of the Lewis County Bank, "Annual Report of the Superintendent of the Banking Department," January 5, 1855, New York Assembly Documents, 1855, document number 10, pp. 110-158.

2/ "Annual Report of the Comptroller," January 4, 1849, New York Assembly Documents, 1849, document number 5, p. 36.

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> promise of protection before the public eye alone, and throwing an ostensible responsibility upon the Superintendent, which it is utterly impossible for him to fulfil. The law, with its present provisions, is simply an inoperative statute, promising beneficial results from the vigilance of the Superintendent, and utterly useless in producing such effects as are apparently promised by it, however watchful and energetic he may be." 1/

Such antagonism towards the law was not shared by all of the men who served as Superintendent of the Banking Department. In the later years, particularly after 1860, the reports indicate a general satisfaction with the law as it stood, reflecting either the virtual elimination from banking of the type of individual responsible for frauds of the early years, or resignation to the impossibility of strengthening the examination provisions.

Bank reports. An important supervisory function was the collection and publication of bank data. Until 1843 annual reports on the condition of participating banks were submitted by the Bank Commissioners. During the period of supervision by the Comptroller quarterly reports were made by the banks but were only occasionally published in official reports. After formation of the Banking Department there was a noticeable improvement in the reports and, beginning in 1854, detailed asset and liability statements were published quarterly for each bank.

The regular submission and publication of bank data was a significant forward step in the development of bank supervision in New York. However, it was not immediately successful in achieving the sought-after goal, i.e., sufficient publicity to enable the public to guard against banking with unsafe institutions and to bring pressure upon such institutions to reform.

The problem of false reporting was probably never completely solved, although it appears to have been most pressing during the earlier years. There was, for example, the case of large amounts of unreported circulation of a number of Buffalo banks, described earlier. 2/

Another problem was the attempt of banks to adjust their accounts in order to present the most favorable statements on the reporting date. Not only did this make an accurate appraisal of the banks difficult but it also was an upsetting factor in financial circles. On the whole, however, it appears that the supervisory authorities made diligent and increasingly successful efforts to secure and publish the most accurate data possible.

Banking practices. Perhaps the most frequent complaint by Bank Commissioners during the earlier period was lack of interest by stockholders in the daily business of their bank. Typical of the

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1/ "Annual Report of the Superintendent of the Banking Department," January 5, 1859, New York Assembly Documents, 1859, document number 5, pp. 14-15.

2/ See above, p. II-50.

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various statements on this subject was that made in the 1841 report: "The only effectual safeguard, /against bad banking/ at last, is in the vigilance and care of the board of directors -- they can, without doubt, do more to prevent this and all other evils, ... than can be done by legislation". 1/

The first reports of the Bank Commissioners tended to discuss general monetary conditions and contained relatively few references to individual banks. After the panic of 1837, and particularly after 1840, the reports turned more to the cause of specific bank failures. Only a few suggestions for changes in legislation were made during this period, the two most prominent being to withdraw insurance protection from deposits 2/ and to allow the date at which reports were made to be set by the Bank Commissioners so as to prevent window dressing. 3/

Reports by the Superintendent of the Banking Department to the legislature after 1851 devoted more space to individual banks in difficulty, although general monetary conditions drew attention in a number of cases. Whatever the type of report, banks participating in insurance occupied an increasingly subordinate role as their charters expired.

Appraisal of New York's Insurance System

New York's insurance system operated 37 years, a period longer than that for any other State bank-obligation insurance system. Its accomplishments and failings have been stated, or are clearly implicit, in the preceding sections. This section is in the nature of a summing-up, rather than additional analysis.

Attainment of objectives. It was stated earlier that the proponents of New York's insurance legislation had two objectives: 1) to guard against the destruction of circulating medium due to bank failures and, 2) to protect the "small" bank creditor against loss. Because neither objective was completely attained there has been a regrettable tendency to overlook the partial but nonetheless important success which New York insurance did in fact attain.

The system's first severe test came in 1837, when the panic of that year resulted in a large number of bank failures in many States. Although there was a very substantial decline in the amount of circulating medium in New York, the situation was not made still more difficult as a consequence of bank failures. It will be recalled that of the five banks in serious financial difficulties in that year, four were rapidly restored to solvency, while the obligations of the fifth were speedily made available to the holders. Without insurance this could not have been done.

1/ "Annual Report of the Bank Commissioners", January 26, 1842, op.cit., p. 8.

2/ "Annual Report of the Bank Commissioners", January 25, 1841, New York Assembly Documents, 1841, document number 64, pp. 16-17.

3/ "Annual Report of the Bank Commissioners", January 26, 1842, op. cit., p. 20.

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During the years 1840-42, insurance operations were less successful. Nevertheless, hundreds of thousands of dollars were paid out of the insurance fund to creditors of failed banks. Had this amount not been available, or if it had only become available after long periods of time, the impact of the depression would have fallen particularly hard on the affected communities and the general effect upon the State would almost certainly have been more severe.

After 1845 the New York insurance system was virtually ineffective as a protector of circulating medium. This was primarily due to the continually diminishing number and importance of banks participating in insurance and to the withdrawal of insurance protection from deposits. The fact that the insurance fund was "mortgaged" and not available to creditors of a bank failing after 1845 was of minor significance in this regard.

The record of protection afforded all creditors of failing banks - "small" creditors as well as "large" - was surprisingly good. As shown in Table 7, approximately 98 percent of all insured obligations was eventually made available to the holders, either in the form of receivers' dividends or insurance payments. If one neglects the time lapse between failure and payment the record is comparable with that of Federal deposit insurance. During the period in which all bank obligations were insured (cases 1-16, Table 12) 99 percent of the obligations of failing banks was made available to the holders. This is about the same as the proportion of total deposits which has been restored to depositors in insured banks requiring disbursements by the Federal Deposit Insurance Corporation.

Small as well as large bank creditors undoubtedly suffered from the inability of New York's insurance system to make immediate payment in all cases of bank failure. However, it should be remembered that there was immediate payment in the 1837 cases, and reasonably prompt payment in the first few cases of the 1840-42 group. Even if the insurance fund had been able to make immediate payment in every case, payments would have been slower than under insurance today because such a large part of the insured obligations consisted of circulating notes, many of which circulated at some distance from the place of redemption.

Comparison with Free Banking system. From 1838, when the Free Banking Act was passed, through 1866 there were 57 free bank failures. These banks had a known circulation at time of failure of \$3.1 million and their deposits were probably of the order of magnitude of \$6 to \$10 million. Average obligations of failed free banks per hundred dollars of total free bank obligations were about \$0.40 per year during the period 1838-66, a ratio slightly lower than for participating banks. 1/

Losses to creditors of failed free banks cannot be accurately determined because of the absence of records of payments to depositors. The loss on circulating notes amounted to \$400,000, or about 13 percent of circulation outstanding at time of failure. It is quite probable that losses to depositors were relatively larger, since holders of circulating notes enjoyed a preferred position by virtue of

1/ See Table 11.

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the fact that certain securities were pledged by each bank for the redemption of its circulating notes. If depositor losses are conservatively estimated at $2 million which is one-third of the minimum estimated deposits in failed free banks, it will be observed that total losses to creditors of free banks were in the neighborhood of $2.5 million.

The record of protection afforded the creditors of free banks is much poorer than that of protection to creditors of banks participating in New York's insurance system. This is so because noteholders who made claims on the insurance fund were reimbursed in full in the case of all 21 failed participating banks, and depositors who made claims were reimbursed in full in the cases of 16 of the 21 failed banks. Further, there is no reason to assume that depositors of the five participating banks which failed after 1842 received any less protection than depositors of the failed free banks.

It is interesting to speculate on the protection which would have been afforded bank creditors had the original New York insurance plan remained intact during the entire period 1829-1866. In other words, would insurance of bank obligations have been more, or less, successful if the plan had included all banks and all obligations. Naturally, no precise answer can be given since it cannot be determined what influence insurance protection would have had upon failures among free banks.

Had free banks been included in the insurance system the additional revenue to the insurance fund from assessments paid by these banks would have amounted to approximately $7 million during the period 1838-1866. Even if the added investment income which the enlarged insurance fund would have provided is ignored, it will be seen that this amount would have been more than sufficient to pay the approximately $2.5 million of losses to all creditors of free banks and, in addition, the losses suffered by depositors of those few chartered banks which failed after 1842. The insurance fund at the end of the period would probably have been completely restored, i.e., it would have been equal to $3 million, or three percent of total bank capital of about $100 million. 1/ Since total bank obligations in the years near the end of the insurance period exceeded $300 million, an insurance fund of $3 million would have been slightly less than one percent of such obligations, and thus of about the same relative size as the present deposit insurance fund of the Federal Deposit Insurance Corporation.

Despite the fact that the revenue of the insurance fund would have been sufficient to meet all losses and restore the fund to its statutory size, a borrowing power would still have been essential. In its absence the insurance system would have been in even more difficulty in 1840-42 than it was in fact when it included only chartered banks. Of the 57 free bank failures, 25 occurred during

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1/ This percentage was calculated as of 1863-64, before the free and chartered banks began winding up their affairs as a consequence of passage of the National Banking Act.

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1840-42. By 1842 free banks would have paid assessments of approximately $200,000, but the 25 failures involved a total circulation of $1.2 million and possibly another $2 million in deposits. To make immediate disbursements the fund would therefore have needed a borrowing power about $3 million greater than that which it secured from the New York legislature in 1845.

If insurance had applied to all operating banks it is doubtful that the assessment rate could have been safely lowered during the insurance period. It will be recalled that the rate was one-half of one percent on capital which, on the average during the period, was equivalent to about one-quarter of one percent per year on total obligations. Although a lower rate would have been sufficient to cover only losses, it would not have been sufficient to make the necessary disbursements during the insurance period, to pay the cost of heavy borrowing which would have been required as a consequence of failures during 1840-42, and to restore the fund to three percent of total bank capital. Failures of free banks occurred in a scattering of individual years during this period but were concentrated in 1840-41, 1854, 1857, and 1861. In 1857, for example, obligations of failed free banks were probably in excess of $1 million and possibly approched $2 million. The actual debt burden arising from bonds issued on behalf of creditors of failed participating banks was $500,000; this amount would have been two to three times larger had free banks been included in insurance.

<u>Deficiencies of the insurance system</u>. New York's insurance system suffered from a number of defects which were either inherent in the insurance law itself or arose out of its administration. Most important of these were: 1) failure to provide for borrowing power until 1845, 2) an unrealistic assessment base and, 3) inadequate supervision. The inadequacies of supervision were discussed in the preceding section and it remains only to point out here that more effective supervision most probably would have prevented several of the failures which developed because of fraudulent or unsafe banking practices.

Failure of the original law to provide for a borrowing power turned out to be the fatal flaw in the operation of the New York insurance system. Without this power insurance authorities were helpless when the large and unexpected demands were made upon them as a consequence of the depression which began in 1839. Had authorities been able to make immediate payment of insured obligations in 1840 and 1841 several of the later failures might possibly have been avoided. But even more important, the protection accorded creditors of these banks would have been much improved.

In addition, when the insurance system was, finally, permitted to borrow it was a mistake to provide that lenders to the fund would have first claim upon the receipts of the insurance fund. As it turned out, this requirement was not needed and merely had the effect of making the creditors of banks which failed after 1845 wait for unnecessarily long periods of time before they could be paid.

It was pointed out earlier that the assessment rate was more than sufficient to meet all claims made against the insurance system. However, the rate was thoroughly impractical in its application, since it applied to bank capital rather than to bank obligations.

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The actual annual rate was one-half of one percent of capital stock; and it will be recalled from Table 14 that this was equivalent, on the average over the period, to about one-quarter of one percent on total obligations. If the computed equivalent rate had been the actual rate the insurance fund would have been approximately 15 percent larger at the end of 1839 than was the case. This is because, by relating the rate to obligations rather than capital, the amount paid by the banks would have been higher during good years - such as 1835-36 - and lower during depression years. With capital as the assessment base the amounts paid by any one bank tended to be fairly constant - or at best to change infrequently. Thus they had little relationship to the amount of insured obligations and, in addition, were apt to be particularly burdensome to the bank at precisely the wrong time. Table 9 shows, for example, that relative to total obligations the highest rates were in the depression years of 1842 and 1857. 1/

Conclusion. New York's system was reasonably successful in attaining the objectives of bank-obligation insurance. Its record was much better than those of a number of States which later adopted insurance plans. Although the New York system had several serious flaws it was, after all, the first to be established and its pioneering efforts were influential in the development of bank-obligation insurance in other States and, ultimately, for the entire country.

1/ Excluding 1865, when the last two participating banks were in process of liquidation because of the pending expiration of their charters.

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CHAPTER III

INSURANCE OF BANK OBLIGATIONS IN VERMONT, 1831-1866

Vermont was the second State to use the insurance principle in providing for the protection of bank creditors. The plan was embodied in "An Act regulating the chartering of banks," passed on November 9, 1831, about two years after adoption of bank-obligation insurance in New York State. Banks participated actively in the Vermont system through the end of 1858 but it was not until 1866, when final creditors' claims were settled, that the system itself became inoperative.

Review of Vermont Banking History to 1831

The first incorporated bank in Vermont was the Vermont State Bank, chartered by the legislature in 1806. This bank was owned and managed by the State, and operated offices in a number of towns. Several years after it opened the bank encountered serious financial difficulties and by 1812 its business was being closed, with financial assistance from the State legislature. Final liquidation was not completed until 1845.

With the cessation of active banking operations by the State Bank, Vermont was left with no institution to provide circulating medium. As a result, a long-standing prejudice against privately owned banks was finally overcome and two bank charters were granted by the legislature in 1818. The banks, at Windsor and Burlington respectively, immediately went into operation. Additional charters were granted in succeeding years and by 1831, the year of adoption of the insurance system, ten chartered banks were operating in Vermont.

The business of these early banks was regulated by their respective charters, which contained restrictions typical of the time. For example, interest was limited to six percent, circulation was restricted to a maximum of three times capital, and loans and discounts could not exceed deposits plus three times capital.

Character of the Insurance Plan

The essential features of Vermont's insurance legislation of 1831 were copied from the plan adopted by New York two years earlier. In fact, creation of an insurance fund to pay creditors of failed banks was described at the time in Vermont as "providing security according to the New York system against the failures of banks." 1/ Because of the similarity of the two insurance plans, this section will deal with the relatively few differences between them and the later amendments to Vermont's legislation.

Objectives of the insurance legislation. Only scattered references to the debates preceding adoption of insurance in Vermont have been located. Although these references reflect a real concern

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1/ Vermont Watchman, November 16, 1831.

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over the problem of bank failures - referring, for example, to the "necessity of security against the losses and ruins" 1/ - they are not sufficiently detailed to attempt an analysis of the motives behind passage of the legislation. However, it may reasonably be presumed that the Vermont legislators sought the same objectives as did their counterparts in New York: first, to prevent destruction of circulating medium and, second, to protect the bank creditor of limited means against loss.

Participation of banks. As was the case in New York, Vermont abandoned the original intention of eventually bringing all banks into the insurance system. In 1839 five banks were given charters which included among their provisions exemptions from the insurance law, and in 1840 new legislation provided that all banks subsequently chartered or rechartered were to have the option of entering or remaining outside of the insurance system. Previously there had been no option; unless specifically exempted each bank chartered or rechartered after 1831 became subject to the insurance legislation. 2/ If after 1840 a bank chose not to participate in insurance its directors were required to give personal bonds, equal in amount to the paid-in capital of the bank, to the Treasurer of the State.

In 1851 the Vermont legislature provided for the establishment of free banks. These banks did not participate in insurance. Although there was no specific prohibition of their participation neither was any provision made for their inclusion in the system. It seems that their participation was never intended. 3/

Insurance fund. In providing for its insurance fund, Vermont established higher assessment rates and a larger maximum size than was the case in New York. Annual assessments of three-quarters of one percent on paid-in capital were to be paid by Vermont banks until an amount equal to four and one-half percent of capital had been paid by each bank. This contrasts with an annual rate of one-half of one percent on capital and a maximum contribution of three percent of capital for New York banks.

Whenever the Vermont fund fell below four and one-half percent of the total paid-in bank capital, assessments were to be resumed until it was restored to its maximum size. The special assessment rate was to be determined by the State Treasurer but was not to exceed the regular rate. 4/

Administration of the insurance fund was also delegated to the Treasurer, who was charged with investing the fund in securities and dividing the income, after payment of administrative expenses, among participating banks in proportion to their contributions. The fund itself remained the property of the banks and was listed among their assets in statements of condition. Investment of the bank fund was to be made in approved bank stock or other securities.

1/ Ibid..

2/ An Act regulating the chartering of banks, November 9, 1831, section 1.

3/ An Act to authorize the business of banking, November 17, 1851, section 35.

4/ An Act regulating ..., section 8.

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Obligations insured. In providing that insurance would apply to all debts of participating banks, 1/ Vermont never seems to have been troubled by the question that later was to plague New York: whether all debts meant circulating notes only, or those liabilities plus deposits. At no time was there uncertainty in Vermont as to the inclusion of deposits. This was quite clearly indicated at the time of passage of the Act of 1840, giving banks the option of either contributing to the safety fund or posting bonds with the Treasurer of the State:

> If the directors of any banking corporation subject to the provisions of this chapter, shall execute bonds to the treasurer of the state to the amount and with the security required ... to be approved by the bank commissioner, and deposited with said treasurer, conditioned that such directors shall at all times pay and redeem, according to law, all the bills issued by such bank, and shall pay and refund all deposits made in such bank, when such payments are demanded, while such directors are in office, such bank shall thereafter be exempt from all payments required ... to the bank fund ... 2/

Method of paying creditors of failed banks. Payment to creditors of a failed bank was to be made from the fund if any deficiency remained after the receiver paid his final dividend upon the assets of the insolvent bank. Thereafter the time limit for presentation of claims was to be fixed by the Chancellor. Vermont never made provison for earlier payment of insured creditors.

Supervision and Regulation of Participating Banks

Bank supervision. Vermont's insurance legislation did not introduce banks supervision to the State. Although the insurance law contained the same basic supervisory provisions as the New York law, Vermont already had a rudimentary supervisory system in the person of the Bank Inspector. This individual was appointed by the State legislature to report on the condition of the banks and he had been performing this function for a number of years prior to 1831.

The bank supervisory system established by the insurance legislation was at first superimposed on the already existing system. The three "Bank Commissioners of the State of Vermont," provided for in the 1831 law, were to examine each of the participating banks at least once each year, but these banks also remained subject to examination by the Bank Inspector. It was not until 1839 that the Inspector's jurisdiction was restricted to banks not participating in insurance.

The Bank Commissioners were to be appointed annually, two by the participating banks and one by the State legislature. However, in 1837 the number of commissioners was reduced to one, to be selected by the General Assembly. The commissioners were to be paid from the fund at the rate of $4.00 per day, plus expenses.

1/ Ibid., section 9.

2/ An Act relating to banks, October 28, 1840, section 39. Emphasis added.

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For a time there appears to have been a considerable difference in authority granted the two supervisory agencies. The Bank Commissioners possessed the very considerable authority to make thorough examinations on the basis of full access to bank records. 1/ The Bank Inspector apparently possessed no such authority, as is indicated by the fact that, on one occasion, he was refused access to the books of a bank suspected to be in serious financial difficulty. His principal duty seems to have been to verify the condition reports of the banks on the basis of such information as the banks were willing to supply. However, in 1837 new legislation gave to the Bank Inspector approximately the same examination powers possessed by the Bank Commissioners.

Statutory limitations on bank operations. Generally, the participating banks chartered under the Act of 1831 and the Act of 1840 were subject to the same provisions relating to bank operations. 2/ However, there were certain features of the 1840 Act which differed from, or were in addition to, provisions embodied in the 1831 Act. Specific statutory limitations on bank operations during the period of insurance in Vermont in the Acts of 1831 (as revised in 1839), 1840, and 1849), are shown in Table 15.

The Act of 1831, dealt largely with the operation and administration of the insurance fund, and with the duties of the Bank Commissioners. Until passage of the Revised Statutes of 1839 and the acts relating to banks in 1840 and 1849, most regulations on a bank's operations were included in its charter.

The commissioners were charged with seeing that participating banks operated within the limitations set forth in their charters or by general legislation. For example, if the statutory provisions were violated in any way with respect to amount of circulation outstanding, payments due the Treasurer, capital stock outstanding, payment of bills, permission to examine officers under oath, and inspection of books, the commissioners had the authority to declare such banks insolvent. However, the commissioners' do not appear to have possessed authority to enforce remedial recommendations regarding unsafe banking practices.

Number and Obligations of Banks

Number of banks. Shortly after passage of the Act of 1831 three banks made contributions to the insurance fund and the following year four others followed suit. In 1837 more than half of all Vermont's banks were participating in insurance and by 1843 participating banks were four-fifths of all operating banks.

In terms of number of participating banks, the peak years of participation were from 1841 through 1848, during which time thirteen banks were continuously members of the insurance system. Of

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1/ The section of the act granting this authority was an exact copy of the New York section, which was discussed in Chapter II, p. 23.

2/ The number of banks participating in insurance to which the 1840 provisions applied ranged from one in 1840 to nine in 1848. The remainder operated under provisions of the 1831 Act, as revised in 1839.

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Table 15. Statutory Limitations on Bank Operations

Item	Act of 1831 (with 1839 revisions)	Act of 1840	Act of 1849
Responsibility of officers, directors, and stockholders:			
Losses resulting from loans made in violation of legal limitations	Not specified	Directors liable to full extent of loss	Not specified
Liability of stockholders	Not specified		Not individually liable for debts contracted
Limitations on loans and investments:			
Loans to officers, stockholders, and directors	Not specified	Directly or indirectly 5% of paid in capital stock, at any one time	3% of capital stock
Total to directors, officers, and stockholders	As of 1839, 15% of capital subject to consent of directors	At any one time aggregate not to exceed 3% of paid-in capital stock for each director	5% of paid-in capital stock
Maximum to single borrowers	As of 1839, $2,000 subject to consent of directors	10% of paid-in capital, subject to consent of directors	Not specified
Other restrictions	As of 1839, loans prohibited until entire amount of capital stock paid in gold or silver coin	Loans prohibited until ½ capital stock paid in gold and silver	Not specified

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Table 15. Statutory Limitations on Bank Operations (cont'd)

Item	Act of 1831 (with 1839 revisions)	Act of 1840	Act of 1849
Limitations on ownership of property:			
Ownership of real estate	Not specified	Forbidden except that necessary for accommodation of bank itself	Same as 1840
Limitations relating to circulation:			
Maximum amount of circulation	Three times paid-in capital stock	Deposits and twice paid-in capital stock	Not specified
Limitations on borrowings:			
Maximum	Not specified	Deposits and twice capital stock paid in	Not specified
Limitations on payment of dividends:			
If capital is impaired	Not specified	Not specified	No dividend until deficit of capital made good
Capital stock requirements:			
Minimum	Not specified	Not specified	Not less than $50,000 or more than $250,000
When to be paid	50% upon commencing operations; no time limit set for payment of remainder, except in case of rechartered bank in which case full amount to be paid within one year	50% upon commencing operation, remainder within 2 years	Not specified
Reduction of	Not specified	Permitted only in case of rechartered bank; not to be reduced below original amount paid in	Not specified

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these thirteen banks, four were subject to the 1831 law while nine were operating under the provisions of the 1840 law.

After 1848 the number gradually began to decline as more and more of the banks proceeded to exercise their option of withdrawing from insurance. By 1859 all banks had withdrawn from insurance but the insurance fund remained in the hands of the Treasurer until 1866 when final settlement was made with the creditors of the Danby Bank. Table 16 shows the number of banks, by insurance status, for each year of the insurance period.

Bank obligations. Obligations covered by insurance included all debts, i.e., deposits, circulation, and miscellaneous liabilities. Thus coverage was the same under Vermont's insurance system as in New York (until 1842), Indiana, and Michigan.

The obligations of both participating and nonparticipating banks are shown in Table 16. It will be observed that during the first nine years of operation less than half of all obligations were in participating banks. However, by the end of 1840 almost 56 percent of all bank obligations were afforded protection by insurance and for the following eight years more than half of all obligations had insurance protection. Maximum protection was reached in 1845 when over 78 percent of all obligations were covered; thereafter insured obligations relative to total bank obligations began to decline and by 1850 nonparticipating banks again held the major portion of bank obligations.

Vermont banks, both participating and nonparticipating, were primarily banks of issue. As can be seen from Table 17, the amount of circulating notes in the two types of banks considerably exceeded deposits, the typical ratio being about 5 to 1. Deposits in this instance include all deposit liabilities; because of the unavailability of detailed statements it is not possible to provide a breakdown of this item.

Relative size of participating banks. It appears that participating banks were generally smaller than nonparticipating banks. Table 18 shows participating and nonparticipating banks grouped by size (as measured by circulation plus deposits) for three year-end dates: 1833, 1843, and 1849.

For the years 1833 and 1843 most participating banks had less than $100,000 of deposits plus circulating notes and none had more than $150,000 of such obligations. In 1849 the typical participating bank had deposits and circulation of from $100,000 to $150,000 and there was one bank with obligations in excess of $200,000. By way of contrast, the majority of nonparticipating banks had deposits and circulation of more than $100,000 in all three years: 1833, 1843, and 1849.

Examination of Table 18 shows that there was no marked concentration of risk for the insurance system in either 1833 or 1843, and only a small degree of risk concentration in 1849. During the latter year two banks, constituting 18 percent of all banks, had 29 percent of insured obligations.

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Table 16. Number and Obligations of Vermont Banks, by Insurance Status, 1831-1858

Year 1/	Number of banks: Total	Participating in insurance: Number	Participating in insurance: Percent of all banks	Not participating in insurance	Obligations (in thousands) of: 2/ All banks	Participating banks: Amount	Participating banks: Percent of all banks	Nonparticipating banks
1831	13	3 3/	23.1	10	4/	4/	--	4/
1832	17	7	41.2	10	$1,501	$ 454	30.2	$1,048
1833	18	8	44.4	10	1,647 5/	579	35.1	1,068 5/
1834	19	9	47.4	10	1,856	697	37.6	1,159
1835	19	9	47.4	10	2,511	1,000	39.8	1,511
1836	19	9	47.4	10	4/	4/	--	4/
1837	19	10	52.6	9	1,784	873	48.9	911
1838	19	10	52.6	9	2,255	1,059	47.0	1,196
1839	19	10	52.6	9	2,249	1,029	45.8	1,220
1840	17	10	58.8	7	1,338	748	55.9	590
1841	18	13	72.2	5	1,791 5/	1,353	75.5	438 5/
1842	17	13	76.5	4	1,080	787	72.9	293
1843	16	13	81.3	3	1,513	1,179	77.9	334
1844	17	13	76.5	4	2,033	1,552	76.3	481
1845	17	13	76.5	4	1,688	1,321	78.3	317
1846	17	13	76.5	4	1,900	1,388	73.0	512
1847	18	13	72.2	5	2,768	1,936	72.4	832
1848	21	13	61.9	8	2,019	1,186	58.7	833
1849	23	11	47.8	12	2,673	1,329	49.7	1,344
1850	27	10	37.0	17	3,475	1,265	36.4	2,210
1851	31	9	29.0	22	4,099	1,276	31.1	2,823
1852	32	9	28.1	23	4,577	1,427	31.2	3,150
1853	33	9	27.3	24	5,552	1,659	29.9	3,893
1854	40	9	22.5	31	4,832	1,269	26.3	3,563
1855	42	9	21.4	33	4,571	1,323	28.9	3,248
1856	41	7	17.1	34	4,765	780	16.4	3,985
1857	41	6	14.6	35	5,024	644	12.8	4,380
1858	41	4	9.8	37	3,693	307	8.3	3,386

Source: Vermont Senate and House Journals, 1831-1836; Reports of Auditor of Accounts, 1837-1858.

1/ End of year, 1831-1836; October dates, 1837-1858.

2/ Consists of circulating notes, deposits, and miscellaneous liabilities.

3/ Banks chartered November 1831. Contributions by these banks to the fund were not made until the following year (1832).

4/ Not available.

5/ Excludes one bank not reporting.

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Table 17. Deposits and Circulation, Vermont Banks by Insurance Status and Year, 1831-1858

Year 1/	Participating in insurance Circulation	Participating in insurance Deposits 2/	Not participating in insurance Circulation	Not participating in insurance Deposits 2/
1831	3/	3/	3/	3/
1832	$ 412,873	$ 40,867	$ 821,306	$ 227,196
1833	535,485	43,107	928,229	139,768
1834	600,464	96,393	928,123	231,012
1835	898,395	101,900	1,165,060	345,450
1836	3/	3/	3/	3/
1837	719,198	153,582	738,243	172,813
1838	880,582	178,242	1,036,592	159,991
1839	924,230	105,252	1,018,751	201,227
1840	616,755	130,895	483,060	107,679
1841	1,150,890	202,068	408,569 4/	29,743 4/
1842	618,414	168,445	229,879	63,160
1843	1,018,477	160,882	268,893	64,359
1844	1,357,809	194,214	385,999	94,866
1845	1,102,490	218,897	298,129	68,438
1846	1,140,277	247,259	419,556	92,733
1847	1,667,576	268,174	685,716	146,087
1848	1,018,281	167,663	715,201	117,980
1849	1,140,369	189,004	1,181,439	162,655
1850	1,078,539	186,550	1,777,488	432,549
1851	1,024,690	251,100	2,352,337	471,147
1852	1,147,752	279,259	2,641,379	508,311
1853	1,386,436	272,858	3,408,780	483,500
1854	1,018,201	250,497	2,971,510	591,380
1855	1,027,974	294,527	2,676,369	572,505
1856	636,786	143,507	3,333,872	651,085
1857	534,491	109,797	3,741,026	638,421
1858	252,336	55,112	2,762,806	622,667

Source: Vermont Senate and House Journals, 1831-1836; Reports of Auditor of Accounts, 1837-1858.

1/ Data for 1831-1836 are for end of year; for 1837-1858, October dates.

2/ Includes interbank deposits. For most years the amount of such deposits is negligible.

3/ Not available.

4/ Excludes one bank not reporting.

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Table 18. Number, Deposits, and Circulation of Vermont Banks, by Insurance Status and Size of Bank, 1833, 1843, 1849

Size of bank	1833 1/				1843 1/				1849 1/			
	Participating in insurance		Not participating in insurance		Participating in insurance		Not participating in insurance		Participating in insurance		Not participating in insurance	
	Number or amount	Percent distribution	Number or amount	Percent distribution	Number or amount	Percent distribution	Number or amount	Percent distribution	Number or amount	Percent distribution	Number or amount	Percent distribution
Number of banks - total	7	100.0%	7 2/	100.0%	12 3/	100.0%	3	100.0%	11	100.0%	12	100.0%
Banks with deposits plus circulation (in thousands of dollars) of:												
Less than 50	2	28.6			2	16.7			1	9.1	1	8.3
50 to 100	3	42.8	3	42.9	6	50.0	1	33.4	2	18.2	3	25.0
100 to 150	2	28.6	3	42.9	4	33.3	2	66.6	6	54.5	6	50.0
150 to 200			1	14.2					1	9.1	2	16.7
200 and more									1	9.1		
Amount of deposits plus circulation - total	$578	100.0%	$790 2/	100.0%	$1,102 3/	100.0%	$333	100.0%	$1,328	100.0%	$1,343	100.0
Banks with deposits plus circulation (in thousands of dollars) of:												
Less than 50	76	13.1			68	6.2			42	3.2	43	3.2
50 to 100	250	43.3	242	30.6	516	46.8	60	18.0	154	11.6	271	20.2
100 to 150	252	43.6	393	49.8	518	47.0	273	82.0	746	56.2	659	49.0
150 to 200			155	19.6					180	13.5	370	27.6
200 and more									206	15.5		

Source: Vermont Report of Inspector of Banks, 1833; Reports of Auditor of Accounts, 1843 and 1849.

1/ Year-end dates.

2/ Differs from number and deposits of operating nonparticipating banks shown in Table 16 due to unavailability of individual statements for three banks.

3/ Differs from number and deposits of operating participating banks shown in Table 16 due to unavailability of statement for one bank.

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History of Operation of the Insurance System

During the insurance system's twenty-eight years of operation only two participating banks failed. Neither of the banks was of especially large size. Nevertheless, after meeting claims of creditors of the first bank the resources of the insurance fund were inadequate to pay in full the creditors'claims in the second failure.

Participating banks in serious financial difficulty. The two participating banks encountering difficulties were the Essex County Bank, which failed in 1839 just prior to the severe nation-wide depression, and the Danby Bank, which failed during the panic of 1857. However, in the first case failure may be attributed to unsafe and unsound banking practices rather than to asset deterioration.

The Essex County Bank was chartered November 7, 1832, with authorized capital of $40,000. It failed October 12, 1839, and its assets passed into the hands of a receiver on November 4, 1839. From the time it was organized until 1838 it operated, according to its statements, with a paid-in capital of $20,000. 1/

The Bank Inspector was extremely critical of the operations of the Essex Bank as early as 1836. In particular, he was disturbed by the fact that immediately after the bank opened loans to the stockholders had been made on the security of the bank's stock to an amount almost equal to the total stock subscriptions. He was also concerned by other evidence of a self-serving management and by the fact that the bank was maintaining its credit by secretly giving its own banknotes as collateral for loans obtained from other banks. 2/ However, when a committee of the State legislature inquired into the condition of the bank later in the same year it concluded that the bank was "perfectly solvent, and in good condition." 3/ In reaching this conclusion the committee apparently relied heavily upon an examination by the Bank Commissioners. But when, several years after failure of the bank, a legislative committee again inquired into the bank's operations, it was concluded that the officers had looted the bank and that, in effect, the Bank Inspector had been correct in his original charges. 4/

The Danby Bank was somewhat larger than the Essex County Bank. It was chartered November 13, 1850, with authorized capital of $50,000, all of which was paid in by the end of 1852. It failed on September 4, 1857, the day it was unable to redeem its notes on demand in Boston, and a receiver was appointed on December 29 of the same year.

1/ In 1838 paid-in capital was increased to $24,000 and by October 1, 1839, to $25,000. Of the approximately $1,117 which should have been contributed to the safety fund, on the basis of paid-in capital, only $825 had actually been paid as of 1839.

2/ Journal of the House, 1836, pp. 50-57; Journal of the Senate, 1840, appendix XIV-XIX.

3/ Journal of the House, 1836, p. 219.

4/ Journal of the House, 1842, pp. 106-112.

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same year.

During its first five years of operation the Danby Bank chose to be a member of the bond security system and in compliance with the Act of 1840 annually renewed its bonds to the Treasurer as security for bills and deposits. It was not until 1856 that the bank exercised the option described earlier and became a member of the insurance system. The bank had therefore paid into the insurance fund only $750 when it failed.

Protection of creditors of failed participating banks. Protection afforded creditors of the two failed participatings banks is shown in Table 19. It will be observed that over two-fifths of total insured obligations was eventually restored to the banks' creditors and that a substantial portion of the remaining obligations was never presented for payment.

In the cases of both failed banks there is some uncertainty as to the amount of insured obligations at date of failure, and the degree of protection given creditors. The receiver of the Essex County Bank reported that as of the date of failure the circulation of the bank was $70,600 and that its borrowings amounted to $3,800, the two comprising the $74,000 of insured obligations shown in Table 19. 1/ However, three years later, after the time for presentation of claims had expired, more than $30,000 of circulating notes was reported as "still outstanding." 2/ In view of the fact that the suspension of the bank was directly attributable to "fraudulent misconduct of its officers and stockholders", 3/ one possible explanation for the amount of circulating notes still outstanding may have been that they were illegally issued or held and never presented for that reason. Another explanation is that the holders believed that they would secure a larger recovery by selling the notes to the bank's debtors, who in turn could use them to offset their liabilities to the bank. This explanation is suggested by reason of the fact that is discussing the receivership of the Bank of Bennington, a chartered bank not participating in insurance, the auditor of accounts in 1845 stated: "a portion of the bill holders ... seeing little prospect of obtaining anything by delivering up their bills to the receivers ... have neglected to present their claims, prefering ... their chance of selling their bills at a discount to the remaining debtors to the bank. This has left a large amount of bills yet outstanding ..." 4/ Whatever the explanation, it appears that the whole of the bank's circulation eventually came into the hands of the receiver, since the final receivership report shows that $75,000 of circulating notes of the Essex County Bank were burned by the receiver. 5/

The amount of Essex County Bank circulating notes deposited with the receiver for payment was $34,400. An additional $5,600 was received by him and, apparently, offset against indebtness of the holders to the bank. 6/ It is also likely that the receiver was able to offset the $3,800 of bank borrowing, since the money had been secured from a heavy borrower.

1/ "Report of the Committee Upon the Affairs of the Essex County Bank," Journal of the House, 1842, p. 110.

2/ Ibid., p. 111.

3/ Report of the Bank Commissioner, Journal of the Senate, 1844, p. 101.

4/ Annual Report of the Auditor of Accounts, 1845, p. 83.

5/ Annual Report of the Auditor of Accounts, 1859, p. 193.

6/ "Report of the Committee ...," op. cit., p. 111.

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Table 19. Bank Creditor Protection and Insurance Disbursements, Vermont, 1831-1858 1/
(Amounts in thousands)

Item	Total	Essex County Bank (failed 1839)	Danby Bank (failed 1857)
Total obligations at date of failure - total	$ 157	$ 74	$ 83
Circulating notes	149	70	79 2/
Deposits or other liabilities	8	4	4
Total payments to creditors	$ 73	$ 44	$ 29
Percent of total obligations	46.5%	59.5%	34.9%
Payments by receiver	26	10 3/	16 3/
Payments from insurance fund:			
Claimed	65	34	31 4/
Paid:			
Amount	47	34	13
Percent of claims	72.3%	100.0%	41.9%
Obligations not paid	$ 84	$ 30	$ 54
Not presented for payment	67	30	37
No funds available	17	--	17

1/ All data partially estimated. For a discussion see section entitled "Protection of creditors of failed participating banks,", p. III-12.

2/ The receiver reported circulation of $92,000. The amount shown here excludes: $9,784 described as "In Suffolk Bank, redeemed" and $2,871, "In Bank, counted as circulation." Annual Report of the Auditor of Accounts, 1865, p. 50.

3/ Assumes deposits or other liabilities paid through offset.

4/ Excludes interest on claims of approximately $4,000.

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Many of the claims comprising the $34,400 were contested by the receiver, who apparently believed they consisted of banknotes redeemed by agents of the bank prior to its failure and, instead of being destroyed, were being presented again for no "honest or honorable purpose." 1/ However, in 1850 the courts apparently decided that most or all of the total represented valid claims against the insurance fund for, under court order, payments totaling $34,300 were made out of the insurance fund to creditors of the Essex County Bank between 1851 and 1855. In 1859 the receivership was terminated after payment of residual claims and receivership expenses, amounting in all to about $1,000. 2/

Summarizing, it appears that all claims against the insurance fund arising out of failure of the Essex County Bank, amounting to $34,000, were paid in full, and that an additional amount of insured obligations amounting to about $10,000 were paid by the receiver, largely through offset. The remaining $30,000 was never presented for payment, either because it did not constitute a valid claim against the fund or because it was sold to the bank's debtors and eventually came into the hands of the receiver in settlement of their debts. If the latter process did in fact take place, then holders of the notes at the time of failure of the bank made some recovery; but this recovery was not comparable to that secured by a noteholder who, at date of failure of the bank, was at the same time indebted to the bank.

The degree of protection given creditors of the Danby Bank is also difficult to determine. Table 19 shows total insured obligations of the bank, at date of failure, as $83,000. This total is partially estimated, since it consists of $79,000 of circulating notes reported outstanding by the receiver plus the amount of deposits shown on the last condition report prior to failure and assumed to have been still on the books of the bank at date of failure.

As in the case of the Essex County Bank, a large amount of circulating notes was not presented to the receiver of the Danby Bank within the one-year period allowed for the making of such claims. Again, there may have been two reasons for this. First, the bank may have had a considerable circulation in the western States - since it had made large loans in those States, most of which proved uncollectable after the panic of 1857 - and one year may not have provided sufficient time for the return of notes circulating so far from the home office of the bank. The second explanation is similar to that advanced in the case of the Essex County Bank, namely, that holders preferred to sell their notes to persons indebted to the bank rather than to present them to the receiver. The auditor of accounts reported in 1859 that the receiver burned $105,000 in notes of the Danby Bank. Some of this represented notes not tabulated as "in circulation" at date of failure - having been previously redeemed by agents - but the fact that the total was $105,000 suggests that the second explanation for the large amount of notes outstanding may be correct. 3/

1/ "Report of the Committee ...", op. cit., p. 110.

2/ It is assumed that this amount was collected from proceeds of liquidation and did not come from the insurance fund.

3/ Annual Report of the Auditor of Accounts, 1859, p. 86.

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Summarizing, of the total insured obligations at date of failure of $83,000 it is assumed that the receiver was able to offset the estimated $4,000 of deposits, and it is known that he did offset $11,000 of circulating notes. 1/ Of the remaining circulation, $31,000 was presented for payment and $37,000 was still outstanding when the time expired for the presentation of claims. Some recovery may have been made on the second amount by the holders through sale of notes to persons indebted to the bank, but the amount of such recovery, if any, is not known. Of the $31,000 presented to the receiver for payment, it appears that the receiver was only able to collect about $1,000 to pay such claims. Accordingly, the $13,000 which was still in the insurance fund at the time of failure of the Danby Bank was paid to these claimants, although because of extensive litigation even this was not fully paid until 1866.

Insurance receipts and expenditures. In the Vermont insurance system, the insurance fund consisted of the accumulated assessments paid by participating banks, less withdrawals to pay the creditors of failed banks or to refund assessments paid by banks whose charters had expired. Neither investment income of the insurance fund nor its disposition could affect the size of the fund. Table 20 shows, for the 27 years of active insurance operations, the amount in the insurance fund at the end of each year and the items affecting the size of the fund; the table also shows the disposition of income received from investment of the fund.

During the early insurance years there was a tendency on the part of Vermont officials to take account of investment income and its disposition in computing the size of the fund. This may account for the fact that for most of the years until 1841 the amount reported as the insurance fund will not correspond with the accumulated assessment income shown in Table 20. However, beginning in 1842 the amount reported as standing to the credit of the fund at the end of each fiscal year corresponds precisely with accumulated assessments to the end of that fiscal year, less any withdrawals for the reasons indicated earlier.

It appears to have been the policy of the State Treasurer to keep the insurance fund fully invested at all times. Until 1852 a portion of the fund was loaned to individuals but the major portion was loaned to the State. After that year all of the fund was loaned to the State. It is probable that the item "collected on safety fund notes," which appears in the reports of the State Treasurer for most of the years prior to 1852, represented repayment by individuals of loans from the insurance fund.

It will be observed that payment of the creditors of the Essex County Bank, which was made in three installments between 1851 and 1855, did not exhaust the insurance fund. The total claimed ($34,000) was larger than the amount in the fund when the claims were first presented in 1842, but by 1851, when payment was finally ordered by the court, the fund had grown to more than $40,000.

1/ Annual Report of the Auditor of Accounts, 1865, p. 50.

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It appears from the records of the State Treasurer that most of the cash needed to pay the creditors of the Essex County Bank was secured through a State loan of $25,000. It is supposed that the State was required to borrow this amount since, at the time of the court order, virtually all of the insurance fund had been loaned to the State. To secure the necessary cash the State undoubtedly issued new securities, which were described in the reports of the State Treasurer for a number of years thereafter as the "Safety Fund loan", but which actually did not represent borrowing by the fund itself.

The amount shown in Table 20 as paid to the creditors of failed banks is $3,750 less then the total paid as shown in Table 19. The difference is accounted for by the payment of $3,750 to the creditors of the Essex County Bank out of accumulated interest income. The reason for payment in this manner is not given in the records.

It will also be recalled from Table 19 that, because of a lack of sufficient money in the insurance fund, $17,000 in insured claims was not paid in the case of the Danby Bank. Table 20 shows that the necessary amount would have been available if refunds totaling about $18,000 had not been made to a number of banks withdrawing from the insurance system. These refunds were apparently made contrary to law, after a number of banks had exercised their option of withdrawing from insurance and substituting bonds to provide for the security of depositors and noteholders. The receiver of the Danby Bank brought suit against the State Treasurer, seeking to have the amount involved paid to him on behalf of the remaining claimants of the Danby Bank. Although the Supreme Court of Vermont agreed with the receiver that the refunds had been unauthorized, since the charters of the banks had not expired, it would not agree that the State was liable for the payments, nor would it agree that the Treasurer in office at the time the suit was filed was personally liable. 1/ The effect of the decision was to make it impossible for the receiver of the Danby Bank to secure the amount necessary to make final payment on the insured claims arising from the failure of the bank.

Although the insurance fund would have been sufficient, in the absence of the illegal refunds made to several banks, to pay all insured claims in the cases of the two failed banks, it is apparent from Table 20 that it would not have been sufficient to pay the relatively large amount which was never claimed because the owners of the obligations saw fit to dispose of their claims in other ways. The amount not claimed is shown in Table 19 as $67,000; about half of this total would have been available if the income secured from investment of the fund, after payment of the bank commissioners' salaries, could have remained in the fund. However, it was all repaid to insured banks in accordance with law.

Table 20 also provides information on assessments paid by the banks as a ratio of total bank obligations, and on the size of the insurance fund relative to total obligations. The average annual assessment rate was 0.21 percent, and ranged from a low of 0.02 percent of total obligations to a high of 0.72 percent. Thus the rate for some years was considerably below the statutory rate of approximately

1/ "Receiver of Danby Bank v. State Treasurer,", Vermont Reports, Volume 39, 1866-67, p. 92.

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Table 20. Insurance Receipts and Expenditures, Vermont Insurance System, 1831-1867

Year 1/	Insurance Fund: Amount in fund at end of fiscal year: Total 2/	Insurance Fund: Amount in fund at end of fiscal year: As percentage of bank obligations	Insurance Fund: Assessment income: Total	Insurance Fund: Assessment income: As percentage of bank obligations	Insurance Fund: Expenditures: Paid to creditors of failed banks	Insurance Fund: Expenditures: Refunded to banks	Expenses: Salary of Bank Commissioner 3/	Expenses: Income paid to banks 3/
1836-66	$21,113 4/	1.93% 4/	$62,072	.21%	$43,723 5/	$18,199	$3,536	$32,771
1831	--	--	--	--	--	--	--	--
1832	447	.10	447	.10	--	--	--	--
1833	447	.08	6/	.31	--	--	--	--
1834	2,700	.39	3,947	.31	--	--	136	--
1835	4,110	.41	6/	.22	--	--	240	--
1836	6,000	.60 7/	6/	.22 7/	--	--	260	--
1837	10,674	1.22	6,200	.22	--	--	232	--
1838	15,528	1.47	4,163	.39	--	--	77	--
1839	19,233	1.87	2,688	.26	--	--	180	--
1840	20,700	2.77	6/	.32	--	--	116	--
1841	22,320	1.65	6/	.32	--	--	124	250
1842	26,730	3.39	9,285	.32	--	--	48	18
1843	29,543	2.50	2,813	.24	--	--	104	5,927
1844	32,055	2.07	2,513	.16	--	--	176	1,639
1845	34,185	2.59	2,100	.16	--	--	140	1,757
1846	36,030	2.60	1,875	.14	--	--	164	1,874
1847	38,444	1.99	2,414	.12	--	--	108	1,867
1848	39,457	3.33	1,013	.09	--	--	128	2,132
1849	40,143	3.02	665	.05	--	--	176	817
1850	40,216	3.18	563	.04	--	489	152	140
1851	15,204	1.19	563	.04	25,575	--	172	1,022
1852	15,791	1.11	4,438	.31	3,850	--	183	978
1853	18,229	1.10	2,438	.15	--	--	140	427
1854	21,041	1.66	2,813	.22	--	--	196	1,021
1855	29,400	2.22	9,532	.72	1,173	--	159	1,359
1856	21,410	2.74	719	.09	--	8,710	125	1,199
1857	17,022	2.64	113	.02	--	4,500	--	1,130
1858	13,012	4.24	750	.24	--	4,500	--	1,404
1859-67	13,125	--	--		13,125	--	--	7,810

1/ Usually ended September.

2/ As reported by the State Treasurer, except for 1832-34, 1836, and 1840 which are estimates. Fund for 1841 was reported including interest, which has been excluded here. Other reported amounts prior to 1842 may also have included interest or may have shown fund net of interest due to banks; either method was incorrect. For some years between 1859 and 1867 the fund varied slightly from the amount shown.

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Table 20. Insurance Receipts and Expenditures, Vermont Insurance System, 1831-1867 (continued)

3/ Data are probably incomplete for earlier years.
4/ Average for 27 years, 1832-1858.
5/ Excludes $3,751 reported by Treasurer as having been paid billholders of Essex County Bank out of interest income.
6/ Included in amount shown for next reported year.
7/ Computed using estimated obligations.

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0.08 percent applicable today under Federal deposit insurance, while in other years it was as much as nine times this rate. On the average, the insurance fund was equal to just under 2 percent of total obligations, or almost three times the present relative size of the deposit insurance fund of the Federal Deposit Insurance Corporation.

Appraisal of supervision and regulation of participating banks.

Banks participating in Vermont's insurance system received reasonably good supervision. It is apparent from the reports that a number of dedicated and conscientious individuals exercised supervisory authority during the insurance period. However, it must also be added that during the early insurance years bank supervision in Vermont was less than satisfactory.

After 1840 the Bank Commissioner and the Bank Inspector were usually the same individual. But prior to that time there was evidently some friction between the two officials. This is strongly indicated in the case of the Essex County Bank. Whereas in 1836 the Bank Inspector was seriously - and justifiably - disturbed over the management of that bank, the Bank Commissioners made what appears to have been only a cursory examination and found nothing wrong. Further, the commissioners made no attempt to assist the Bank Inspector when he attempted to inquire more closely into the condition of the bank. Since at that time both authorities were examining participating banks the only conclusion which can be drawn is that the Bank Commissioners were less interested in carrying out their duties than they were in contesting with the Bank Inspector for authority over participating banks. On the other hand, it is possible that the diligence of the Bank Inspector in this case - as well as his stated opposition to bank-obligation insurance in general - stemmed partly from the fact that he was interested in protecting his own position in the supervisory area.

The failure of the Danby Bank in 1857 cannot be attributed primarily to supervisory laxness. The difficulties of that bank developed out of the unwise policy of making a number of large loans in an industry and area - railroads and western States respectively - which were particularly hard hit by the panic of 1857. Although such a lending policy is properly subject to criticism by bank supervisors - and was so criticized as early as 1854 - there is little more that supervisory officials could do then (or can do today) when the bank is not insolvent and the disagreement is over the judgment exercised by bank officers.

The Bank Commissioners did not, nor could they be expected to, immediately develop a system of examination which resembles that which we have today. Despite their authority to examine fully into the affairs of the bank, considerable reliance seems to have been placed upon statements made by bank officials under oath. It is not entirely clear when, if ever, the Bank Commissioners began to rely upon their own appraisal of assets. Nevertheless, it is evident from their reports that by the 1840's they paid considerable attention to the character of a bank's assets, rather than to its volume, and assigned classifications to assets of the kind now being used by bank supervisory authorities.

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One of the major difficulties of bank supervision in Vermont during the insurance period seems to have been a reluctance on the part of the State legislature to fully support the Bank Commissioners. In the early years the legislature was caught up in the jurisdictional dispute between the Bank Inspector and the Bank Commissioners, apparently siding with the latter. But even after this dispute was resolved the legislature acted on few of the suggestions made by the various commissioners for improving the supervisory system. In 1855 the Bank Commissioner commented:

> I do not find any recommendation of any bank commissioner has ever been followed by the Legislature. From which it is fair to infer, that the State has been singularly unfortunate in its selection of Commissioners, or else the control of Vermont legislation, upon this subject, has fallen into hands which would accord to the banks the largest liberty. 1/

This remark seems to have been somewhat extreme, since there is evidence to indicate that at least a few recommendations had been adopted by the legislature over the years. However, the Bank Commissioner was probably correct in his implicit assessment of the attitude of the legislature towards a more strict supervisory system.

Appraisal of Vermont's Insurance Plan

Vermont's insurance system had only a limited success in attaining the objectives it sought. As has been described earlier, some replacement of circulating medium destroyed because of bank failure, and some protection of bank creditors, was accomplished through insurance. However, this protection was far less than was possible or desirable. Taking the long view, perhaps the most important success enjoyed by Vermont's insurance system was the introduction of important bank supervisory legislation.

The fact that 72 percent of all claims against the insurance fund were paid out of the fund obscures two important deficiencies in the degree of protection accorded creditors. First, in both cases of bank failure, payments from the fund were made many years after the claims were presented - and thus far too late to provide much protection against the consequences of destruction of the circulating medium. Second, more than two-fifths of the obligations of the failing banks were never presented for payment, and one of the reasons for this may well have been that holders had more faith in their ability to recover something on the notes themselves than on the ability of the insurance fund to provide the necessary amounts.

So far as bank supervision is concerned, the importance of the insurance law was that it introduced the idea that bank examiners should have complete access to bank records. Although it does not appear that supervisory officials made full use of this power - at least in the early years - the principle was undoubtedly important in the eventual development of effective supervisory procedures and of a sound banking system.

1/ "Bank Commissioner's Report," Report of Auditor of Accounts, 1855.

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The insurance plan adopted by Vermont suffered from certain internal weaknesses, particularly in the failure to provide for a borrowing power and in the manner in which assessments were levied. It will be recalled that New York remedied the first of these defects in its plan, but Vermont never did so. The drawback of levying assessments on capital rather than on insured obligations has been discussed in Chapter 2 in connection with the New York insurance plan.

The basic difficulty in Vermont did not stem from the plan itself but, instead, from the inability of the State to select one of a number of plans for the protection of bank creditors and stick to it. It will be recalled that in 1839, only a few years after the insurance plan was adopted, several banks were exempted from participating in insurance; and that in the next year a general law gave to all chartered banks the option of remaining in the insurance system or withdrawing and providing for the security of bank creditors by other means. Finally, free banking was authorized in Vermont in 1851, with none of the banks included in the insurance system. In view of these developments it is not too much to say that bank-obligation insurance was never really tested in Vermont.

It can easily be seen that many of the difficulties encountered by the insurance system were a reflection of the legal problems created by the State. For example, the Danby Bank had remained outside of the insurance system for a number of years; when it finally entered the system it had an opportunity to make only a partial contribution to the insurance fund before it failed. Another illustration is the mistake by the State Treasurer in refunding to banks withdrawing from the insurance system the amounts they had contributed to the fund. This was perhaps not so much his fault as the fault of the legislators who had provided for a general banking system in which there was considerable uncertainty as to the responsibilities of the individual banks.

How bank-obligation insurance would have fared in Vermont if the insurance system had embraced all banks is a legitimate subject of inquiry. It appears that the fund would have become liable for the payment of the obligations of four - or possibly five - additional failing banks between 1831 and 1858, and that the amount involved would have been upwards of $100,000. The additional assessment income would have been more than sufficient to pay this amount of claims, but would not have been sufficient to pay them at the times they would have been made. This is because most of the failures of nonparticipating banks were clustered in the depression years of the early 1840's or the panic of 1857. Accordingly, it seems reasonable to conclude that bank-obligation insurance in Vermont could have been made to operate successfully if the State had required all banks to participate and if a borrowing power had been granted to insurance authorities.

Comparison with other insurance systems. Vermont's insurance system is most logically compared with those adopted in New York and Michigan, since all three insurance plans were the same and all were placed into operation within a seven-year period, 1829-1836. In such a comparison it is clear that the Vermont system did not operate as successfully as did New York's, but was far more successful then the Michigan insurance system. As will be described in the following chapter, the Michigan system collapsed within a short time

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after it began operation and was not able to provide any protection to insured bank creditors.

The superiority of Vermont's insurance history over that of Michigan stemmed almost entirely from two facts: first, the Vermont system was in operation for a number of years before the first failure occurred, thus providing time during which an insurance fund could be accumulated; second, Vermont was free from the difficulties which Michigan faced at that time as a consequence of the unprecedented migration to the State. The reason for the more successful operation of New York's plan was probably also due to two facts: first, the New York legislature made significant improvements in the plan, particularly with respect to borrowing powers; second, although New York abandoned the idea of including all banks within the insurance system, the transition from an insurance to a bond-security plan was accomplished in a more orderly manner and over a longer period of time.

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CHAPTER IV

INSURANCE OF BANK OBLIGATIONS IN INDIANA, 1834-1865

Indiana was the third State to make use of the insurance principle in providing for the protection of bank creditors, and the first to establish a mutual guaranty system for this purpose. The plan was put in operation in 1834, following by several years legislation in New York and Vermont designed to protect bank creditors through the establishment of insurance funds. It became inoperative when most of the participating banks converted to national banks after 1864.

Review of Indiana Banking History to 1865

Banking prior to 1834. Two banks were chartered in Indiana shortly before the adoption of the State constitution in 1816: the Farmers and Mechanics Bank of Madison and the Bank of Vincennes. The former was apparently ably conducted and satisfied the modest banking requirements of its immediate area, but hostility on the part of the Bank of the United States forced it to cease operations about 1825. 1/ The Bank of Vincennes had failed earlier so that by 1825 there was no bank in operation in Indiana. 2/

State Bank of Indiana. By the end of 1833 it had become evident that the Federal charter of the second Bank of the United States would not be renewed in 1836. Since much of Indiana's currency consisted of notes of this bank, it was feared that its removal from the national scene would result in a severe contraction of the State's circulating medium. The State constitution of 1816 prohibited the establishment of any bank except a State Bank with branches and, consequently, an act chartering the State Bank of Indiana became law on January 28, 1834. The charter was to run to January 1, 1857, with an additional two years provided for winding up the bank's affairs.

Although the charter of the State Bank of Indiana seems to have been modeled in part on that of the second Bank of the United States, in structure the new bank was much different. As was pointed out in Chapter I, the State Bank of Indiana was not a large central bank with branch offices scattered throughout the State, but instead a federation of independent banks. Apparently this odd and sometimes confusing, structure was devised in order to circumvent the State constitution and permit the establishment of what was essentially a unit banking system.

1/ The closing was voluntary and as late as 1835 notes of the bank still circulated at par. There is some evidence that the bank briefly resumed operations in 1832.

2/ Some private banking may have been done by merchants, but there is no record of such activity. Most of the early settlements in Indiana were in the southern part of the State, along the Ohio River, and the banking business was probably handled by Cincinnati banks.

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The entire capital stock of the State Bank was divided among the so-called Branch Banks. The act required that all banking be done through these Branch Banks, each of which had its own officers and board of directors. Further, each Branch Bank distributed its earnings separately, to its own stockholders. While the State Bank had a president, cashier, and board of directors located at Indianapolis, their function was simply to supervise the activities of the Branch Banks. 1/ They may be compared with present-day State supervising authorities, though their powers included activities which would now be regarded as central bank functions. 2/

As originally established the State Bank consisted of ten Branch Banks, each with a capital of $160,000. By 1839 three additional Branch Banks had been placed in operation and the number thereafter remained at thirteen. 3/ With these additions, plus some further subscriptions to stock by the State, the capital of the State Bank, i.e., the Branch Banks combined, was raised to over $2,700,000 in 1841. In 1843 the legislature made provision for a reduction of capital, after which time it remained at about $2,000,000.

Of the original capital of $1,600,000, half was taken by the State and half reserved for private subscription. Individuals were required to pay $13.75 in specie per $50 share, with the remainder due in two equal, annual instalments. Because of the scarcity of funds for investment, the State agreed to loan subscribers the two annual payments. To secure the necessary funds for such loans, as well as to pay for its own stock, a State bond issue of $1,300,000 was authorized in the original act.

One-half of the capital of a Branch Bank had to be paid in specie, $50,000 by the State and $30,000 by individuals, before it was allowed to open. Subsequent payments also had to be in specie. By the fall of 1834 the requisite amounts had been secured and on November 19, 1834, the Governor issued a proclamation declaring the State Bank ready for business. The Branch Banks opened their doors about ten days later.

Not long after its start, the State Bank was faced with the panic of 1837, followed by a severe depression which lasted from 1839 until 1842. Although many Western banks were not able to survive this combination of events, the State Bank of Indiana came through successfully. Indeed, in August of 1842 the cashier was able to inform an eastern magazine that "the paper of this bank is the

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1/ Banking in the capital city was done by the Indianapolis Branch Bank. The term survives today in the name of Indiana's oldest bank, the National Branch Bank of Madison, Indiana.

2/ Throughout the remainder of this chapter all references to the State Bank, or its successor the Bank of the State, should be understood to mean the system of banks comprising the State Bank of Indiana. Branches of the State Bank and the Bank of the State are referred to here as the Branch Banks, though at the time they were simply called "the branches".

3/ The original Branch Banks, comprising the State Bank of Indiana, were located at Bedford, Evansville, Indianapolis, Lafayette, Lawrenceburgh, Madison, New Albany, Richmond, Terra Haute and Vincennes. Three additional Branch Banks were established: at Fort Wayne in November 1835, at South Bend in November 1838, and at Michigan City in December of the same year.

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standard currency in the West, from Pittsburg to New Orleans." 1/

Free banking. Following the depression, the State Bank had a prosperous, relatively uneventful career until the expiration of its charter in 1857. However, it did not continue to enjoy a monopoly of banking in the State since a new constitution, adopted in 1851, permitted the legislature to provide for the establishment of free banks. An act so doing became law on May 28, 1852, despite a veto by the Governor. Within six months 15 banks were formed and two years later, in 1854, about 90 free banks were in operation. Many were organized to meet the legitimate banking needs of their respective communities but others appear to have been unnecessary or even fraudulent.

In 1855 disturbances in the money market, combined with a lack of public confidence in the new banks, resulted in the failure of many of the free banks. The legislature revised the law in that year but the free banking principle was retained and the law itself remained the basic banking law of the State until well after the conclusion of the Civil War.

Bank of the State of Indiana. The new constitution also empowered the State to create a bank with branches, but ownership by the State of the stock of any bank (except for that already held in the State Bank of Indiana) was prohibited. Substantial opposition to the State Bank had developed, apparently because of its conservative management, and it proved impossible to secure a renewal of its charter. However, with a great deal of effort - some of it of a very dubious nature - a charter was secured on February 24, 1855, for a new system of banks, the Bank of the State of Indiana.

The Bank of the State of Indiana was very similar to the State Bank of Indiana except that the State no longer held stock in the Branch Banks and did not have the right to name the president of the system. Twenty Branch Banks were provided for and by 1858 all were in operation. 2/ At the peak, in 1862, combined Branch Bank capital amounted to over $3,300,000. Many of the old Branch Banks were brought into the new concern along with their key personnel so that the Bank of the State of Indiana was in fact the State Bank of Indiana in slightly altered attire.

Shortly after beginning business the new banking system, like its predecessor, was faced with a country-wide financial crisis which lasted from 1857 to 1859. It managed to survive the storm and only went out of business when most of the Branch Banks converted to

1/ Letter, August 24, 1842, Letterbooks of the State Bank of Indiana, MSS, Indiana State Library Archives, Indianapolis, Indiana. Hereafter the Letterbooks are referred to as "Indiana Letters."

2/ Branch Banks comprising the Bank of the State of Indiana were located in Bedford, Connersville, Evansville, Fort Wayne, Indianapolis, Jeffersonville, Lafayette, Laporte, Lawrenceburg, Lima, Logansport, Madison, Muncie, New Albany, Plymputh, Richmond, Rushville, South Bend, Terra Haute and Vincennes.

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national banks beginning about 1864.

Character of the Insurance Plan

Purpose of the insurance plan. No direct evidence is available on the functions which the Indiana legislature intended its insurance program to fulfill. Nevertheless, the clearly understood relationship between banking and the area's money supply, and the fact that no limit was placed on the amount of deposits and banknotes protected, indicate that the chief function of the insurance system was to protect the State from a collapse of its circulating medium caused by bank failures.

That the connection between bank lending and the circulating medium was recognized is indicated by the fact that the State Board began one of its first resolutions with the words: "Whereas the prime object of this, as well as all other well regulated banks, is to increase and regulate the circulating medium, to encourage trade and industry and to afford safe depositories ...". 1/ Similarly, in a circular letter to the Branch Banks, the president of the State Bank flatly asserted in 1837: "The institution was intended to furnish a sound currency on a specie basis." 2/

A second function which may well have been considered was that the insurance program would be of particular benefit to the holders of circulating notes in the event of a bank failure. Banknotes, especially those of small denominations, had a tendency to remain in general circulation, and bank failures often resulted in particular hardship upon tradesmen and laborers who customarily were paid with such notes. However, there was no greater protection given to noteholders than to depositors.

Obligations insured. The Indiana plan for the protection of bank creditors was embodied in three short sections of the act establishing the State Bank. Unlike the other five State programs for insurance of bank obligations instituted prior to 1860, it did not provide for the creation of an insurance fund. Instead, the Branch Banks were made "mutually responsible for all the debts, notes, and engagements of each other". 3/ The principal items covered by the mutual guaranty plan were circulating notes and individual deposits.

Methods of paying bank creditors. Payment of the debts of a failing Branch Bank was to be made by the other members of the system if, after the assets had been liquidated and the stockholders had made their required contributions, a deficiency existed. The directors of the State Bank were charged with the duty of calling upon

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1/ Resolution of November 21, 1834, Journal of the State Bank of Indiana, MS, Indiana State Library Archives, Indianapolis, Indiana. Hereafter, references to this volume are identified as "Journal".

2/ May 22, 1837, Indiana Letters, op. cit..

3/ An Act establishing a State Bank, January 28, 1834, section 9. Its counterpart in the charter of the Bank of the State of Indiana was worded in similar fashion and had the same section number.

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the Branch Banks for the necessary sum. 1/ If the amount realized from liquidation of assets and from contributions of the stockholders was not sufficient to meet all debts within one year, the State Bank was obliged to have the Branch Banks make up the deficiency then existing, at the same time turning over to them the remaining assets in return for such payments. 2/ The same plan for the mutual guaranty of bank creditors was carried over into the charter of the Bank of the State of Indiana. 3/

Admission of banks to insurance. Indiana's insurance program was restricted to the Branch Banks. These banks automatically became participating banks upon their formation, in much the same fashion as national banks become insured today. No provision was made or contemplated for the inclusion of any other banks in the insurance program. Indeed, for the first 17 years of its operation all Indiana banks were included since no other class of bank was permitted in the State.

Supervision and Regulation of Participating Banks

Supervisory authority. Responsibility for operation of the mutual guaranty system was given the President and Board of Directors of the State Bank and, after 1857, to the same personnel in the Bank of the State of Indiana. No other supervisory body was created. However, the General Assembly of Indiana did reserve to itself the right to investigate the Branch Banks and had the power, as did the Governor of the State, to institute court action to stop their operation or close them entirely. 4/

The Board of Directors was made up of four members appointed by the General Assembly and one representative from each of the Branch Banks. Consequently, there were seventeen directors of the State Bank (except for the first few years) and twenty-four of the Bank of the State. The President of the State Bank was chosen by the State legislature 5/, but this provision was dropped from the charter of the Bank of the State, and the president thereafter chosen by the Board of Directors from among its own members. 6/ Salaries and all other expenses arising from supervision of the two banking systems were met by assessments levied on the Branch Banks. Except for the president and cashier of the State Board it is unlikely that members of the board were expected to give full time to their duties.

1/ An Act establishing ..., section 46: An Act to establish a bank with branches, March 3, 1855, section 41. In the remainder of this study these Acts will be distinguished only by the year in which passed, i.e., 1834 or 1855.

2/ Section 47 (1834); Section 42 (1855).

3/ Sections 9, 41, and 42 (1855).

4/ Section 23 (1855). Unless there is specific mention otherwise, it should be assumed that statements as to the various regulations and provisions apply to both banking systems.

5/ Section 32 (1834).

6/ Section 29 (1855).

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It will be noted that in neither system were the State representatives a majority of the Board of Directors, even though the State at one time held 50 percent of all Branch Bank stock. As the president pointed out in his first report to the legislature:

> The state only appoints such a portion of the officers, that she can, through them at all times know the true situation of the institution; but the control has been wisely committed to persons chosen by the stockholders, that the steady course of individual enterprise may never be interrupted by political changes and revolutions. 1/

Bank examination. The supervising authority had ample access to information. The law required that it examine each Branch Bank at least once every six months and could do so more often if it saw fit or if the directors of any Branch Bank so requested. 2/ Also, the Branch Banks were required to send condition reports to the Board every month and could be made to do so more frequently if the Board desired. 3/

Functions of supervisory authority. As the supervisory authority for the Branch Banks the State Board was charged not only with examination of the banks but also with responsibility for the maintenance of a stable banking system. Consequently, it was given broad powers, some of which went much further than those given State supervisory authorities today. The most striking single power provided that the State Board could close a Branch Bank without the necessity of appealing to the courts or to any other State agency or official. 4/ Such action required a two-thirds vote of the Board and could be taken if, in the Board's opinion, a Branch Bank was guilty of any of the following offences: (1) had become insolvent, (2) was "mismanaging its affairs" so as to endanger the interests of the other Branch Banks, (3) had violated any of the provisions of the act creating the system, or of any other act pertaining to it, (4) had refused to comply with any legal directive of the State Board. 5/

A rather important power of the State Board related to the volume of business done by the Branch Banks. The 1834 act limited debts due the Branch Banks together, i.e., the State Bank, as well as those due an individual Branch Bank, to not more than twice the paid-in capital. Debts (exclusive of deposits) owed by the Branch Banks, separately or together, were limited to twice the paid-in

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1/ "Communication from the President of the State Bank to the Senate", December 5, 1834, Indiana State Journal, 1834-5, pp. 60-62. Underscoring in original. Directors of the individual Branch Banks were elected by stockholders, except for three appointed by the Board of Directors in the case of the State Bank and two in the case of the Bank of the State. The State appointed directors were less than a majority of the directorate of each Branch Bank. The acts made no mention of the voting rights of State-held stock and it does not appear that the State voted its stock. For requirements to be met by Branch Bank directors see section 71, 75 (1834); sections 66, 68 (1855).

2/ Section 41 (1834); Section 36 (1855).

3/ Section 43 (1834); Section 38 (1855).

4/ Section 44 (1834); Section 39 (1855).

5/ Sections 44, 49 (1834); Sections 39, 44 (1855). A permanent record of the vote of each director had to be made in these cases.

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capital. 1/ In 1836 this section was amended to permit the Branch Banks, at the discretion of the State Board, to increase their loans and discounts to not more than three times the amount of paid-in capital at any one date and to average not more than two and one-half times paid-in capital over the fiscal year. Essentially the same provisions were carried over into the charter of the Bank of the State in 1855. 2/

In addition to setting an upper limit beyond which the loans and discounts of the Branch Banks could not be expanded, the State Board was also given the further power to vary the ratio of loans and discounts to capital so that, at the lower limit, loans and discounts of any or all of the Branch Banks could be held to one and one-quarter times the paid-in capital. 3/ In contrast to the former provision, this was not typical of bank restrictions of the time and appears to resemble the authority over reserve requirements granted the Federal Reserve Board almost one hundred years later.

It was probably the case that the framers of the law were not interested in the amount of loans and discounts _per se_ but in the quantity of circulating notes. Since the granting of a loan commonly resulted in the creation of circulating notes it was assumed that a limitation on loans and discounts was at the same time a limitation on circulation. So strong was this feeling that in its first order to the Branch Banks the State Board apparently forgot that its authority was expressed in terms of loans and discounts and ordered: "Until the next quarterly meeting of the Board the several Branches shall not issue paper beyond once and a quarter the Capital paid ..." 4/ The president of the Madison Branch Bank was quick to note that the Board had technically exceeded its authority and he therefore ignored the order. The reaction of the State Board, expressed in a letter from its president, is significant: "I do not see how you cannot be mistaken in the intention of the parent Board to limit the loans and the discounts of the branches to once and a qtr. the Capital until the 2nd Monday of February next:--and in this way you should have construed the Resolution on that subject. Our Board has no power to limit the issue of Bank paper ..." 5/

The treatment of deposits in these restrictions should be noted. The 1834 law excluded deposits in limiting debts owed by the Branch Banks while the 1855 law restricted loans and discounts: "to an amount the average of which, for each fiscal year, shall not exceed their deposits and two and a half times the capital stock actually paid in ..." 6/ Apparently deposits were not thought of as a function of bank lending operations and, further, were traditionally considered to be in specie. Thus, as the 1855 provision

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1/ Section 98 (1834).
2/ Section 86 (1855).
3/ Section 40 (1834); Section 35 (1855).
4/ November 20, 1834, _Journal op. cit._.
5/ January 15, 1835, Indiana Letters, _op. cit._.
6/ Section 86 (1855).

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demonstrates, deposits could be included in the base against which the volume of loans and discounts was measured.

Despite the powers given the State Board, the Branch Banks retained a great deal of autonomy. Directors of each were chosen by the stockholders with the exception of a minority appointed by the State Board and, within the limits set forth by the act, the daily business of a Branch Bank was its own affair. 1/ Two points at which the authority of the Board touched this business might be cited: (1) no corporation could be indebted to a Branch Bank for more than $5,000 without consent of the Board, and (2) the Board had the power to limit the dividends of each Branch Bank to prevent capital impairment. Contrariwise, the Board had the right to close a Branch Bank if it was not able to pay a six percent annual dividend. 2/

Statutory limitations on bank operations. The architects of the Indiana system were evidently concerned over the possibility that the Branch Banks might engage in types of business other than banking. 3/ Consequently, after granting the usual banking powers the legislature went on to prohibit bank activity in two important areas. First, in a provision obviously aimed at speculative land booms, the Branch Banks were not permitted to deal in real estate, except to the extent necessary for the locations of their buildings. All real estate obtained through mortgage foreclosure had to be offered at public sale at least once each year. 4/ Second, both the 1834 and 1855 laws forbade the State Bank to "use or employ any part of its capital stock or other funds in the buying or selling of goods, wares, or merchandise, or in any other business or dealing, than is by this act authorized or permitted." 5/

A number of other restrictions, similar to those in other States at that time, were placed on the activities of the Branch Banks: (1) loans for which Branch Bank stock was offered as security were prohibited; (2) loans to individuals who were in arrears in any payments due the bank were prohibited, unless the amount due was retained out of the new loan; (3) security was never to be lessened when renewals were granted; (4) directors receiving loans were to be subject to the same terms as other borrowers; (5) the officers and directors of the State Bank or any of the Branch Banks could not endorse for one another, nor could they vote in matters pertaining to themselves; (6) loans of $500 or more required the consent of five-sevenths of the directors and (7) dividends could not be paid an individual indebted to a Branch Bank, although the sum due could be retained to his credit at the bank. 6/

1/ In the case of the State Bank, each branch was permitted from seven to ten directors, the number being determined by the State Board, which also appointed three of the directors; Section 67. Branch Banks of the Bank of the State could have between five and ten directors, the number still determined by the Board. However, in their case, the Board could only appoint two of the directors; Section 62.

2/ Sections 79, 54, and 57 (1834); Sections 74, 49, and 52 (1855).

3/ It was not unusual to find banks which also dealt in other businesses. This was particularly true of unauthorized banks.

4/ Section 6 (1834); Section 6 (1855).

5/ Section 19 (1834); Section 18 (1855).

6/ Section 79 (1834); Section 74 (1855).

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As was the case with almost every charter granted at that time, a maximum rate of interest was established on loans and discounts. In the case of the State Bank the rate was six per cent, 1/ but this was modified in the charter of the Bank of the State to whatever rate was legal in the State. 2/ A popular method in the West of evading such a limitation was to loan bank funds through brokers. There is no evidence that the State Bank had resorted to this practice but the implication is there since in 1855 it was specifically prohibited in the charter of the Bank of the State. 3/

Provisions affecting notes issued by the Branch Banks were less stringent than those of most States. Failure to redeem notes in specie entitled the holder to receive 12 percent interest from the time of refusal and also made the offending Branch Bank subject to closure. 4/ The issuance of post-notes; i.e., notes payable on demand in specie after a stated period of time, was permitted. 5/ Notes less than five dollars were prohibited, although for a short time in the early 1840's, when the suspension of specie payments led to a scarcity of small change, notes as small as one dollar were allowed. To guard against counterfeiting and to provide a uniform currency, the plates from which the notes of the Branch Banks were printed were held by the State Bank, which in turn furnished the Branch Banks with the required notes. 6/

Liability of bank stockholders and officers. The provisions of the 1834 and 1855 acts creating the Branch Banks were not entirely clear as to the liability of bank stockholders. 7/ However, it appears from a close examination of the relevant provisions that stockholders were subject to double liability in the event of a bank failure. 8/

So far as the officers and directors of the Branch Banks (and also of the State Bank and Bank of the State) were concerned, the act required that a failure be presumed to have resulted from their fraudulent action and placed upon the burden of proving otherwise upon the officers and directors. 9/ If they were unsuccessful their liability to the creditors of the bank was unlimited.

Number and Obligations of Indiana Banks, 1835-64

The thirty years during which Indiana's plan for the insurance of bank creditors was in effect may, for purposes of analysis,

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1/ Section 13 (1834).
2/ Section 13 (1855).
3/ Section 13 (1855).
4/ Section 8(1834); Section 8 (1855). The same penalty was provided in the event of a refusal to redeem deposits in specie. Other States often provided that the charter was forfeited if specie payments were suspended.
5/ Section 5 (1834); Section 8 (1855).
6/ Section 62 (1834); Section 57 (1855).
7/ Section 102 (1834); Section 90 (1855).
8/ See William F. Harding, "The State Bank of Indiana", Journal of Political Economy, December 1895, pp. 6-7.
9/ Sections 100, 101 (1834); Sections 88, 89 (1855).

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be divided into two sub-periods: 1835-51 and 1852-64. The former extends from the first full year of operation of the State Bank system to the last year in which banking in Indiana was restricted to the Branch Banks; 1/ the latter begins with the addition of free banks to Indiana's banking system and ends when most Branch Banks were preparing to convert to national banks. 2/

Table 22 shows the number of Branch Banks and their principal obligations for each year of both periods. Table 23 shows total circulation and deposits of individual Branch Banks for six selected dates.

Number and obligations of Branch Banks, 1835-51. Except for the first few years, 13 Branch Banks were in operation during this period. Ten of these had commenced business near the end of 1834, one had started in 1835, and two in 1838.

The importance of circulating notes relative to deposits, which was noted earlier, is illustrated by Table 22. It will be seen that after 1837 the amount of circulating notes was generally three to five times as large as total deposits. The reverse situation during the first three years, 1835-37, was due to large deposits which the Federal Government maintained with several of the Branch Banks. These deposits were a part of the large U. S. Treasury surplus which was deposited in selected State banks throughout the country. Beginning in 1837 the surplus was withdrawn from the banks and distributed among the various States.

The record of combined circulation and deposits of the Branch Banks between 1835 and 1851 reflects the intense prosperity period of 1835-36, the depression of 1839-42, and the recovery and subsequent period of stability of 1843-51. The severity of the 1839-42 depression is indicated by the fact that circulation and deposits declined about 45 percent in these years. This was probably the most trying period with which the Branch Banks were faced but no failures occurred. However, a contemplated increase in the number of Branch Banks was effectively checked and the number remained at 13 during the remainder of the period.

It will be noted from Table 23 that except for the first year there was no marked concentration of risk for the insurance system. For example, in 1851 the Madison and Indianapolis Branch Banks were the two largest banks, yet they had only about 21 percent

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1/ It may be assumed that there were several private banks in operation during the entire thirty years but data relating to them are lacking. Those few which issued banknotes, in apparent violation of the State constitution, were listed in the various banknote reporters of the period. However, their business was undoubtedly small and there does not appear to be any record of protest by the Branch Banks that their monopoly rights were violated.

2/ In 1865 the State legislature gave the Branch Banks official permission to liquidate and convert to national banks. However, it is clear that some had begun to do so in the preceding year. See John Jay Knox, A History of Banking in the United States, (New York: Bradford Rhodes & Co., 1900), p. 700.

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Table 22. Obligations, Indiana Branch Banks, 1835-64 1/
(Amounts in thousands of dollars)

Year 2/	Number of Branch Banks	Total obligations	Circulation	Deposits				Miscellaneous liabilities
				Total	Individual and business	Interbank	Government 3/	
1835	10	3,266	1,534	1,732	380	226	1,126	
1836	11	5,603	1,927	3,676	432	899	2,345	
1837	11	3,910	2,380	1,530	336	431	763	
1838	12 4/	3,941	2,952	989	394	323	272	
1839	13	3,695	2,985	710	320	272	118	
1840	13	3,652	3,031	621	298	183	140	
1841	13	3,722	3,136	586	272	157	157	
1842	13	2,182	1,828	354	184	81	89	
1843	13	2,602	2,311	291	189	54	48	
1844	13	3,538	3,101	437	293	52	92	
1845	13	4,163	3,667	496	359	76	61	
1846	13	3,960	3,337	623	410	121	92	
1847	13	4,458	3,606	852	556	104	192	
1848	13	4,260	3,552	708	453	154	101	
1849	13	4,071	3,304	767	476	107	184	
1850	13	4,177	3,422	755	556	118	81	
1851	13	4,870	3,935	935	630	171	134	
1852	13	5,094	3,861	1,233	805	108	320	
1553	13	4,829	3,832	994	716	171	107	
1854	13	3,977	2,995	946	630	274	42	36
1855	13	4,084	3,336	748	599	121	28	
1856	13	4,195	3,385	813	605	176	32	
1857	20	4,076	3,278 5/	798	625 5/	173 5/	--	
1858	20	5,657	4,502	1,141	986	155	--	14
1859	20	5,202	4,303	899	834	65	--	
1860	20	6,997	5,764	1,233	1,187	46	--	
1861	20	5,876	4,822 5/	1,054	979 5/	75 5/	--	
1862	20	7,898	5,516	2,382	2,040	342	--	
1863	20	7,648	5,680 5/	1,968	1,745 5/	223 5/	--	
1864	20	4,419	1,560	2,859	2,756	103	--	

1/ Sources: Harding, op. cit., Table IV; Annual Reports of the State Bank and Bank of the State.

2/ Most reports of condition were made in the second or third week of November.

3/ Includes deposits of both the Federal and State governments. After 1856 such deposits were apparently included with individual and business deposits.

4/ Michigan City Branch Bank was formed in December of 1838, after the report from which 1838 data were secured was submitted. It is possible that the data also do not include circulation and deposits of the South Bend Branch Bank which was formed just prior to the 1838 report.

5/ Estimated by subtracting from circulation and deposits for all Indiana banks, as shown in 1876 report of the Comptroller of the Currency, the respective amounts attributed to free banks, taken from State Auditor reports for the indicated years. Since the two sets of reports were presumably for different dates, and also because data for free banks were not always complete, the resulting estimates can only indicate the order of magnitude of the individual items.

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Table [illegible]. Circulation and Deposits, Indiana Branch Banks, Selected Dates 1/
(Amounts in thousands of dollars)

	Circulation plus Deposits											
	1835		1843		1851		1854		1858		1862	
	Total	Percent of total	Total	Percent of total	Total	Percent of total	Total	Percent of total	Total	Percent of total	Total	Percent of total
Branch Banks, total 2/	$3,265	100.0%	$2,602	100.0%	$4,872	100.0%	$3,939	100.0%	$5,646	100.0%	$7,896	100.0%
Branch banks located at:												
Bedford	149	4.6	172	6.6	193	4.0	134	3.4	241	4.3	309	3.9
Connersville									244	4.3	185	2.3
Evansville	176	5.4	144	5.5	327	6.7	331	8.4	325	5.8	617	7.8
Fort Wayne			284	10.9	419	8.6	346	8.8	228	4.0	331	4.2
Indianapolis	964	29.5	355	13.6	511	10.5	381	9.7	387	6.9	556	7.0
Jeffersonville									109	1.9	267	3.4
Lafayette	248	7.6	277	10.7	443	9.1	364	9.2	420	7.4	654	8.3
La Porte									229	4.1	338	4.3
Lawrenceburgh	251	7.7	79	3.0	474	9.7	450	11.4	265	4.7	455	5.8
Lima									203	3.6	244	3.1
Logansport									202	3.6	125	1.6
Madison	310	9.5	241	9.3	517	10.6	313	8.0	354	6.3	524	6.6
Michigan City			182	7.0	307	6.3	261	6.6				
Muncie									251	4.5	443	5.6
New Albany	247	7.6	114	4.4	389	8.0	190	4.8	465	8.2	553	7.0
Plymouth									189	3.3	175	2.2
Richmond	514	15.7	155	6.0	349	7.2	367	9.3	473	8.4	684	8.7
Rushville									231	4.1	271	3.4
South Bend			157	6.0	224	4.6	191	4.9	217	3.8	356	4.5
Terra Haute	215	6.6	231	8.9	395	8.1	322	8.2	323	5.7	514	6.5
Vincennes	191	5.8	211	8.1	324	6.6	289	7.3	290	5.1	295	3.8

1/ Source: Annual Reports of the State Bank and Bank of the State.
2/ May differ from totals shown in Table 22 because of rounding.

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of total circulation plus deposits.

Number and obligations of Branch Banks, 1852-64. The number of Branch Banks remained at 13 through 1856. When the Bank of the State of Indiana succeeded the State Bank there was a net increase of 7 Branch Banks, as 8 new ones were formed and 12 were continued in the old locations. Only Michigan City was not represented after 1856.

Total circulation and deposits of Branch Banks increased substantially during this period, reaching a high of almost $8 million in 1862. This was a reflection of the increased number of Branch Banks and, after 1860, of the impact of the Civil War upon the State's economy. These data, which are shown in Table 22, also reflect the panics of 1854 and 1857, both of which were weathered successfully by all of the Branch Banks. As in the first period, no Branch Banks failed, and the Branch Banks of Indiana thus compiled a remarkable record for stability over a thirty-year period marked by at least two severe depressions.

The volume of circulating notes continued to exceed total deposits in this period, although in the later years deposits tended to grow faster than circulating notes. The sharp decline of circulation in 1864 is presumably explained by the deliberate withdrawal of notes from circulation as the Branch Banks prepared to convert to national banks.

The distribution of total circulation and deposits among the individual Branch Banks during this period, as shown in Table 23, indicates that, to the end, the Indiana insurance system was not endangered by a concentration of risk in one or a few Branch Banks.

Number and obligations of all Indiana banks, 1852-64. Table 24 shows the number and obligations of all Indiana banks in the period 1852-64, by class of bank. The Table includes the free banks, which were authorized in 1852 but did not participate in the insurance program.

The number of free banks increased rapidly after 1852, reaching a high of 91 in 1855. Since the number of Branch Banks remained the same until 1857 only about 13 percent of all Indiana banks were participating in the insurance program in 1855. However, the larger size of the Branch Banks is indicated by the fact that even in 1855 almost half of the total circulation and deposits of all Indiana banks was protected by insurance.

The failure of many of the free banks in 1855 and in several of the following years, and the increase in the number of Branch Banks in 1857, resulted in a marked rise both in the proportion of all banks participating in insurance and the proportion of total circulation and deposits so covered. After 1857, and until the final year of the period under review, Branch Banks constituted more than half of all banks and their combined circulation and deposits amounted to about three-fourths of the State total.

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Table [illegible]. Obligations, All [illegible]iana Banks, 1852-64 1/
(Amounts in thou[illegible]s of dollars)

Year 2/	All banks		Branch Banks		Free Banks		Branch Banks as a percent of all banks	Percent of total obligations in Branch Banks
	Number	Obligations	Number	Obligations	Number	Obligations		
1852	28	6,184	13	5,094	15 3/	1,090 4/	46.4	82.4
1853	43	9,563	13	4,829	30	4,734	30.2	50.5
1854	103	15,472	13	3,977	90	11,495 5/	12.6	25.7
1855	104	9,084	13	4,084	91 6/	5,000 7/	12.5	45.0
1856	53	7,196	13	4,195	40	3,001	24.5	58.3
1857	46	7,038	20	4,076	26	2,962	43.5	57.9
1858	38	7,450	20	5,657	18	1,807	52.6	75.9
1859	37	7,161	20	5,202	17	1,959	54.1	72.6
1860	40	9,185	20	6,997	20	2,188	50.0	76.2
1861	38	7,672	20	5,876	18	1,796	52.6	76.6
1862	38	10,155	20	7,898	18	2,257	52.6	77.8
1863	34	10,248	20	7,648	14	2,600	58.8	74.6
1864	30	6,541	20	4,419	10	2,122	66.7	67.6

1/ Sources: Free bank data from Annual Reports of Auditor of the State, except as indicated below. For State Bank and Bank of State data see Table 22, note 1.

2/ Dates of reports of free banks and Branch Banks generally differed, in any one year, from two to five months.

3/ Maurice O'Rear, An Analysis of Commercial Banking in the State of Indiana, unpublished dissertation, University of Chicago.

4/ Circulation as reported by Ross (see note 6) for 15 free banks plus deposits as reported in January 1853 to Auditor of State by 10 free banks.

5/ Condition as of July 1, 1855, as reported in Governor's message (see note 4) plus deposits as reported by 46 banks on same date.

6/ "Report of the Joint Select Committee to Investigate the Condition of the Free Banks", Indiana Documents, 1853-54, pp. 915-918.

7/ Estimated from "Governor's Message to the General Assembly", January 4, 1855, Indiana Documents, 1853-54, and Auditor of State Report of condition of free banks as of January 1856.

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History of the Operation of the Insurance Plan

Branch Bank record. During the 30 years of operation of Indiana's insurance plan creditors of the participating banks enjoyed a degree of security unmatched by any other plan for the insurance of bank obligations. Not a single depositor or noteholder suffered a loss because of inability of a Branch Bank to meet its obligations.

No Branch Bank failed, though one suspended operations for a few months at the instigation of the State Board. The lending policies of the Lawrenceburgh Branch Bank had drawn the criticism of the Board for a number of years, beginning in 1839. 1/ Unable to resolve the difficulty, the State Board closed the bank in the fall of 1843 and the president announced that: "receivers are now in possession of the effects of the branch. Until redeemed by them, its paper will be taken as heretofore by the other branches ..." 2/

The situation of the branch, which apparently first appeared hopeless, was better than expected and only a few months were required to rights its affairs. No assessment was levied on the other Branch Banks, nor is there any evidence that a creditor of the Lawrenceburgh Branch Bank suffered a loss. The 1844 Annual Report to the State legislature noted: "the Lawrenceburgh Branch ... by order of the State Board, has been restored to its former functions and franchises, under auspices altogether favorable to its future prosperity and usefulness. The re-installment took place on the 26th day of February last ..." 3/ This seems to have ended the controversy and Lawrenceburgh continued to maintain one of the most active banks in the mutual guaranty system.

Comparison of records of Branch Banks and free banks. Unfortunately, the creditors of banks not participating in the Indiana insurance program did not fare as well. Between 1854 and 1863 no fewer than 68 free banks suspended operations. Fifty-three did so in the period 1854-55, while most of the remainder were not able to survive the panic of 1857. It will be recalled that at one time about 90 free banks were in operation so that the failure rate was well over 50 percent.

Losses suffered by creditors of the failing free banks do not, at first glance, appear to have been excessive. Free banks were required to secure their circulating notes by depositing Federal and/or State bonds with the State Auditor equal to 100 percent of the face value of the notes. 4/ Examination of the reports of the

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1/ January 22, 1839, Indiana Letters, op. cit..

2/ "Report of the President of the State Bank," December 1843, Indiana Documents, 1842-43.

3/ "Annual Report of the President of the State Bank," December 1844, Indiana Documents, 1843-44.

4/ This requirement was changed to 110 percent in 1855.

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State Auditor indicate that about $230,000 was lost by noteholders. At its peak, circulation of the free banks was about $9,000,000 so that the loss amounted to less than three percent of the total. Table 25 provides information on losses to noteholders.

Table 25

Losses to Noteholders, Indiana Free Banks, 1855-62 1/

Year	Number of suspensions	Note circulation at time of suspension	Amount of circulation not redeemed
1855	53	$2,860,134	$155,423
1856	-	-	-
1857	10	153,548	67,740
1858	1	908	-
1859	2	48,551	-
1860	-	-	-
1861	1	40,226	6,034
1862	1	-	-
Total	68	$3,103,367	$229,197

1/ Annual Reports of the Auditor of the State.

It is probable that the actual loss to holders of the notes at time of suspension was greater than the indicated sum. In the chaotic situation which characterized the free banking system in 1854 and for several years thereafter it is likely that many noteholders were persuaded by the banks or by speculators to part with their notes at substantial discounts.

It may be presumed that depositors in the free banks suffered a relatively greater loss than noteholders. Deposits had no special security beyond the general assets of the bank and the liability of the stockholders. Little information is available on these losses but when it is recalled that many of the banks were recklessly and even fraudulently operated it may be presumed that depositors were inadequately protected.

Losses to depositors in the case of the free banks take on added significance when it is pointed out that deposits constituted a larger percentage of combined free bank deposits and circulation than was true for the Branch Banks. In three of the years between 1853 and 1864 deposits in the free banks exceeded circulation and over the entire period deposits, on the average, were about equal in amount to circulation.

Appraisal of the Supervision and Management of the Branch Banks

Supervision of banks included in Indiana's mutual guaranty system appears to have been of particularly high quality over the

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entire period. 1/ The State Board was diligent in requiring that the Branch Banks conform with charter provisions. What discretionary authority the Board possessed was used primarily to insure the soundness of the individual Branch Banks and of the system as a whole even, as critics sometimes maintained, at the expense of depriving the State of the quantity of circulating medium which it needed.

Between 1834 and 1842 there occurred the Specie Circular of 1836, the withdrawal, beginning in 1837, of the large deposits of the Federal Government, the financial crisis of 1837 culminating in the countrywide suspension of specie payments, and, finally, a second suspension of specie payments followed by prolonged and severe depression. In addition, the State of Indiana contracted during this period for the construction of an elaborate system of internal improvements which later had to be abandoned. That the Branch Banks of Indiana were able to survive this combination of events, so disastrous for many of the nation's banks, can be attributed in part to the kind of supervision they received.

Adequacy of examinations. Examination of the Branch Banks by the State Board was required at least once every six months. From the success of the system in avoiding bank failures due to large defalcations or to mismanagement, it must be assumed that examinations were well conducted over the entire period. Certainly this was the case under the first president, Samuel Merrill, concerning whose examinations the cashier of one of the Branch Banks later commented:

> As no notice was ever given of the time these examinations were to be looked for, no special preparations could be made for them by the officers of the branches, and they were always of the most searching and thorough character. So searching and thorough were they that fraud and mismanagement could hardly have escaped detection. 2/

Some of the problems which faced these bank examiners were similar to those which examiners meet today, while others were peculiar to the time and area. Examination policies in 1840 are illustrated by the following letter, quoted in its entirety: 3/

1/ Three men served as president of the State Bank, between 1834 and 1857, while the Bank of the State had only one president during its relatively short life. This position, similar to that of a State Bank Commissioner today, was filled by Samuel Merrill, James Morrison, and Ebenezer Dumont for the State Bank, and by Hugh McCulloch for the Bank of the State. McCulloch later became the first Comptroller of the Currency, following which he served as Secretary of the Treasury in three administrations.

2/ Hugh McCulloch, Men and Measures of Half a Century, (New York: 1888), p. 114.

3/ March 9, 1840, Indiana Letters, op. cit..

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Ste. Bank March 9, 1840

Sir:

You are appointed an Examiner on the part of the State Bank to visit and examine the Branches at Fort Wayne, South Bend, and Michigan City, previous to the May Session of the State Board. You can consult your convenience as to time, but perhaps it would be best to go on horse back from your place to Fort Wayne, thence 80 miles to South Bend, Thence 37 to Michigan City, Thence by Laporte 82 miles to Logansport. I annex a copy of Interrogatories propourded to the Branches.

Yours Truly,
S. Merrill, Presd.

Question

No. 1. Do you know of any proceedings in your Branch which are not allowed by the Charter, and if so what are they?

No. 2. For what period are your notes discounted, and what is the usual requisition on renewing notes?

No. 3. Are there any Directors in your Branch who do not regularly pay the usual curtailments on their loans, and if so who are they, and on how many occasions since they have been Directors have they neglected to pay such curtailments?

No. 4. Are any of your stockholders permitted to renew their loans without curtailment, and if so what is the amount of their loans and the stock held by them?

No. 5. Can your stock be sold at par or over for cash, or on short credits, or if not, what prices can it be sold in either way?

No. 6. Are Notes renewed for persons who do not or cannot make any curtailment without requiring better security for the same, and if so what are the reasons for granting such favors?

No. 7. When notes are renewed without curtailment, are any reasons spread on the minutes by any of the Directors to prevent their being liable in their individual capacities for losses if such should occasion the insolvency of the Branch?

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No. 8. What is the amount due your Branch from persons who do not pay regular curtailments on their notes, and do any such persons obtain new discounts and if so, who are the persons obtaining these discounts, and what is the amount due from each?

No. 9. What is due from each of your Directors?

No. 10. What amount is due from stockholders who owe more than their stock and what is the amount of their stock?

No. 11. What amount of stock is owned by persons who owe nothing or less than their stock?

No. 12. What is the amount of actual payments on Bills and Notes the last 90 days and what is the usual proportion of payments?

No. 13. What is the amount of your Loans in the hands of Dry Goods Merchants and what amount of money has been loaned to this class of borrowers within the last 90 days?

No. 14. Do you know of any Loans being made by our Branch in the name of one person for the benefit of another, or do you know of any Directors or officer of the Bank who use the names of others to diminish their apparent indebtedness, and if so state the particulars?

No. 15. What is the suspended debt in your Branch, what part of it is in suit, what part is considered doubtful, and what part desperate?

No. 16. What is the usual premium charged on the purchase of Bills of exchange at the principal points where they are payable?

No. 17. What is the amount of purchased notes on hand, and what is the average discount charged?

No. 18. What amount beyond your present discounts could your Branch loan quarterly which would be punctually paid on an average of not more than six months?

No. 19. What preference if any is given to Directors and Stockholders?

No. 20. When business paper--of Merchants, Farmers, Manufacturers, exporters of produce, and other classes of business men apply for Loans--what is the order in which they are preferred?

No. 21 Are new discounts ever made to persons who suffer their paper, either for collection or loans to lie under protest?

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Loans to officers, directors and stockholders. It will be noted that a number of the questions in the above letter deal with loans to bank officers, directors, and stockholders. This is, of course, still an object of inquiry today, but the problem was much more acute at that time. Excessive loans of this sort were dangerous for a bank, not only because through constant renewal they turned into long-terms loans but also because they provided opponents of banking, who were then particularly strong, with telling arguments for the aboliton of all banking. Indeed, Merrill commented in a letter to Henry Clay in 1841: "Nearly all of the difficulties in managing our institution have arisen from the large loans to Directors and stockholders in a few br. who subscribed stock not for the Dividends but to borrow money." 1/

The letters of the President of the State Bank testify both to the concern with which supervisory officials viewed such loans and to their efforts to restrict them so far as possible.

One of the earliest and most serious cases involved the Lafayette Branch Bank. Apparently the cashier and several of the directors had borrowed quite heavily. The State Board strongly condemned this but the Board of Directors of the Branch Bank refused to do so. Thereupon, the State Board declared that either the offending officers leave or the Branch Bank would be suspended. One of the letters dealing with this case illustrates the attitude of the State Board:

> The requirement of Mr. _____'s resignation was not considered by any one of the State Board as a matter personal towards him, but he had been guilty of several matters which the Branch board had refused to disapprove ... All that the State board expect is that your branch shall by its safe, prudent and honorable management, recover and retain public confidence ... I suppose this might be done much more effectually even than by removing the Cashier if your Directors who are large borrowers would resign and their places could be supplied by prudent, sensible men, not borrowers ... If you think this can be brought about and it should be done very little inquiry will be made as to the Cashier and if he be as he ought to be, the agent of safe and prudent Directors, it is their business alone to select him. But to have Directors generally large borrowers, receiving special favors of the Cashier and each other; suffering their own notes to be under protest: refusing to disapprove misconduct in their agents: and favors at the expense of the bank granted by the Cashier to the Directors: such acts when taken together are of a character not to be tolerated. The State board must have assurance that matters will be managed otherwise or your branch must and will be suspended. Either Mr. ____ or the persons who have been tempted ... to use him to their own purposes must leave the branch. 2/

1/ May 29, 1841, Indiana Letters, op. cit.. Underscoring in the original.

2/ June 6, 1838, Indiana Letters, op. cit.. Underscoring in the original; names deleted by author.

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The Lafayette affair was ended with the resignation of the Cashier, but in the Lawrenceburgh case it will be recalled that suspension of the Branch Bank was the ultimate decision. Although the latter bank had violated a number of regulations of the State Board, its major offense was the favoritism shown certain of the stockholders and directors in making loans. In 1839, for example, Merrill wrote:

> I must fear that there are almost no stockholders in the Law. br. who hold the stock for any other purpose than to borrow money ... I fear too that there are at least three directors in the branch who would fail at once if they were called upon to pay even an eighth every three months ... I do not doubt the good intention of your Cash. according to his notions of propriety but I believe he manuvers too much. 1/

So critical was the problem of loans to stockholders of the Lawrenceburgh Branch Bank that, on one occasion, Merrill took the unusual step of writing directly to one such borrower, suggesting that if his loans and those of the other stockholders were not repaid the Branch Bank would have to be suspended. 2/

Although the Lafayette and Lawrenceburgh cases were perhaps the most serious, they were not the only ones to come to the attention of the State Board. Loans to stockholders and directors in the Branch Banks at Bedford, South Bend, and Michigan City also drew the criticism of the State Board. The Board did not object to all such loans but only to those which gave evidence of becoming permanent. Perhaps the best indication of its position is found in a letter from Merrill to the Cashier of the Lawrenceburgh Branch Bank:

> Though it may not be wrong to loan money to a Director for the promotion of public improvement, or for some useful object in the same manner as would be allowed to others, yet if Directors are suffered to renew their notes without curtailment the reason for each proceeding should appear on the minutes, and if the building a Mill or other sufficient cause be alleged for the grant of such a favor I suppose no complaint could be made. I notice that Mss. ____ and _____ have several times renewed their notes without any reduction. If there be any special cause why they are more favored than others, it would be well to state the same in a Resolution of your Board to be forwarded up to the State Board ... but if you have inadvertently made allowances in these cases which should not have been it would be well by Resolution of your Board to condemn the practice and abandon it hereafter. 3/

1/ August 3, 1839, Indiana Letters, op. cit..
2/ December 3, 1842, Indiana Letters, op. cit..
3/ March 3, 1840, Indiana Letters, op. cit.. Names deleted by author.

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Limitation of loans and discounts. The power of the State Board to vary the maximum ratio of loans and discounts to capital has been discussed earlier. From the nature of the period following the great depression of the early 1840's, it is doubtful that much use was made of this power. However, in the earlier years the record indicates that it was used frequently.

At the commencement of operations in 1834 loans and discounts were ordered held to the lowest level; i.e., one and a quarter times capital. 1/ In the prosperous period which followed, loans and discounts were permitted to increase almost to the limits set forth in the charter. However, in May of 1836 the State Board anticipated the panic which was to engulf the nation's money markets one year later. In view of the "state of the currency and exchange in the West, and the heavy demands made by the Secretary of the Treasury on the ... branches", the Board resolved that "the Branches be advised to prepare at the close of this present quarter to reduce their discounts to an amount not exceeding twice the amount of capital paid in, that they be advised to act with great Caution as to the Species of Business they encourage by Bank facilities." 2/

In November of the same year the restriction on discounts was lifted, only to be returned the next spring as a consequence of "the rapid withdrawal of the United States Deposites, and the confusion that now prevails in the money market." 3/ As was noted previously, several of the Branch Banks were among the banks used by the Federal Government for the deposit of its surplus balances. In June 1836, an act for the distribution of the surplus among the States was passed, to take effect January 1, 1837. It is possible that the Indiana deposit banks received their call for the deposits about April 1, 1837.

From the letters Merrill wrote in the months immediately following this order, it appears that difficulty was met in only two cases. On July 21, 1837, Hugh McCulloch, then Cashier of the Fort Wayne Branch Bank, was ordered to explain his tardiness in reducing discounts. 4/ Later in the same year, Merrill informed the Lafayette Branch Bank that the State Board would be forced to exercise its right to suspend a Branch Bank for failure to obey its orders unless a reasonable explanation of its course was provided. 5/ Evidently these warnings were sufficient and the erring banks brought back into line.

It soon became apparent that orders respecting the contraction of Branch Bank discounts ran counter to the Board's desire to encourage loans to individuals engaged in the export trade. Not only was the export of the surplus produce of the State essential to its economic growth but also, as is indicated in several of the questions in the examination letter, the Board felt that paper arising from the trade was ideally suited for the Branch Banks' portfolios.

1/ See p. IV-7 above.
2/ May 19, 1836, Journal, op. cit..
3/ Ibid., May 18, 1837.
4/ July 21, 1837, Indiana Letters, op. cit..
5/ September 8, 1837, Indiana Letters, op. cit..

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However, when the discount line was reduced the Branch Banks complied by allowing their holding of bills of exchange and other short paper to run off. At the same time, the volume of accommodation paper, i.e., renewable notes of individual borrowers not based on a particular commercial transaction, remained stationary. Consequently, starting in 1837, orders of the State Board relative to the ratio of loans and discounts to capital became more selective.

In November of 1837, the Board notified the Branch Banks that "whereas it is of great importance to the interests of this State that such bank accommodations should be extended to the exporters of produce ..." they were authorized to extend their discounts to two and one-quarter times paid-in capital by "discounting such paper". 1/ Later orders continued to favor this kind of paper and, at the same time, struck directly at accommodation notes. In August of 1839, discounts were restricted to one and one-quarter times capital, unless on prompt paper of not more than six months. 2/ As Merrill explained in a critical letter to the South Bend Branch Bank: "One of the orders or rules of the State Board for the government of the branches requires in substance that the branches respectively shall not discount accommodation notes exceeding once and a fourth the capital actually paid in." 3/

On occasion the State Board singled out individual Branch Banks in its orders. The banks at Lawrenceburgh, Madison, and New Albany were ordered in 1839 to keep at least one-third of their total discounts in bills of exchange not having more than four months to run. 4/ In 1840, the South Bend Branch Bank was ordered to hold its discounts to one and one-quarter times its paid-in capital and was forbidden to renew accommodation notes unless at least one-tenth of the principal was paid at each renewal. However, it was specifically authorized to discount up to $30,000 in new bills of exchange, provided they were not presented by individuals already indebted to the branch. 5/

Real estate loans. In the course of steering the Indiana banking system through its difficult early years, supervisory authorities had to contend with the effects of the speculative land boom which raged in the middle 1830's. The 1835 Annual Report of the State Bank to the legislature took a strong stand against loans based on real estate security. 6/ Private instructions which went to the Branch Banks indicate that the concern was real. In a letter to the officers of the Lafayette Branch, Merrill wrote: "As we have

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1/ November 25, 1837, Journal, op. cit..
2/ Ibid., August 14, 1839.
3/ October 27, 1840, Indiana Letters, op. cit..
4/ August 14, 1839, Journal, op. cit..
5/ November 11, 1840, Journal, op. cit..
6/ Report, December 12, 1835, op. cit..

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no difficulty in securing loans on real property not subject to such variations in price we reject in all cases where there is any suspicion of a high valuation and in general we take no town lots unless in very special cases." 1/ The fact that the Branch Banks weathered the collapse in land values which took place soon after, and which led to the failure of many western banks, is indication that the policy was successful.

Internal improvements loans. Merrill and the State Board had no illusions as to the danger the State internal improvements program held out for the Branch Banks. An 1840 letter emphatically warned against any "connection with the Internal Improvements of the State which it is highly important both for our credit and interest to avoid." 2/

Since the State was a stockholder and was represented in the management of the State Bank, the Branch Banks could not entirely ignore the program. However, they endeavored to serve only as transfer agents for internal improvement funds raised by the State through bond sales in the East and abroad. Money was advanced the State by the Branch Banks, which were then repaid out of the receipts of bond sales. However, when the State ran into difficulty in placing its bonds the Branch Banks found that they had in fact made long-term loans of about $700,000. This was the full extent of their participation, and although it resulted in some difficulties seems to have done no permanent damage.

Policy during suspension of specie payments. The Branch Banks, along with all other western banks and most banks in the country, were forced to suspend specie payments twice within five years after they had opened for business. The dates at which banks in the various States suspended differed but, in general, the two periods of suspension were from the spring of 1837 to the summer of 1838 and from the summer of 1839 to the summer of 1842. The State Bank of Indiana suspended specie payments in May 1837, and resumed in August 1838. It suspended again in November of 1839 and resumed, never to suspend again, in June of 1842.

In periods of suspension there was a strong temptation for unwise bank management to expand loans and discounts, even if prohibited by law. The reason, of course, was that banks were free of

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1/ February 1, 1836, Indiana Letters, op. cit.. Town lots, often located in towns not yet in existence, were a particular favorite of speculators.

2/ September 23, 1840, Indiana Letters, op. cit.. How disastrous such an alliance would be was illustrated by the case of the State Bank of Illinois. From the beginning the State regarded the bank as an important agent in its plans for internal improvements. To pay interest on the funds borrowed for internal improvements' purposes it invested heavily in bank stock, paying for the stock in additional state bonds which the bank was unable to dispose of. The decline in value of the bonds was an important factor in the failure of the State Bank of Illinois in 1842.

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the obligation of having to redeem their notes in specie and could thus operate on a smaller reserve. Such a policy usually proved to be disastrous, however, because of the abnormally large demand for specie when the breathing spell ended.

Supervisory authorities in Indiana did not permit the Branch Banks to become vulnerable in suspension periods. In March 1837, loans and discounts of the State Bank were the highest since 1834, amounting to well over $4,000,000. They then declined until the summer of 1838. The resumption of specie payments at about that time led to a new rise which carried loans and discounts to just under $5,000,000 in March 1839. The second suspension of specie payments, occurring in 1839, lasted until 1842. During this period loans and discounts showed some variation in response to the needs of the community but the trend was downward, so that when resumption took place in June of 1842 the total was well under $3,000,000.

Note circulation showed the same general movement. A peak was reached in April 1837, after which the trend was downward until the late summer of 1838. Another high was reached in June 1839, and thereafter circulation declined until November 1842.

Political entanglements. The bitter contest in 1832 between the major political parties over the rechartering of the second Bank of the United States made banking a leading issue in almost every political campaign during the 1830's and 1840's. The anti-bank forces, and especially the hard-money wing of the Democratic party, lost few opportunities to criticize banks, particularly the chartered institutions. In some States the failures of several of the leading banks were in great part due to such politically inspired attacks.

The State Bank of Indiana was not able to sidestep this problem completely. 1/ Nevertheless, it appears to have been the conscious policy of the supervisory authorities to avoid those practices which always provided fuel for anti-bank forces. Post-notes, for example, were in Merrill's opinion only justified in periods of crisis. 2/ When he discovered that the Lawrenceburgh Branch Bank was issuing such notes in 1839 he ordered it to stop and informed the Branch Banks that they were not to accept the notes. 3/ The avoidance of excessive lending to directors and stockholders has already been cited. Another unpopular activity of banks involved securing higher rates of interest than were permitted, through the device of "purchasing" notes or bills of exchange rather than discounting them. Typical of a number of letters by Merrill on this subject was one to an official of the Bedford Branch Bank: "The power

1/ One of the most severe political attacks was made in a report by Mr. Judah of the General Assembly, January 29, 1838. Journal of the House of Representatives, 22nd Session of the General Assembly, 1837-38. 2/ Post-notes were redeemable by the issuing bank only after a stated period, usually six months to a year, after the date of issue. They commonly did not pay interest.

3/ October 3, 1839, Indiana Letters, op. cit..

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referred to in the last query seems to be given by the Charter, but if exercised should be met with much caution." 1/

Supervision after 1845. After emerging from the depression period, the Branch Banks apparently continued to receive supervision which seemed directed to maintaining their soundness. Correspondence is not available for this period but continued maintenance of high capital ratios and substantial specie reserves testify to this policy.

The policy of favoring borrowers who were engaged in the export of surplus produce seems to have been continued and even intensified. Advances to exporters commonly took the form of discounting bills of exchange drawn on eastern and southern importers. Although several of the Branch Banks did a substantial amount of such business from the beginning, in 1835 the "bills of exchange" part of loans and discounts for all Branch Banks combined amounted to less than 25 percent. However, by the 1850's "bills of exchange" accounted for well over 75 percent of the discount business of the State Bank. The change in this aspect of the Branch Banks' business is illustrated in Table 26.

Perhaps the clearest indication that the State Bank continued to be managed in a conservative manner is supplied by the fact that the most frequent and telling criticism of the system was on the ground that it was not expanding the volume of currency as rapidly as was desirable. So effective was this charge that it was impossible for the State Bank to secure a renewal of its charter.

The organization of the Bank of the State of Indiana, as indicated previously, was effected only after some dubious, and possibly fraudulent, activities on the part of its promoters. As a result the public was understandably suspicious of the new system. Nevertheless, it

> very largely redeemed its reputation as a result of the very excellent management provided for it. Hugh McCulloch, a former president of the branch of the Second State Bank of Indiana located at Fort Wayne, was chosen as president of the new bank; and James M. Ray, former secretary of the board of directors and cashier of the Second State Bank of Indiana, was appointed cashier. 2/

Although little is known of the quality of supervision accorded Branch Banks during the later years, the fact that the banks weathered the panic of 1857 without even suspending specie payments,

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1/ December 27, 1834, Indiana Letters, op. cit..

2/ See Maurice O'Rear Ross, An Analysis of Commercial Banking in the State of Indiana, unpublished dissertation, University of Chicago. Ross refers to the State Bank as the "Second" State Bank "because the old Bank of Vincennes, chartered before Indiana became a State, had for a very brief period operated as the State Bank of Indiana."

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Table 26. Discounted Bills of Exchange, State Bank of Indiana, 1835-57 1/
(Amounts in thousands of dollars)

Year 1/	Total loans and discounts 2/	Discounted bills of exchange	Percent of loans and discounts
1835	1,811	376	24.9%
1836	3/	3/	3/
1837	3/	3/	3/
1838	3/	3/	3/
1839	3,940	724	18.4
1840	3,311	842	25.4
1841	3/	3/	3/
1842	3/	3/	3/
1843	1,970	366	18.6
1844	2,980	443	14.9
1845	3,028	1,197	39.5
1846	3,019	1,359	45.0
1847	3/	3/	3/
1848	3,439	1,791	52.1
1849	3,589	1,912	53.3
1850	4,125	2,415	58.5
1851	4,358	2,835	65.0
1852	4,250	2,765	65.1
1853	5,037	3,439	68.3
1854	4,199	3,335	81.0
1855	4,679	3,654	78.1
1856	3/	3/	3/
1857	798	299	37.5

1/ Data are for one date in each year, usually in November.
2/ The sum of "bills discounted" and "discounted bills of exchange".
3/ Not available.

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in contrast with most other banks, is indication that the quality of supervision continued to be high.

Appraisal of the Insurance Plan

In view of this fact that there were no failures among banks participating in Indiana's insurance system, an appraisal of that system must ascertain whether or not it was simply an unimportant appendage of the two successful banking systems which existed between 1834 and 1864. In other words, would creditors have fared just as well if Branch Banks had not been responsible for the unpaid debts of a failing member?

To fully appreciate the success of participating banks in Indiana, the banking experiences of several other western States might be cited. Two major banking crises occurred in these years: 1839-42 and 1857-59. When the first ended banking in the West had virtually disintengrated. In Michigan only an insurance company was left to do any banking. 1/ Ohio had eight banks in operation, where scarcely five years before there had been 35. The situation in Illinois was succinctly described by one observer with the comment "all the banks of Illinois have ceased to be", 2/ while in Wisconsin the few banks which had been chartered were gone and only the Wisconsin Marine and Fire Insurance Company of Milwaukee was left to meet the banking requirements of the northern Illinois and southern Wisconsin area.

Similarly, the years 1857-59 witnessed many bank failures. The most important single failure in the West - and possibly in the entire country - was that of the Ohio Life Insurance and Trust Company of Cincinnati. 3/ However, there were numerous others, especially among the free banks of Indiana and other States. Not only did all of the Indiana Branch Banks survive this crisis but they were among the very few banks in the entire country which did not suspend specie payments.

Five factors could be cited to account for the success of Indiana's Branch Banks: (1) the excellence of the supervision and management of the Branch Banks, (2) the restrictions of law under which the Branch Banks operated, (3) the large amount of paid-in specie with which the Branch Banks began business, (4) the avoidance of complete entanglement in the State's internal improvements program, and (5) the fact that no single Branch Bank became so large as to dominate the system.

1/ The panic of 1837 and the depression of 1839-42 are discussed in some detail in Chapter V, dealing with insurance of bank obligations in Michigan.

2/ George W. Dowrie, The Development of Banking in Illinois, 1817-63, University of Illinois Studies in the Social Sciences, II, 131.

3/ The panic of 1857 is discussed at somewhat greater length in Chapter VI, dealing with insurance of bank obligations in Ohio.

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While these factors were important, by themselves they are not a sufficient explanation of that success. Why, for example, was the supervision excellent? For the most part, officers of Branch Banks were inexperienced bankers in the early years, and even the president of the State Bank was new to banking. Harding has stated flatly: "the officers of the State bank were practically all without experience in banking." 1/ This is borne out in an examination of the letters of the first president which shows that one of his important tasks was to instruct many of the Branch Bank officers in some of the elementary principles of banking.

Granted that over-all supervision was of a high quality, why were the restrictive provisions of law observed at all? Michigan, for example, had excellent supervision of banks operating under its insurance plan but the main task of the examiners seems to have been that of closing up banks which refused to abide by the law. Certainly the Indiana restrictions were not unique. For example, the requirement that loans and discounts, as well as circulation, not exceed a certain multiple of the paid-in capital is found in almost every bank charter granted in the West at that time. Other restrictions, such as the prohibition of real estate dealings and the limiting of loans to directors and officers, were also common.

Similar questions might be asked regarding the other factors cited. How were the Indiana banks able to avoid becoming too closely allied with the internal improvements program? Granted that the law made possible a commencement of operations with a large specie reserve, why was a substantial reserve maintained during the entire period? In both cases higher profits lay in the opposite direction.

The answer to these questions is not found in differences between Indiana and its neighboring states. Indiana was virtually a frontier state when it established its new banking system in 1834. In the following years it was subject to the same waves of immigration and settlement, and suffered the same spells of feverish speculation in land, as did the other western States. The major occupation was agriculture and its industries were largely those connected with the preparation and export of surplus produce to the East and South. With the possible exception of Madison there were no commercial towns of any size in 1834. Even when the insurance plan ended Indiana was still an agricultural State and could boast of no cities comparable to Cincinnati or Chicago.

The key to an understanding of the success of the Indiana State Bank is found in the character of its insurance plan and of bank supervision. A number of essentially independent banks were placed under the general supervision of a common board of directors and president. Since each bank also had its own officers and board

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1/ Harding, op. cit., pp. 33-34.

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this would not appear, at first glance, to differ materially from the systems in other States, except that the supervisory authorities in other States were more often called Bank Commissioners rather than directors. However, there was two important differences: first, the supervisory board was made up almost entirely of representatives from each of the participating banks; second, supervision in Indiana included some functions of central banking.

Having each bank represented on the supervisory board could have been quite dangerous. In the event of violation of the law or the Board's directives by a Branch Bank, the same body would have been prosecutor, jury, and judge. The errors of one bank might well have been overlooked in hope that the favor would be returned in another instance. What made it work was the fact that the banks were mutually liable for the debts of a failing member.

The Branch Banks themselves were the ones immediately and directly affected in the event of the failure of any one, so each was vitally interested in the proper operation of every other Branch Bank. Since each was represented on the State Board, this interest could be, and was, translated into effective action. Add to this the fact the scope of the powers of the State Board and the important differences between the banking systems of Indiana and other States become clear.

Insurance of bank obligations in Indiana was a success because it helped make possible the operation of a banking system in which no bank failures occurred. Thus it achieved what is perhaps the ultimate goal of an insurance plan for the protection of bank creditors.

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INSURANCE OF BANK OBLIGATIONS IN MICHIGAN, 1836-1842

Michigan was the fourth State to make use of the insurance principle in providing for protection of bank creditors and the third to establish an insurance fund for this purpose. An "Act to create a fund for the benefit of the creditors of certain moneyed organizations" became law on March 28, 1836, shortly after Michigan had organized as a State and almost a year before it was admitted to the Union. The law became inoperative about 1842 as a result of the complete collapse of the Michigan banking system.

Review of Michigan Banking History to 1844

Michigan's banking history to 1844 opens with the stablishment of a fictitious bank and closes at a time when banking had almost disappeared in the State. In the interval there had been a meteoric rise in banking activity, followed by a collapse of awesome proportions. To an important degree the development of Michigan banking during this period was closely allied with population changes in the territory and State, a discussion of which is included below.

Michigan population changes, 1805-1844. The present State of Michigan was originally part of the "Old Northwest" Territory. The Michigan Territory, which included what is now the State of Wisconsin as well as Michigan, was settled more slowly than the other sections of the "Old Northwest", i.e., Ohio, Illinois, and Indiana. During the early decades of the 19th century much of Michigan's small population was of French-Canadian origin, attracted to Michigan by the fur industry.

During the 1820's settlers began to arrive in Michigan from New York and from several of the New England States. This movement was relatively slow, as is indicated by the fact that in the census of 1830 the population of the Michigan Territory was reported at slightly over 30,000 people. Only 16 counties, several of which were located in what is now Wisconsin, reported any residents at all.

For reasons which are still not altogether clear a veritable craze for Michigan land swept through the northeastern States beginning about 1832-33. This "Michigan fever," as it has been called by historians, saw tens of thousands of people, and sometimes entire villages, leave their homes in New York and New England to settle in Michigan. The magnitude of the influx - which probably reached a peak in 1836-37 - is reflected in the census figures which show Michigan population in 1840 in excess of 200,000 people, or about seven times the number in 1830.

County census figures provide even more dramatic examples of the consequences of the "Michigan fever." In 1840 thirty-two counties reported a population, compared with fewer than 16 (for the State of Michigan) in 1830. Among these were Lenawee County with less than 1500 people in 1830 but almost 18,000 residents in 1840, and Wayne County, which includes the city of Detroit, with fewer than 7,000 residents in 1830 but more than 24,000 in 1840. Among the counties reporting population for the first time in 1840 were

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Calhoun and Jackson, with 11,000 and 13,000 residents respectively.

Banking to 1834. Though Michigan was one of the last States to be carved out of the "Old Northwest" Territory, the first bank charter granted in the Territory was to a Michigan bank. In 1806 a charter for the Bank of Detroit was secured by several Boston speculators. The institution was possibly fraudulent and certainly did no actual banking business in Michigan It closed in 1807 and there was no bank in the Michigan Territory for the following ten years.

In 1817 a charter was granted the Bank of Michigan, at Detroit, which bank did a modest but successful business during the 1820's, becoming one of the leading Western banks in the 1830's. Its monopoly of banking in Michigan was not disturbed until 1827, when the Bank of Monroe received a charter from the legislature. This was followed with charters for the Farmers and Mechanics Bank at Detroit in 1829 and the Bank of the River Raisin at Monroe in 1833. Thus by 1834 there were four operating banks in the Michigan Territory, all of which were located at either Detroit or Monroe. The latter, at the west end of Lake Erie and about 25 miles south of Detroit, was at that time one of the important settlements in the Territory.

Bank legislation, 1835-37. The daily arrival of new settlers enabled Michigan to organize as a State in 1835 and brought demands for still more banking facilities. During the two years 1835-36 twelve new banks were chartered so that when Michigan was admitted to the Union in 1837 there were 16 authorized banks, most of which were in active operation. 1/

The flurry of bank chartering legislation in 1835-36 apparently caused the Michigan legislature to give some thought to the consequences of possible bank failures. Accordingly, on March 28, 1836, an insurance system almost identical with that adopted earlier in New York and Vermont was established.

Even the granting of 12 bank charters in 1835-36 did not satisfy the demands for banking facilities in the new State. As migration from the East continued additional applications for charters were made to the legislature. When that body met in January of 1837 it not only had to consider these demands but was also faced with indications of a developing nationwide financial crisis. The solution adopted was to pass the country's first free banking act, which permitted any 12 citizens to establish a bank upon meeting stated requirements. The rapid drafting and adoption of the law - it became effective on March 15, 1837 - was possible because the Michigan legislature simply used a preliminary version of New York's famous Free Banking Act of 1838.

1/ Michigan organized as a State in 1835 but a dispute with Ohio over the boundary delayed its admission to the Union until 1837.

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The destruction of banking, 1838-44. By the spring of 1838 the number of banks in Michigan had increased from 16 to more than 50 as free banks were opened in almost every community in the State. Banks were organized so rapidly that fraud and deception became commonplace. Difficulties were further compounded for the State by the panic of 1837 followed a year later by a severe depression.

By mid-1839 probably no more than ten of the free banks were still in operation and by 1840 all had closed. Although some had voluntarily liquidated, most failed during the second half of 1838. The chartered banks were also experiencing difficulty and by 1843 not a single bank was operating in the State. 1/ Only the Michigan Insurance Company of Detroit, an institution which was not chartered as a bank, was apparently doing a banking business at this time. An end was written to this period of banking history when the Supreme Court of the State ruled that the Free Banking Act was unconstitutional and that the free banks had never enjoyed legal existence.

Purpose and Character of the Insurance Plan

The heart of Michigan's insurance plan was an insurance fund which was to stand as a guarantee for the obligations of failed participating banks. In this, as well as in virtually every other respect, the plan was the same as that adopted by New York State in 1829.

Purpose of insurance. There is almost no information available on the motives which led Michigan to adopt an insurance program. They were very likely the same as those which actuated the New York legislature in 1829 and which were discussed in Chapter II. In other words, the Michigan legislature hoped to protect the State against destruction of circulating medium as a consequence of bank failures and, in addition, sought to protect the small bank creditor, who was usually a noteholder.

Obligations insured. The insurance plan extended protection to "such portion of the debts, exclusive of capital stock, of any of the said corporations which shall become insolvent, as shall remain unpaid ..." 2/ Thus insurance applied to circulating notes, deposits, and miscellaneous liabilities of participating banks.

There is no indication, either in the act or in contemporary records, that the Michigan legislature meant by the term "debts" anything other than the items noted above. Whether at a later time it would have been claimed - as was the case in New York - that insurance had been intended to apply only to circulating notes cannot be known because of the early collapse of the insurance system in Michigan. 3/

1/ Several of the chartered banks which closed in the early 1840's were later reorganized and resumed business.

2/ An Act to create a fund for the benefit of the creditors of certain moneyed organizations, March 28, 1836, section 4.

3/ It is interesting to observe that if there had really been some uncertainty in New York as to the extent of insurance coverage because of the precise meaning of the term "debts" such uncertainty should have been resolved by, or reflected in, the Michigan law. That this was not the case strengthens the conclusion in Chapter II that insurance was originally intended to apply to all bank obligations in New York.

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Insurance fund. The insurance fund was established by annual assessments of one-half of one percent on the paid-in capital of participating banks. 1/ Such payments were to be made until each bank paid an amount equal to three percent of its capital stock. No additional payments were to be made unless capital stock of the bank was increased or unless there was a loss to the insurance fund as a consequence of payments to creditors of insolvent banks. In the latter case special assessments, not to exceed the regular rate, were to be levied on participating banks until the insurance fund was restored to its maximum size. 2/

Assuming no change in its capital stock, each participating bank would make six or seven payments to the insurance fund. Seven payments were required if the bank took advantage of a provision of the law which permitted it to make the first payment after organization on the basis of the number of months the bank had been in actual operation. 3/ In ordinary circumstances this provision would be of negligible significance but it turned out to be of some consequence in Michigan's case, as will be shown later.

The insurance fund was the "property of the corporations [i.e., banks] by which the same shall be paid, in proportion to the amount which each of such corporations shall have contributed thereto ..." 4/ The Auditor General and the Treasurer of the State were directed to "keep proper accounts of the said fund separate and distinct from the funds of the State ..." 5/

Since the insurance fund remained the property of the banks, income from investments of the fund was to be returned to the banks in proportion to the amount which each had contributed. However, a first charge against the income was supervisory salaries. 6/

Method of paying creditors of failed banks. Upon failure of a participating bank the first payments to creditors were to be made by the receiver out of the liquidation of the bank's assets. After the final dividend the receiver was to be directed by a court of chancery to apply to the Auditor General for the amount needed, if any, from the insurance fund to pay the remaining debts of the failed banks. 7/ No provision was made for the issuance of warrants or similar instruments to bank creditors in the event that the insurance fund was smaller than the amount required. In such a case it was provided that the deficiency would be paid to the receiver out of the first monies received thereafter from assessments. 8/

As was true of the original New York act, no provision was made in the Michigan plan for the issuance and sale of securities to the general public if the insurance fund proved insufficient. There

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1/ An Act to create ..., section 2.
2/ Ibid., section 3.
3/ Ibid., section 2.
4/ Ibid., section 6.
5/ Ibid., section 5.
6/ Ibid., section 7.
7/ Ibid., section 9.
8/ Ibid., sections 10 and 11.

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was no mention of any distinction to be made in the payment of noteholders as compared with depositors, nor was there mention of use of the fund to restore the solvency of a failing bank.

Participation of banks. Insurance in Michigan applied to "every moneyed corporation having banking powers, hereafter to be created in this state, or when their charter shall be renewed or extended ..." 1/ In addition any bank chartered prior to March 28, 1836 had the option of becoming subject to the law before the expiration of the bank's charter. 2/ No provision was made for the voluntary withdrawal of a bank participating in the insurance system.

It was evidently the intention of the formulators of the Michigan plan to follow New York's lead and provide for the eventual inclusion of all banks in the insurance system. However, whereas New York abandoned this objective it was scrupulously adhered to in Michigan.

Michigan's Free Banking Act of 1837 was a version of one of a number of bills being considered in the New York legislature. In 1837 there seemed a good possibility that the New York legislation would include the new banks under New York's insurance system. However, there was a sharp shift of opinion in New York in mid-1837 as a consequence of the difficulties in which several of the already insured banks found themselves and the requirement that free banks be included in insurance was dropped from the New York bill, which became law in 1838. Michigan's version, passed a year earlier, reflected the 1837 climate of opinion, with the result that the "Act to organize and regulate banking associations" that year specifically provided that "every such association ... shall be subject to the provisions of this act and the act to create a fund for the benefit of creditors of certain moneyed corporations, and to such alterations of said acts as shall be made from time to time by the legislature."3/ This single provision was to provide more difficulties for insurance in Michigan than any other event which occurred.

Statutory Provisions Relating to Supervision and Regulation of Participating Banks

Modern procedures of bank supervision were an integral part of Michigan's insurance system. Briefly, the system provided for regular bank examination by salaried personnel specifically appointed for that task and empowered to make a thorough examination of all bank records. A discussion of the background and development of this type of bank supervision - which represented a radical departure from bank supervision to 1830 - is included in Chapter II.

Supervisory agency. Because of the relatively small number of banks originally included in the insurance system, the 1836 law

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1/ Ibid., section 1.

2/ An Act to create ..., section 32.

3/ An Act to organize and regulate banking associations, March 15, 1837, section 32.

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provided for a supervisory agency consisting of only one person, "to be styled the Bank Commissioner of the State of Michigan". 1/ No provision was made for additional staff. With the increase in the number of participating banks as a consequence of passage of the Free Banking Act the number of Bank Commissioners was raised to three. 2/

Michigan Bank Commissioners were to be appointed to two-year terms by the Governor, with the advice and consent of the legislature. 3/ Initially the salary of the Commissioner was $300 per year but when the number of Commissioners was raised to three in 1837 the salary of each was increased to $1,250 per year.

On March 25, 1840, Michigan ended bank supervision by an independent agency by abolishing the office of Bank Commissioner. 4/ This move was probably taken because the large number of bank failures during 1838-40 created doubts as to the usefulness of such an agency and, moreover, by March of 1840 there were few banks left to examine. The bank examination power was given to the Attorney General of the State but it was apparently to be used only at the request of the Governor. 5/

Bank examination and reports. Examination of each of the banks participating in the insurance system was to be made by the Bank Commissioners at least once in every four months and more frequently whenever any three participating banks so requested. 6/ The scope of examination was the same as that provided in the New York law. That is to say, it was made the duty of the examiners to

> thoroughly examine the affairs of said moneyed corporations, to examine all the books, papers, notes, bonds and other evidences of debt of said corporations; to compare the funds and property of said corporations with the statements to be made by them as hereinafter provided; to ascertain the quantity of specie the said corporations have on hand; and finally, to make such other inquiries as may be necessary to ascertain the actual condition of the said corporations and their ability to fulfill all the engagements made by them. 7/

1/ Ibid., section 15.

2/ An Act to amend An Act entitled An Act to organize and regulate banking associations, December 30, 1837, section 37.

3/ An Act to create ..., section 20.

4/ An Act to abolish the office of bank commissioner, and for other purposes, March 25, 1840, section 1.

5/ Ibid., "It shall be the duty of the Attorney General of this state, whenever by the Governor required, to institute an examination into the condition and affairs of banks and banking associations in this state, and to do and perform all the duties now or hereafter required to be done and performed by said bank commissioners ..."

6/ An Act to create ..., section 15 and 16. However, free banks were to be examined once every three months, and more often when requested by the Governor or any other free bank; An Act to organize ..., section 13.

7/ Ibid., section 15.

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In addition, the Commissioners were to question bank officials under oath, which oath the Commissioners were personally empowered to administer. 1/

The Bank Commissioners were given ample power to close and place in receivership any bank which they judged to be insolvent or to have violated the law. 2/ In addition, they could take steps to place a bank in receivership if it gave evidence of being in serious financial difficulties. The tests in such cases were: (1) if the capital of the bank was impaired to the extent that net sound capital was equal to or less than one-half of paid-in capital stock, or (2) if the bank had not redeemed its notes on demand in specie for a period of 90 days. 3/

There was no specific grant of authority to the Bank Commissioners which would permit them to act against continuance of unsafe and unsound banking practices. However, certain restrictions on bank operations were incorporated into the insurance law and also in the law authorizing free banks. Violations of these restrictions would, of course, have constituted violation of the law, for which offense the Commissioners could proceed against the bank in question as an insolvent institution.

Reports of condition in the cases of chartered banks were generally required by their charters. Free banks were required to submit reports of condition semiannually to the Bank Commissioners.4/ These reports were probably similar to those required of chartered banks. Items to be reported were: (1) circulation, (2) individual, partnership, and corporation deposits, (3) loans to directors, (4) loans to stockholders, (5) all other loans, (6) specie, (7) amount due from other banks, (8) real estate owned by the bank, and (9) capital paid in. 5/ Statements of condition of free banks were also to be published by the bank in a newspaper within the State. 6/

An annual report from the Bank Commissioners to the legislature was to be made in January of each year. 7/ These reports were to include a discussion of the Commissioners' activities during the year and abstracts from condition reports made to the Commissioners by the individual banks.

Bank operations. The act providing for an insurance system in Michigan contained relatively few provisions dealing with bank operations. This was because it was not originally anticipated that any but chartered banks would become subject to the law, and for these banks such provisions were included in the individual charters.

The most important limitations placed on bank operations by the 1836 law related to the volume of circulating notes and loans and discounts, and to maximum interest on loans and discounts.

1/ *Ibid.*, section 17.
2/ *Ibid.*, section 18.
3/ *Ibid.*, section 25.
4/ *An Act to organize ...*, section 24.
5/ *Ibid.*.
6/ *Ibid.*.
7/ *An Act to create ...*, section 19.

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Circulating notes could not exceed three times the capital stock paid in and the same ratio to capital applied to loans and discounts. 1/ It might be observed that these limitations were not as strict as those in New York's insurance act, which required that circulating notes not exceed twice, nor loans and discounts twice and a half, capital stock paid in.

Possibly to compensate for the cost of participation in the insurance program, the 1836 Act established the maximum interest rate for each bank at that permitted by its charter plus one-half percent. 2/ However, the additional one-half percent was not granted to any bank whose charter permitted a rate of seven percent. The act also required that all notes issued by banks be made payable on demand. 3/ In other words, "post-notes", i.e., notes usually payable six or twelve months after issue, were prohibited.

The liability of bank directors in the event of bank failure was spelled out in the 1836 act in the strongest possible terms. It was declared that any case of bank insolvency "shall be deemed fraudulent unless its affairs shall appear, upon investigation, to have been fairly and legally administered, and generally with ... care and diligence". 4/ In the event of insolvency the directors were "to repel by proof the presumption of fraud." 5/ The act did not provide for double liability of stockholders.

Michigan's Free Banking Act of 1837 contained numerous provisions relating to bank operations. Since the free banks were also included in the insurance system these provisions are summarized below because it is probable that they were generally similar to those appearing in the charters of the other banks.

The restrictions on circulation and on loans and discounts were somewhat tighter for free banks than for chartered banks since neither item was permitted to exceed twice and a half times the capital stock paid in. 6/ Deposits were not specifically mentioned in this connection, but were included in a provision which limited the total debts of a bank to an amount not to exceed three times the capital stock paid in. 7/

Directors of each bank were required by the 1837 Act to conduct their own examination once in each three-month period. 8/ In the event of failure, the liability of directors was unlimited and that of the stockholders was limited to the amount of their stock, i.e., double liability attached to free bank stock. 9/

1/ Ibid., section 24.
2/ Ibid., section 30.
3/ Ibid., section 31.
4/ Ibid., section 27.
5/ Ibid..
6/ An Act to organize ..., section 17.
7/ Ibid., section 25.
8/ Ibid., section 20.
9/ Ibid., section 25.

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Several other provisions of the 1837 Act also deserve mention. No free bank was to hold any real estate except as was necessary to conduct its business or as a consequence of foreclosure; neither could such a bank conduct other than a banking business. 1/ The maximum interest rate was set at seven percent. 2/ Finally, the amount of loans (direct or indirect), to all directors together, or to any single individual or company, could not exceed one-sixth of the total volume of loans and discounts permitted the bank. 3/

Number and Obligations of Michigan Banks, 1835-41

Michigan's published bank statistics for the period covered by this study are exceptionally poor because they omit data for a sizable number of banks. Accordingly, liberal use has been made of estimated data in this section in order to provide a more correct picture of Michigan banking experience. All data, both reported and estimated, relate only to commercial banks operating under State law.

Number of operating banks. As was described earlier, by the end of 1836 the Michigan legislature had issued charters for sixteen banks. Six of these charters were granted on or after the date of adoption of the insurance law and the banks concerned thus became subject to provisions of that law. A seventh bank, the Erie and Kalamazoo Railroad Bank, had received its charter prior to adoption of the insurance law but became subject to insurance by an act amending its charter passed on March 28, 1836. Thus, seven of the sixteen banks authorized by the end of 1836 were subject to participation in insurance, while nine were excluded from the insurance program until such times as their charters expired and were either extended or renewed.

Not all of Michigan's chartered banks actually went into operation by the end of 1836. As shown in Table 27, only twelve banks were operating at that time, and of these only four were participating in insurance. By mid-1837 all but one of the chartered banks had gone into operation. Michigan's Free Banking Act had been passed several months earlier but no free banks had as yet been organized. Consequently, on June 30, 1837, there were fifteen operating banks in Michigan, six of which were participating in the insurance program.

The following year, i.e., from June 1837 to June 1838, saw a marked change in Michigan's banking structure. The number of operating banks increased almost four-fold because of organization of free banks. All of these new banks were participants in the

1/ *Ibid.*, section 26.
2/ *Ibid.*, section 30.
3/ *Ibid.*, section 28.

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Table 27. Number and Percentage Distribution of Operating Banks, by Insurance Status, Michigan, 1835-1841

Year	Number of banks 1/					Percentage distribution				
	Total	Participating in insurance			Not participating in insurance 3/	All banks	Banks participating in insurance			Banks not participating in insurance
		Total	Chartered	Free 2/			Total	Chartered	Free	
1835										
Dec. 31	7	--	--	--	7	100.0	--	--	--	100.0
1836										
June 30	6	--	--	--	6	100.0	--	--	--	100.0
Dec. 31	12	4	4	--	8	100.0	33.3	33.3	--	66.7
1837										
June 30	15	6	6	--	9	100.0	40.0	40.0	--	60.0
Dec. 31	45	36	6	30	9	100.0	80.0	13.3	66.7	20.0
1838										
June 30	52	44	7	37	8 4/	100.0	84.6	13.5	71.1	15.4
Dec. 31	42	34	7	27	8	100.0	81.0	16.7	64.3	19.0
1839										
June 30	19	14	4	10	5	100.0	73.7	21.1	52.6	26.3
Dec. 31	13	8	4	4	5	100.0	61.5	30.8	30.7	38.5
1840										
June 30	7	1	1	--	6 5/	100.0	14.3	14.3	--	85.7
Dec. 31	7	1	1	--	6	100.0	14.3	14.3	--	85.7
1841										
June 30	5	--	--	--	5	100.0	--	--	--	100.0

Sources: The following periodicals were heavily relied upon in determing the dates of operation of Michigan banks: Bicknell's Counterfeit Detector and Bank Note List, various issues of 1835-40; Clark's New England Bank Note List and Counterfeit Bill Detector, various issues of 1838-39; Day's New York Bank Note List, various issues of 1836-40. Also useful were: United States Senate Documents; 23rd Congress, 1st Session, number 86; 24th, 1st, numbers 2, 226, 312, 313, 331, 356, 379, and 423; 24th, 2nd, numbers 2 and 21; United States House Documents; 24th Congress, 1st Session, number 42; 24th 2nd, number 65; 25th, 1st, numbers 2 and 30, 25th, 2nd, number 79, 25th, 3rd, number 2; 26th, 1st, number 172.

1/ See Appendix to this chapter for the names of operating banks.

2/ All numbers are minimum estimates by the writer. See Appendix A for a list of free banks, grouped by probability of operation.

3/ Chartered banks. Excludes one institution, the River Raisin and Lake Erie Railroad Company, which exercised (illegally) certain banking functions under its railroad charter.

4/ Includes the Michigan Insurance Company of Detroit, an institution which apparently exercised full banking powers beginning in 1838 and for the remainder of the period.

5/ Includes Bank of St. Clair, a chartered bank which was permitted to withdraw from the insurance system by a special act of the State legislature, March 19, 1840.

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insurance program, thus raising the proportion of participating banks from 40 percent to 85 percent of all banks. 1/

The rapid increase in the number of operating banks during 1837-38 was matched by an equally rapid decline during 1838-39. As can be seen from Table 27, the total number of operating banks in Michigan fell from 52 in June of 1838 to 19 by June 30, 1839, and to 7 by June 30, 1840. Of the banks still in operation on the last date only one was participating in the insurance system. Within the next year the last participating bank was closed. 2/

Obligations of all operating banks. During the period under review several of the Michigan banks not participating in the insurance system acted as "deposit banks" for the Federal government. The large volume of such deposits, plus the incomplete nature of published statistics, makes it difficult to compare the obligations of banks participating in insurance with those not included in the insurance program. Because more information is available on circulating notes, and to a lesser extent on individual and business deposits, estimates of these items are easier to prepare than estimates of total obligations. Consequently, Table 28 contains estimates of the total circulating notes and individual and business deposits of all operating banks in Michigan, with banks distributed by insurance status. It is believed that these data provide better information on the proportions of circulating medium attributable to the two groups of banks than would be the case with the inclusion of United States Government and interbank deposits.

On June 30, 1836, before any bank participating in insurance had gone into operation, Michigan banks had circulating notes and individual and business deposits of approximately two and a quarter million dollars. One year later the total of such obligations had declined to just under $2 million and it is estimated that about 20 percent represented obligations of newly organized participating banks and was therefore covered by insurance.

The volume of bank-obligations grew rapidly after June 30, 1837. By the end of 1837 circulating notes and individual and business deposits of Michigan banks exceeded $3 million, about two-fifths of which was covered by insurance. The relatively small size of participating banks is indicated by the fact that they comprised 80 percent of all operating banks on the same date.

The rapid formation of free banks explains the divergent movements in obligations of participating and nonparticipating banks during the early months of 1838. Circulating notes and

1/ There was a net decline of one in the number of chartered banks not participating in insurance, as two closed and one new bank, using an insurance company charter, opened for business.

2/ A list of Michigan free banks will be found in an appendix to this study.

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Table 28. Circulating Notes; Individual and Business Deposits of Operating Banks, by Insurance Status, Michigan, 1835-1841
(Amounts in thousands of dollars)

Year	Obligations of banks: 1/ Total	Participating in insurance: Total	Participating in insurance: Chartered	Participating in insurance: Free	Not participating in insurance	Percentage distribution of obligations of banks: Total	Participating in insurance: Total	Participating in insurance: Chartered	Participating in insurance: Free	Not participating in insurance
1835										
Dec. 31	1,795	--	--	--	1,795	100.0	--	--	--	100.0
1836										
June 30	2,224	--	--	--	2,224	100.0	--	--	--	100.0
Dec. 31	2,117	239	239	--	1,878	100.0	11.3	11.3	--	88.7
1837										
June 30	1,946	352	352	--	1,594	100.0	18.1	18.1	--	81.9
Dec. 31	3,088	1,198	448	750 2/	1,890	100.0	38.8	14.5	24.3	61.2
1838										
June 30	2,315	1,423	423	1,000 2/	892	100.0	61.5	18.3	43.2	38.5
Dec. 31	1,915	943	443	500 2/	972	100.0	49.2	23.1	26.1	50.8
1839										
June 30	976	388	338	50 2/	588	100.0	39.8	34.7	5.1	60.2
Dec. 31	905	395	362	33 3/	510	100.0	43.6	40.0	3.6	56.4
1840										
June 30	806	22	22	--	784	100.0	2.7	2.7	--	97.3
Dec. 31	920	22	22	--	898	100.0	2.4	2.4	--	97.6
1841										
June 30	765	--	--	--	765	100.0	--	--	--	100.0

Sources: See note on sources for Table 27, particularly government documents.

1/ "Obligations" as used here includes circulating notes and deposits of individuals, partnerships and corporations. It excludes, because of insufficiency of data, interbank deposits, deposits of United States government, and miscellaneous liabilities.

2/ Minimum estimates by writer.

3/ From returns from four free banks, U. S. House of Representatives Documents, 26th Congress, 1st Session, document number 172, p. 1298.

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individual and business deposits of banks not participating in insurance declined by more than one-half in the six months ended June 30, 1838 - reflecting the effects of the panic of 1837 - but the obligations of participating banks increased more than 20 percent during the same period. As a result, by June 30, 1838, more than 60 percent of the State's total of these obligations was protected by insurance.

The effects of the depression and of the closing of many participating banks are reflected in the bank-obligation data for 1839. Table 28 shows that by June 30, 1839, circulating notes and individual and business deposits of all Michigan banks were less than $1 million, two-fifths of which was attributable to participating banks and therefore insured. The following two years saw a further decline in circulating notes and individual and business deposits in Michigan banks as banks continued to close or contract their obligations.

Obligations of reporting banks. A more detailed picture of the composition of bank liabilities is given in Table 29, which shows liabilities as reported on three dates during the insurance period. The dates are: December 1, 1836, at about the height of the nationwide boom; February 1, 1838, after the general contraction of bank operations due to the panic of 1837 had begun but at the time when new free banks had just gone into operation; near January 1, 1839, after many of the free banks had closed and when the nationwide depression was getting underway. It should be kept in mind that not all operating banks made reports and that some reports were seriously inaccurate.

The 1836 reports provide information on seven banks, only two of which were included in the insurance system. It will be observed that less than a quarter of the deposits of the latter group of banks consisted of deposits of individuals, partnerships and corporations. The largest deposits were those of the United States Government and most of these were in two banks.

The relative importance of circulating notes also differed among banks. Thus, on December 1, 1836, circulating notes of the two banks participating in insurance were almost five times the total deposits in such banks, whereas in nonparticipating banks circulating notes were only two-fifths of total deposits. If deposits of United States Government are excluded from the latter tabulation circulating notes in nonparticipating banks were about equal to the volume of deposits.

In February 1838, total obligations of reporting banks participating in insurance were just under $1 million. Approximately half of this amount was attributable to 21 reporting free banks, with the remainder representing obligations of the six participating chartered banks in operation on that date. For both the free and chartered banks circulating notes were the most important type of obligation, comprising about three-fourths of the total obligations of all such banks. Deposits consisted largely of individual and business deposits, with a relatively small amount of interbank deposits and no reported United States Government deposits.

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Table 29. Total Obligations of Operating Banks, Michigan, Selected Dates, 1836-39
(Amounts in thousands of dollars)

Banks	December, 1836 1/							February, 1838 2/							January, 1839 3/						
	Total obligations	Circulating notes	Deposits: Total	Deposits: IPC	Deposits: Interbank	Deposits: US Gov't	Deposits: Other	Total obligations	Circulating notes	Deposits: Total	Deposits: IPC	Deposits: Interbank	Deposits: US Gov't	Deposits: Other	Total obligations	Circulating notes	Deposits: Total	Deposits: IPC	Deposits: Interbank	Deposits: US Gov't	Deposits: Other
All banks	3,768	1,229	2,539	619	218	1,537	165	3,399	1,579	1,820	975	176	640	29	3,009	962	2,047	675	320	333	719
Banks participating in insurance - total	180	147	33	31	2	--	--	988	735	253	209	43	--	1	890	460	430	238	192	--	--
Erie and Kalamazoo Railroad Bank	117	96	21	19	2	--	4/	80	63	17	15	1	--	1	57	40	17	17	4/	--	4/
Calhoun County Bank	5/							78	60	18	15	3	--	4/	104	55	49	12	37	--	4/
Clinton, Bank of	6/							86	67	19	9	10	--	4/	5/						
Constantine, Bank of	5/							40	30	10	10	7/	--	7/	53	40	13	13	4/	--	4/
Oakland County Bank	5/														10	10	--	--	--	--	--
St. Clair, Bank of	5/							69	64	5	5	7/	--	4/	116	115	1	1	--	--	4/
Ypsilanti, Bank of	63	51	12	12	4/	--	4/	118	109	9	8	1	--	4/	86	62	24	3	21	--	4/
Free Banks - total	5/							517 8/	342	175	147	28	--	4/	464 9/	138	326	192	134	--	4/
Banks not participating in insurance - total	3,588	1,082	2,506	588	216	1,537	165	2,411	844	1,567	766	133	640	28	2,119	502	1,617	437	128	333	719
Farmers & Mechanics Bank of Detroit	824 10/	254	570	175 11/	76	266	53 12/	491	149	342	191	4/	151 13/	4/	150	26	124	124	4/	4/	4/
Macomb County, Bank of	5/								6/						51	50	1	1	4/	--	4/
Michigan, Bank of	2,173 14/	490	1,683	304 11/	76	1,191	112 12/	1,174	343	831	274	68	489	4/	802 14/	160	642	148	68	333	93
Michigan Insurance Company	5/														6/						
Michigan State Bank	124	49	75	50 12/	25	--	4/	408	114	294	244 12/	40	--	10 13/	856	128	728	102	4/	--	626 15/
Monroe, Bank	191	147	44	44	4/	--	4/	5/													
Pontiac, Bank of	6/														34	30	4	4	4/	--	4/
River Raisin, Bank of the	276	142	134	15 11/	39	80	4/	159	91	68	39	16	--	13 13/	152	84	68	42	26	4/	4/
Tecumseh, Bank of	6/							80	70	10	10	7/	--	4/	74	24	50	16	34	--	4/
Washtenaw, Bank of	6/							99	77	22	8	9	--	5 13/	5/						

Sources: For December, 1836: U.S. House of Representatives Documents, 25th Congress, 2nd Session, document number 79, p. 813; U.S. Senate Documents, 24th Congress, 2nd Session, document number 21, pp. 26-27. For February, 1838 and January, 1839: U.S. House of Representatives Documents, 26th Congress, 1st Session, document number 172, pp. 1105-06; 1149-54.

1/ Data are for December 1.

2/ Data provided in response to a request by the State legislature on February 1, 1838. Data are assumed to relate to this date, or dates slightly later in February.

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Table 29. Total Obligations of Operating Banks, Michigan, Selected Dates, 1836-39
(Amounts in thousands of dollars)

3/ Data are from examinations or reports made at various dates, most of which were near December 31, 1838. Earliest date was November 21, 1838; latest date was January 21, 1839.
4/ None, or included with other items.
5/ Not in operation on this date.
6/ Not available.
7/ Less than $500.
8/ From returns from 21 free banks.
9/ From returns from 14 free banks.
10/ Includes branch at St. Joseph, Michigan.
11/ Total deposits as shown in document 79 less U. S. Government and other deposits shown in document 21. See Sources.
12/ Probably includes deposits of State government.
13/ Excess of assets over liabilities as shown on report giving only principal asset and liability items.
14/ Includes branch at Bronson, Michigan.
15/ Deposits of State Treasurer, consisting principally of receipts from sale of internal improvement bonds.

NOTE: Spaces left blank indicate bank was not in operation that date.

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On the same date reporting banks not participating in insurance had total obligations equal to about two and a half times the obligations of participating banks. Deposits of the United States Government still bulked large for several of these banks, thus bringing the total deposit figure for the nonparticipating banks substantially above the total of their circulating notes. It is interesting to observe, however, that when United States Government deposits are excluded, deposits of individuals, partnerships, and corporations were almost as large as the volume of circulating notes; while such deposits, plus interbank and other deposits, considerably exceeded the volume of circulating notes.

Reports for January 1839, reveal little new information about the relative importance of bank liabilities. Once again, banks not participating in insurance accounted for more than two-thirds of all bank obligations, which by this date had declined by about 10 percent since February 1838. Circulating notes still comprised the most important liability of participating banks, while for nonparticipating banks such notes were exceeded in importance by total deposits and about equaled in amount by deposits other than those of the United States and of the State of Michigan.

Among banks participating in insurance, interbank deposits were surprisingly large when compared with the two earlier dates. Most such deposits were attributable to free banks and probably represented concealed borrowings by these banks. Large deposits by the State of Michigan, representing receipts from a sale of bonds to finance internal improvements, account for the very marked increase in size of the Michigan State Bank, a nonparticipating bank. On the two earlier dates the Bank of Michigan, also nonparticipating, far exceeded in size any other bank, participating or nonparticipating. Indeed, the total obligations of the Bank of Michigan at the end of 1836 were more than 50 percent of the obligations of all reporting banks, while in February of 1838 they were more than a third of all such obligations. The decline of this bank to second largest by January of 1839 reflects, in addition to the large State deposits in the Michigan State Bank, the continued withdrawal of United States Government deposits.

The relatively greater importance of circulating notes for banks participating in insurance as compared with nonparticipating banks has been noted for each of the three reporting dates. This is largely an indication of the smaller size of participating banks and of the fact that they tended to be located in the smaller towns and villages of the State. For example, none of the chartered participating banks and only one of the free banks (the Detroit City Bank) was located in Detroit, the largest city in the State. In smaller population centers, and among relatively new banks, circulating notes were always more important than deposits.

So far as circulating notes alone are concerned, bank-obligation insurance was probably fairly extensive during most of the insurance period. It will be observed that in early 1838

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less than 30 percent of all bank obligations were insured but almost 50 percent of circulating notes were insured; approximately the same percentages apply to the January 1839 data. Also, on both of these dates reports are missing for many free banks, most of whose obligations were in the form of circulating notes.

History of Operation of Insurance System

Michigan's insurance system has a brief and rather dramatic history. Events moved so rapidly that a chronological rather than topical presentation seems warranted. An account of economic conditions, a discussion of the status of the insurance fund, and a record of bank failures is given below for the respective time periods.

March 28, 1836 through December 1836. The first nine months of bank-obligation insurance in Michigan were largely taken up with organizing the insurance system. There were no failures of participating banks during this period and, consequently, no call upon the insurance fund for assistance. However, during this period there were several developments which were to have an important bearing on the future of Michigan's insurance system.

1836 was a year of high-level economic activity. Prosperity was nationwide and was fully shared by western States such as Michigan. Perhaps the most significant characteristic of western economic activity was the rapid settlement of the area and the attendant boom in land values. The policy which the Federal Government had been following since about 1834 with respect to its surplus funds contributed to western prosperity. These funds, which had previously been deposited with the Bank of the United States, were being placed in selected State banks and those in western States, including Michigan, seemed to have been particularly favored.

In mid-1836 three events signalled the end of the nationwide boom. These were: the financial collapse in England as a consequence of restrictive monetary action by the Bank of England, the issuance of the "Specie Circular" by the Federal government on July 11, 1836, and the decision (on June 23, 1836) to distribute the Federal surplus among the various States. All three of these occurrences were instrumental in causing the panic of 1837 and the severe depression which began in 1839; and two were to weigh particularly hard on Western States such as Michigan. The "Specie Circular" ordered government land offices to accept only specie in payment for government lands after August 15, 1836. Thus in one stroke the use of banknotes for land purchase was eliminated; and it was largely the notes of western banks which had been so used. The distribution of the Federal surplus was scheduled to begin on January 1, 1837, with the amount each State received to be in proportion to its representation in Congress. This meant that the western States would suffer a net loss of such deposits.

The "Specie Circular" and the surplus distribution law threatened to exert tremendous pressure on bank reserves, which consisted of specie or specie funds, so long as specie payments were required by law. The effect would be similar to the kind of pressure on bank operations which would be exerted today under a drastic policy of drawing reserves out of the banking system.

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By the end of 1836 the Michigan insurance system was thus in the position of having gone into operation during the final stages of a boom and just before economic disaster was to strike the country. As described earlier, only four participating banks had been started by that time. Although each had probably made a partial payment into the insurance fund there is no record of the financial condition of the fund on or near December 31, 1836.

January 1837, through July 1837. The seven-month period ending with July 1837, saw the development of the financial crisis foreshadowed by Federal monetary policy of 1836. Also, the Michigan legislature compounded the difficulties in store for the new insurance system by taking steps designed to alleviate the monetary stringency. However, as was the case during the preceding period, events through July 1837, were to become important at a later date; there were no current failures of participating or nonparticipating banks and consequently no necessity for the insurance system to make provision for the payment of creditors.

The Federal Government made its initial call for funds on deposit in selected State banks at the beginning of 1837. The effect of these withdrawals on Michigan's banking system can be judged from the statements of the two largest banks in the State. As shown in Table 29, on December 1, 1836, the Bank of Michigan had total deposits of $1,683,000, of which $1,191,000 represented deposits of the United States Government. Six months later, on May 1, 1837, United States Government deposits in the Bank of Michigan were $592,000! In the case of the Farmers and Mechanics Bank, withdrawal of United States Government deposits had started in the fall of 1836. From a total of $1,266,000 of such deposits, withdrawals to May of 1837 brought the total to less than $500,000!

The Michigan legislature apparently believed it could offset the contraction of bank operations by passing the Free Banking Act of March 15, 1837. This is suggested, for example, in the report of the Bank Commissioner at the end of 1837, which stated: "In supplying a circulating medium at home the want of which was already greatly felt, the banks which have gone into operation under the general banking law have effected a sensible relief, and have thus acquired a not unmerited popularity." 1/

Scarcely had the Free Banking Act become effective when the developing crisis came to a head. On May 10, 1837, the New York City banks announced the suspension of specie payments and within the next several weeks almost every bank in the country followed suit. The legislature authorized Michigan banks to suspend specie payments by an act signed into law on June 22, 1837, although probably many of the banks had suspended a month earlier. 2/ Suspension was permitted

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1/ "Annual Report of the Bank Commissioner of the State of Michigan," December 6, 1837, Documents Accompanying the Journal of the Senate of the State of Michigan, Annual Session 1838, document number 2.

2/ An Act suspending for a limited time certain provisions of law, and for other purposes, June 22, 1837.

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until May 16, 1838, at which time the banks were required to resume specie payments. This applied to all operating banks and, in addition, to all banks put into operation prior to May 16, 1838. 1/ Thus it opened the way for banks to organize under the Free Banking Act without the necessity of redeeming their notes in specie during the first months of operation.

There are no available data on receipts or expenditures of the insurance fund for the seven months ending with July 1837. Presumably, each of the six banks participating in insurance had made at least one payment into the fund by that date.

August 1837, through December 1837. In August 1837, the Farmers Bank of Homer commenced operations, becoming the first bank to start business under the Free Banking Act. The formation of 29 additional free banks during the remaining months of the year was the most significant development in this period of Michigan's insurance history

It will be recalled from Table 28 that during the latter part of 1837 there was a 50 percent increase in circulating notes and individual and business deposits of Michigan banks. This was due to two factors: the opening of the 30 free banks and, second, the expansion of operations of all operating banks as a consequence of the act permitting suspension of specie payments. The increase in liabilities of operating banks during a period of suspension of specie payments was not prudent banking but was to be expected since the suspension act was tantamount to the removal of all reserve requirements. With the rapid pace of western economic development it would have required exceptionally skillful and conservative bankers to have reacted otherwise. However, specie, which was always in short supply in a frontier community, was being further diminished by the withdrawal of United States Government funds from Michigan so that during late 1837 all Michigan banks were becoming increasingly vulnerable to any adverse economic development.

The potential danger was evident to some observers at the time. While visiting Michigan an official of a Wisconsin bank wrote these prophetic words in a private letter:

> The suspension law extends as well to those who have not commenced business as to those that have. If the system is not going to produce an explosion in the end, I am very much mistaken. The people appear to like it. Good, easy, souls, they little dream of what they are nourishing. 2/

It is presumed that most banks participating in insurance by the end of 1837 made some payment into the insurance fund at the time of their organization. For many such payment would have been

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1/ This was later amended (December 28, 1837) to forbid the suspension of specie payments by any bank going into operation after January 1, 1838.

2/ Letter, December 4, 1837; Morgan L. Martin Papers, MSS, State Historical Society of Wisconsin Library, Madison, Wisconsin.

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exceedingly small since more free banks were organized in December than in any other month in 1837. Each of the banks organized during the final month of the year, if it made any payment at all, was only required to pay in proportion to the time it was in operation, i.e., one-twelfth of its full annual assessment.

There is no detailed information on receipts and disbursements of the insurance fund during the whole or any part of 1837. However, a report for 1838 does give the status of the fund as of the end of 1837. At that date there was available for the protection of bank creditors the sum of $145.14. 1/

1838. For all practical purposes bank-obligation insurance in Michigan collapsed during the early months of 1838 as the insurance fund was faced with bank failures involving hundreds of thousands of dollars more than was available for insurance purposes. Table 30 shows the number and obligations of banks which ceased operations during 1838 and during the two following years.

During the first quarter of 1838 six free banks suspended operations. These banks, comprising one-sixth of all banks participating in insurance, had obligations at time of failure of $193,000. Although the insurance fund was only obligated for the deficiency remaining after liquidation, the fraudulent organization and operation of several of these banks assured that the total which would eventually be claimed from the fund would far exceed the $145 available at the beginning of 1838. For example, the Bank Commissioners estimated the loss in the case of one of these six banks as $25,000.

Events in the months to follow merely brought additional difficulties to the insurance system. The attempt to resume specie payments on May 16, 1838, as required by law, had precisely the effect which some persons had anticipated. During the second and third quarters of 1838 ten more free banks suspended with total obligations in excess of $250,000.

As noted in Table 30, there were probably additional failures in the fourth quarter of 1838 but no precise information is available in this connection. It is of some significance that all 16 failures known to have occurred during 1838 were free banks; none of the chartered banks participating in insurance failed. However, two chartered banks not participating in insurance did fail in 1838; one near the beginning of the year and one in August.

There is no record of payments on behalf of creditors of failed participating banks during 1838. This is to be expected since it is doubtful that liquidation of any of the failed banks had been completed by the end of the year.

1/ Documents Accompanying the Journal of the Senate of the State of Michigan, Annual Session 1839; document number 2, December 31, 1838. On January 1, 1838 the State Treasurer reported receipts totaling $592.96 from payments by four participating banks on behalf of a ½ of 1 percent regular tax on bank capital. Since they paid this tax the same banks may also have paid the insurance assessment, total receipts from which would also have been $592.96. Documents Accompanying the Journal of the Senate of the State of Michigan, Annual Session 1838, document number 5, January 1, 1838.

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Table 30. Participating Banks Ceasing Operations, Michigan Bank-Obligation Insurance System, 1838-1840
(Amounts in thousands of dollars)

Year and quarter 1/	Banks in operation at beginning of quarter		Banks becoming insolvent				Banks liquidating voluntarily or closing for reasons unknown	
			Number		Obligations 3/			
	Number	Obligations 2/	Total	As percent of number of operating banks	Total	As percent of obligations of operating banks	Number	Obligations 4/
1838-40	...	...	39	...	$1,091	...	10	$150
1838-1	36	1,198	6	16.7	193 5/	16.1	--	--
-2	44 6/	1,310	1	2.3	42	3.2	--	--
-3	44 7/	1,423	9	20.4	214 8/	15.0	1	20
-4	34	1,183	-- 9/	--	-- 9/	--	--	--
1839-1	34	943	9 10/	26.5	316 11/	33.5	5	82
-2	20	665	5 12/	25.0	60 13/	9.0	1 14/	12 13/
-3	14	388	2	14.3	24 13/	6.2	1 14/	12 13/
-4	11	391	2	18.2	24 13/	6.1	1 14/	12 13/
1840-1	8	395	5 15/	62.5	218 16/	55.2	1 14/	12 13/
-2	1 17/	22	--	--	--	--	--	--
-3	1	22	--	--	--	--	--	--
-4	1 18/	22	--	--	--	--	--	--

Sources: See Table 27.

1/ Quarter-year periods are considered as beginning on the first days of January, April, July, and October.

2/ First and third quarter dates are from Table 2. Second and fourth quarter data are interpolations.

3/ Circulation plus individual and business deposits at time of failure or last report prior to failure.

4/ Circulation plus individual and business deposits at date of closing or last report prior to closing.

5/ Includes Bank of Lapeer for which no information is available on obligations. The sum of $25,000, estimated by the Bank Commissioners as the ultimate loss, was included in the total.

6/ Six failures during the first quarter of 1838 were offset by 13 free banks and one chartered bank beginning operation during the quarter.

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Table 30. Participating Banks Ceasing Operations, Michigan Bank-Obligation Insurance System, 1838-1840 (cont'd)
(Amounts in thousands of dollars)

7/ One failure during the second quarter of 1838 was offset by one free bank beginning operations.

8/ Includes an estimated $25,000 of obligations of two banks (Berrien County Bank; Peoples Bank of Grand River) for which there is no information on obligations at time of failure, or at any previous time.

9/ It is probable that some of the failures shown for the first quarter of 1839 occurred during this quarter.

10/ Includes two chartered banks (Bank of Ypsilanti; Bank of Clinton) with estimated obligations of $141,000.

11/ Includes an estimated $25,000 of obligations of two banks (Bank of Coldwater; Saginaw City Bank) for which there is no information on obligations at time of failure, or at any previous time.

12/ Includes one chartered bank: Oakland County Bank.

13/ Estimated: each bank arbitrarily assumed to have had obligations amounting to $12,000.

14/ No information is available on the number of banks voluntarily liquidating during these quarters as compared with those which failed. It is arbitarily assumed that of the 18 which closed during these four quarters at least four did so voluntarily.

15/ Includes two chartered banks: Calhoun County Bank; Erie and Kalamazoo Railroad Bank.

16/ Estimated: $12,000 total obligations arbitrarily assigned each of the three free banks; $182,000 of obligations of the two chartered banks is an estimate based on earlier reports.

17/ In addition to the six participating banks which closed, the Bank of St. Clair, a chartered bank, was permitted to leave the insurance system by virtue of a special act of the legislature on March 19, 1840.

18/ The Bank of Constantine, a chartered bank and the last remaining participant in insurance, failed at about the end of 1840 or early in 1841, obligations shown are of the order of magnitude of those shown in its last report, September 1839.

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For the year 1838 the first detailed record of receipts and expenditures of the insurance system is available. 1/ This report shows receipts in excess of $1,100 and expenditures of only $51.00. Receipts came entirely from assessments; there is no record of income from invested funds. Sixteen free banks paid a total of $542.75 in assessments, while three chartered banks paid assessments amounting to $623.49.

The receipts and disbursements shown above would have left the insurance fund at the end of the year with a balance of approximately $1,250. However, it must be presumed that the salaries of the Bank Commissioners, which by law were a charge against the insurance fund, were paid and that, in fact, the insurance fund did not have a real balance at the end of 1838.

<u>1839</u>. If there was any doubt about the insolvency of the insurance fund at the end of 1838 it was quickly dispelled in 1839. More important, events occurring during 1839 were not so much unfavorable to the insurance system - which was already beyond help - as reflective of the beginning of the disintegration of Michigan's entire banking system. Although there had been a partial recovery from the consequences of the panic of 1837 by the middle of 1839 another downturn began, which continued for almost four years.

As shown in Table 30, 26 of the 34 participating banks in operation at the beginning of the year closed during 1839. At least 18 of these 26 banks closed because of insolvency and their obligations at the time of closing were in excess of $400,000. Three of the 18 failed participating banks were chartered banks, the remaining 15 being, of course, free banks. Whereas the bank suspension of 1838 can possibly be attributed to the early discovery of inadequately capitalized banks organized during the hectic months of late 1837, the failures during 1839 involved the large majority of all participating banks, including chartered banks with sizable amounts of obligations and operating records of several years.

Failures among nonparticipating banks also became serious as two such banks closed during 1839. In addition, one of the larger nonparticipating banks (Michigan State Bank) appears to have suspended operations at about this time. There is some evidence that this bank resumed operations at a later date but as of December 31, 1839, only five nonparticipating banks were doing business. This represented a 50 percent decline in the number of such banks.

Too late, the Michigan legislature now attempted to prevent further deterioration of the banking situation by repealing the Free Banking Act. In a measure with the interesting and significant title: "An Act more effectively to protect the public against various frauds," the legislature prohibited the formation of any new banks under the 1837 law and ordered closed all such banks which had not completed

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1/ Document number 2, December 31, 1838, <u>op. cit.</u>.

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six months of operation. 1/

Strangely enough, the insurance fund was reported to have slightly increased in size during the year 1839. The State Treasurer's report for that year exhibited receipts amounting to $762.64 and expenses of $687.50. 2/ Only one of the free banks (Merchants Bank of Jackson County) paid an assessment. The bulk of receipts consisted of assessments paid by three chartered participating banks: the Calhoun County Bank, the Bank of St. Clair, and the Bank of Constantine. Expenses were attributed to three warrants drawn in favor of two of the Bank Commissioners, presumably representing partial salary payments. There is no record of any payment to a creditor of a failed bank from the insurance fund.

The balance of the insurance fund at the end of 1839 was therefore $1,335, most of which, according to the indicated report, was deposited in the Michigan State Bank. Once again it must be observed that the insurance fund could not have had a balance at the end of 1839. By that date the Bank Commissioners had been in office for two full years and, at salaries of $1,250 per annum, should have received payments totaling $7,500. Although this amount exceeded the assessments paid during 1838-39, no recognition of the discrepancy is apparent in the reports for those years.

1840-1844. The early months of 1840 saw a continuation of the banking difficulties of the preceding year. Six of the eight remaining participating banks closed during the early part of the year. At least five of these banks were insolvent and had obligations at time of failure in excess of $200,000. Included among them were all of the remaining free banks and two of the chartered banks.

Of the two participating banks still in operation in the spring of 1840, the Bank of St. Clair was permitted by the legislature to withdraw from insurance. 3/ The Bank of Constantine struggled along for a time and finally failed near the end of the year. Thus within three years every bank participating in Michigan's bank-obligation insurance system - except one which was permitted to withdraw from insurance - had either failed or gone into voluntary liquidation.

In 1840 the State Treasurer and the Auditor General, both of which officials were charged with the administration of the insurance fund, reported what had been evident all along, namely, that the insurance fund had been insolvent for some time. Expenses of the insurance fund had actually been paid out of the State's general fund, with the result that at the end of 1839 the fund was in fact

1/ An Act more effectively to protect the public against various frauds, Annual Session 1839, section 5. [Date not known.]

2/ Documents accompanying the Journal of the Senate of the State of Michigan, Annual Session 1840, document number 3, December 1, 1839.

3/ An Act for the relief of the Bank of St. Clair, March 19, 1840.

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overdrawn by more than $4,200. 1/ During 1840 receipts totaled $280 and expenditures were somewhat less so that by December of 1840 the fund was overdrawn by about $4,100. 2/ It will be observed that even the amount the fund was overdrawn does not account for all salary payments to the Bank Commissioners. Consequently, it may be assumed that no payments were ever made out of the fund to creditors of failed banks.

Official recognition of the end of bank-obligation insurance in Michigan may be dated as November 30, 1842. In a report of that date the Auditor General remarked: "The amount for which this fund was overdrawn ... having been paid from the general fund, and the receipts and payments under the law creating it having wholly ceased, it has been deemed proper to cancel this fund by carrying the amount to the general fund." 3/

It was also during 1842 that the remains of Michigan's banking system began to dissolve. By 1841 there were only five operating banks, all of which were nonparticipating banks. The largest of these, the Bank of Michigan, failed disasterously in 1842. Several of the other banks closed at about the same time, although there is again some evidence to indicate that these banks later reorganized and resumed business. Aside from the Bank of St. Clair, which was in difficulty after 1842 and failed about 1845, only one bank is known to have operated continuously during this period without becoming involved in serious financial difficulty. This was the Michigan Insurance Company, a firm which operated as a bank despite its title and despite a charter which evidently had not contemplated such a development.

Appraisal of Supervision and Regulation of Participating Banks.

Bank supervision in Michigan during the period of bank-obligation insurance was conducted in the face of difficulties which, it is safe to say, have never been matched in perplexity for any supervisory authority at any time. For three men to examine upwards of 40 banks three or four times a year in a State which was largely a wilderness was an almost impossible undertaking. But overriding all of these difficulties was the fact that supervisory officials were sworn to enforce banking laws which a large majority of the bankers were determined to ignore.

Bank organization under the Free Banking Act. The central fact to be remembered about banking developments in Michigan during 1837-38 is that there was an extraordinary demand for circulating medium due to, first, the rapid migration of population to the State and, second, the enforced contraction of circulating medium, largely

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1/ Michigan Joint Documents, Annual Session 1841, document number 2, December 20, 1840; document number 3, December 30, 1840.

2/ Ibid..

3/ Michigan Joint Documents, Annual Session 1843, document number 2, November 30, 1842.

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because of Federal monetary policy. Probably most of the individuals who attempted to meet this demand by organizing new banks under the Free Banking Act did so for purely personal reasons, but their actions, at the beginning at least, had the approval of the vast majority of the people.

Such was the demand for circulating medium that banks were organized and went into operation at a rate of about two per week during the last four or five months of 1837. At the end of 1837 the legislature attempted to restrain this movement by requiring that no new bank could issue circulation - and thus for all practical purposes could not open for business - until each banknote had been endorsed by a Bank Commissioner. 1/ However, even when obeyed this provision came too late to be of use.

The Free Banking Act was a rather carefully drawn piece of legislation. Indeed, the procedure for placing banks in operation was "hedged around with so much care, and guarded with so many provisions, that few, it was supposed, would venture to bank under /the law/." 2/ Section 10 was the most formidable obstac e to the formation of banks, since it began: "At least thirty per centum of the capital stock of such association shall be paid in specie before such an association shall be permitted to commence operations ..." 3/ The methods by which this particular provision was circumvented are illustrative of the general attitude in Michigan during 1837-38, particularly when it is remembered that in most instances the individuals concerned were not financial adventurers from out of State (although Michigan did not lack for these) but "worthy men, with the most upright intentions ... with no knowledge whatever of banking business ..." 4/ Among the various methods used were: exhibiting worthless metals as specie; shifting specie from one bank to another one jump ahead of the examiners; and the "purchase" of fictitious specie certificates. The last mentioned instrument purported to represent specie on deposit in the issuing bank and available on demand to the organizing bank. As a matter of fact, there was simply not enough specie available in Michigan to provide reserves for operating banks, let alone for banks to be newly organized, so that the vast majority of these certificates were entirely worthless.

The use of specie certificates provides another illustration of the public sanction given to violation of the law. Many, if not most, of these certificates were furnished by chartered, nonparticipating banks. Correspondence files of several of the prominent Detroit bankers of the time contain requests for specie certificates, with no effort to disguise the purpose intended. For example, a request to one such banker went as follows: "Will you and Mr. ____

1/ An Act to amend An Act to organize and regulate banking associations, and for other purposes, December 30, 1837, section 39.

2/ "Report of the Bank Commissioners," January 18, 1839, House of Representatives Documents, 26th Congress, 1st Session, document number 172.

3/ An Act to organize ....

4/ "Bank Commissioners' Report," January 18, 1839, *op. cit.*.

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lend about $3,000 in specie which I pledge my honor shall be forthcoming as you direct ... I do not conceive that 'tis necessary to have the specie actually here - but only a certificate of deposit in your bank which will not interfere with your report of specie and will go for as much in our stock." 1/ That such requests were often acted upon favorably is indicated by a report of the Bank Commissioners in which they noted that many banks were able to organize because of "the base dishonesty and gross cupdity of a few who had the control of the specie of the country /i.e., Michigan/". 2/

Participation of the older bankers in the movement to organize free banks may be explainable simply in terms of profits which these bankers hoped to secure; in the short run through making fictitious loans and in the long run through tying the new banks to their own institutions. But more important, their participation is still another indication of the general refusal to abide by the terms of the Free Banking Act.

The public attitude which permitted the banking developments described here and earlier in this study was, at root, the most formidable obstacle which was presented to bank supervisory officials. Their frustration - and even dispair - over this situation will never be expressed more dramatically than by words which appeared in one of their official reports:

> The singular spectacle was presented, of the officers of the State seeking for banks in situations the most inaccessible and remote from trade, and finding at every step an increase of labor by the discovery of new and unknown organizations ... Gold and silver flew about the country with the celerity of magic; its sound was heard in the depths of the forest, yet, like the wind, one knew not whence it came or whither it was going ... The vigilance of a regiment of /examiners/ would have been scarcely adequate, against the host of bank emissaries which scoured the country to anticipate their coming and the indefatigable spies which hung upon their path; to which may be added perjuries, familiar as dicers' oaths, to baffle investigation. 3/

Bank examination. It will be recalled from an earlier section that all banks participating in Michigan's insurance program were required to submit to examination by the Bank Commissioners. Beginning in June 1837, examination was extended to those nonparticipating banks which accepted the conditions of the act permitting the suspension of specie payments until May 16, 1838. It appears that three of the nonparticipating banks did not accept the provisions of this act and therefore did not become subject to examination, although it must be presumed that these banks nevertheless

1/ Letter, September 5, 1837, C. C. Trowbridge Papers, MSS, Burton Historical Collections, Detroit, Michigan.

2/ "Bank Commissioners' Report," January 18, 1839, op. cit..

3/ "Bank Commissioners' Report," January 18, 1839, op. cit..

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suspended specie payments. 1/ It will also be recalled that examinations were to be made once in each four-month period in the case of chartered participating banks and once in each three-month period in the case of free banks.

During most of the first two years of bank-obligation insurance there was only one Bank Commissioner. His two reports to the legislature (January 5, 1837 and December 6, 1837) reveal little real information about the condition of Michigan banks and provide no basis on which his examinations may be appraised. 2/ Beginning in 1838, after the number of Bank Commissioners was raised to three, reports to the legislature provided a considerable amount of information on examination activities.

The reports deal largely with the Commissioners' activities in ferreting out and exposing violations of law as a consequence of the organizing of new banks. There was little occasion for the Commissioners to concern themselves with the quality of assets acquired during regular bank operations and, aside from a few incidental references, there is no report which deals with anything but cases of insolvency, violation of law, fraudulent organization, or mismanagement.

In April of 1838 two of the three Bank Commissioners submitted a special report to the legislature in answer to a request by that body. 3/ Of the 42 banks subject to the examination of these Commissioners, nine were chartered banks and 33 were free banks. The Commissioners reported that five had not yet been examined and four others were just going into operation. Of the 33 remaining banks they reported that they had secured injunctions against the continued operation of six and were dubious of the solvency of two others. Some of the reasons for their action in the case of the six banks not only serve to illustrate the previous discussion of bank organization but also suggest that the examinations were quite thorough.

When the examiner called and proceeded to count the specie of the newly organized Jackson County Bank he:

> ... selected a box ... and found the same to contain a superficies only of silver, while the remaining portion consisted of lead and ten-penny nails. [He] then proceeded to open the remaining seven boxes; they presented the same contents precisely, with a single exception, in which the substratum was window-glass broken into small pieces. 4/

1/ In the Bank Commissioners' Report of April 6, 1838, op. cit., the Farmers and Mechanics Bank, the Bank of Pontiac, and the Bank of Macomb County are so described.

2/ "Annual Report of the Bank Commissioner of the State of Michigan" January 5, 1837, Journal of the House of Representatives of the State of Michigan, 1837, document number 6; "Annual Report of the Bank Commissioner of the State of Michigan", December 6, 1837, Documents accompanying the Journal of the Senate of the State of Michigan, Annual Session 1838, document number 2.

3/ "Bank Commissioners' Report," April 6, 1838, op. cit..

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The Wayne County Bank was found to be using specie certificates in which "the cashier ... had so little confidence .... that he made no entry of them upon the books of the bank." 1/ The Bank of Lapeer was found to have $16,000 in specie, $15,000 of which was a specie certificate issued by the Farmers and Mechanics Bank (a chartered, nonparticipating bank) upon receipt of a check for the same amount drawn upon a nonexistent account in the Bank of Lapeer by one of its directors. 2/ The Farmers Bank of Genesee County also had fictitious specie certificates, while the Farmers Bank of Sandstone had never received any payments on its capital stock and, in addition, had issued circulating notes without the necessary (in its case) endorsement of a Bank Commissioner. The last of the six banks, the Exchange Bank of Shiawassee, had "specie" consisting of: a fictitious specie certificate issued by the Farmers Bank of Genessee County, a forged specie certificate of a New Haven, Connecticut bank, a counterfeit banknote of a New York bank, and "seven coppers ... in the safe." 3/

In each of these six cases the Commissioners made a careful attempt to estimate the potential loss which would fall on bank creditors, with the combined total coming to about $100,000. Also, the Commissioners suspected that additional circulating notes were outstanding but were not shown on the books of the banks.

Examinations conducted during the nine months of 1838 following the Bank Commissioners' report noted above resulted in the securing of at least 19 additional injunctions against operating banks, one of which was a nonparticipating bank subject to examination. 4/ Still other banks were allowed to go into voluntary liquidation, although many could presumably have been enjoined by the Commissioners. In all of these examinations the diligence of the Bank Commissioners, judged both from their reports and the results obtained, seems to have been exceptional.

There are no detailed reports of examination activities during 1839. However, it may be presumed that during that year most of the banks which closed did so because of insolvency attributable to asset deterioration. By that time the Bank Commissioners had probably weeded out most of the banks which were organized fraudulently, or were flagrantly violating the law. The relatively few free banks which continued operations through 1839 were probably better organized and better managed banks.

Consequences of examination policies. The history of bank-obligation insurance in Michigan provides an interesting, and perhaps unique, illustration of a completely ineffective insurance system possessing bank supervision of the highest quality. This, of course, is simply a reflection of the fact that forces far more powerful than the quality of bank supervision were at work. Nevertheless, supervision was of some importance to the events of 1838-39,

4/ "Bank Commissioners' Report," April 6, 1838, U.S. House of Representatives Documents, 26th Congress, 1st Session, document number 172.

1/ Ibid..

2/ Ibid..

3/ Ibid..

4/ U.S. House of Representatives Documents, 26th Congress,

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though the part it played was scarcely that which had been anticipated.

The collapse of Michigan's banking system which began in 1838 was touched off by the examination procedures of the Bank Commissioners. This is not to say that the collapse was caused by supervisory officials, but rather that their activities served as catalytic agents in the decline. By their very diligence and thoroughness the examiners exposed examples of fraud and insolvency which shook the confidence of the public, both in Michigan and in surrounding areas.

With so many new banks in operation, the public found it difficult to distinguish between those of good credit and those whose notes were at a heavy discount or worthless. The early reports of the Bank Commissioners contributed to the uneasiness of the public. Notices began to appear in the newspapers of neighboring States early in 1838. For example, an Indiana newspaper commented: "from necessity we are compelled to notify our distant subscribers that we cannot any longer receive the bills of any Michigan banks in payment for subscriptions. Doubtless some of them are good but all of them are uncurrent in this part of the state." 1/ And a newspaper in Cleveland declared: "a list of banks of Michigan, bankable at Detroit, is greatly desired by persons in the Lake country. All sorts of reports are afloat touching the value of different kinds of Michigan paper at home." 2/

The very fact that a bank was participating in insurance added to the public suspicion. A person could quickly determine if a bank was a free bank, and thus suspect, or an older chartered bank by noting whether or not a proffered banknote bore an inscription to the effect that the holder was protected by reason of the bank's membership in the insurance system. Those which did bear such a description were, of course, the notes of free banks, or of the few chartered participating banks. The public soon began to use the term "wildcat bank" to apply to all free banks, even to those known to be sound. The following letter to the Governor from a large stockholder of one of the well-managed free banks describes the difficulty of operating under these conditions. This gentleman wrote that his bank:

> has been in operation for two years and has never in one instance failed to redeem its bills in specie when presented ... but still they do not have a first credit because it is a wildcat Bank - and that is enough to condemn anything. We are now entitled to a good charter. .... and in your message to the Next Legislature ... I hope that you will recommend the chartering of the Bks. in good credit that were organized under the general Bkg. law. 3/

1st Session, document number 172, pp. 1122-1148. Several of these injunctions may have been secured in the first weeks of 1839.

1/ Indiana Journal, February 3, 1838.

2/ Cleveland Herald Gazette, June 6, 1838.

3/ Letter, December 14, 1839, William Woodbridge Papers, MSS, Burton Historical Collections, Detroit, Michigan.

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Although bank supervision was of no assistance in strengthening the Michigan banking system, and probably actually hastened its collapse, it nevertheless gave some protection to Michigan bank creditors. By their prompt action supervisory officials were often able to close a bank after it had been in operation only a brief time, thus preventing it from issuing large additional amounts of circulating notes.

Numerous illustrations of this can be found in the records. For example, the Farmers Bank of Sandstone went into operation on January 29, 1838. Twenty-five days later, on February 23, 1838, the Bank Commissioners reached the bank, conducted their examination, and applied for an injunction to close the bank. During its 25 days of operation the bank had succeeded in issuing a reported circulation of $46,933. In addition, it was believed that the bank had placed much larger amounts in the hands of its agents, which were about to go into circulation. The minimum estimated loss was $26,956, which loss would obviously have been greater had the bank been allowed to operate even an additional several weeks.

Appraisal of Michigan's Insurance System

Insurance of bank-obligations in Michigan failed to attain either of the two objectives its proponents had in mind: the State was not guarded against collapse of the circulating medium due to bank failures nor was the "small" bank creditor protected against loss arising from the same cause. The Michigan experience demonstrates that however well-conceived and managed, an insurance system cannot be effective unless lawmakers and those who determine monetary policy provide at least the minimum requisites for successful operation.

Protection of bank creditors. Whatever protection was afforded creditors of banks participating in Michigan's insurance system arose out of the ability of the Bank Commissioners to close insolvent banks as rapidly as possible. No payments to creditors of failed banks are known to have been made from the insurance fund.

Losses to creditors can be only roughly approximated. This is due to the absence of liquidation records, which in turn is due in great part to the fact that liquidation proceedings were stopped when the Free Banking Act was declared unconstitutional in 1844. The Bank Commissioners reported in January 1839, that "at a low estimate, near a million dollars of the notes of insolvent banks are due and unavailable in the hands of individuals." 1/ It may be assumed that the bulk of this $1 million was never recovered since the banks concerned were those most fraudulently and recklessly operated. To this amount must be added: the notes of participating banks which failed after the above estimate was made, plus the deposits in all participating banks at dates of failure, less whatever recovery was later made on these items. It would appear not unlikely that the total loss to creditors of failed participating banks exceeded $1 million and approached $2 million during Michigan's insurance history.

Reasons for failure of the insurance system. Insurance of bank-obligations in Michigan was a failure for two reasons: the

1/ "Bank Commissioners' Report," January 18, 1839, op. cit..

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timing of its adoption and, second, the peculiar character of the State's banking development just after the insurance system began operation. There were, it is true, certain deficiencies in the insurance law. However important these deficiencies might have become under normal circumstances, they were of little significance in contributing to the collapse of bank-obligation insurance in Michigan.

Bank-obligation insurance did not fail in Michigan due to a lack of good bank supervision, nor can its difficulties be traced to the insolvency of a few large participating banks. On the contrary, precisely the opposite situation was true in each case. The explanation is simply that Michigan put its insurance system into operation just prior to a severe depression. By itself this would probably have been sufficient to cause the collapse of the system but the Michigan legislature compounded the difficulties by adopting banking legislation which increased to an extra-ordinary degree the potential liability of the insurance fund without providing any immediate increase in its resources. Since this potential liability became almost immediately an actual liability the insurance system broke down.

Deficiencies of insurance law. Michigan's insurance law suffered from the same defects as that of the New York law from which it was copied. These deficiencies were: (1) insurance authorities were not provided with a borrowing power to be used in the event of an emergency, (2) the examining force was adequate in quality but decidedly inadequate in number, (3) no payments could be made to the creditors of failed participating banks until liquidation of the banks' assets had been completed, and (4) assessments were levied on capital stock rather than on insured obligations.

Of the various shortcomings noted above the only one which, if remedied, could possibly have influenced the course of events in Michigan was the lack of a borrowing power. However, the needed amount was so large that it is scarcely conceivable that adequate funds could or would have been secured. Further, western States such as Michigan had a poor credit standing during 1838-42 and found it exceedingly difficult to borrow money. In fact, Michigan had trouble placing a bond issue of $5 million, authorized in 1837 for internal improvements purposes, and to this day has not redeemed half of that issue.

So far as the other deficiencies are concerned, a larger examining force would simply have meant that many banks would have been closed even sooner than they were; the need for a method of payment prior to liquidation of a bank's assets was of no consequence since there were no funds available for such payments, while assessments on insured obligations rather than capital would not have yielded sufficient additional revenue.

Comparison with other insurance systems. Michigan's bank-obligation insurance system may be compared with those of New York and Indiana, both of which were in operation during the panic of 1837 and the depression which followed. New York's insurance system also broke down by 1842, but it was eventually able to pay all insured

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claims arising out of the failure of participating banks. Indiana's insurance system, which was of an entirely different type than that of Michigan, was completely successful in protecting bank creditors during the crisis years of 1837-42.

The different results attained by New York and Michigan are clearly attributable to the matter of timing. By 1837 New York's system had been in full operation for six years and the fund was sufficiently large to permit authorities to handle the first cases caused by the panic of 1837. The fact that they were given authority to act promptly, without having to await liquidation of bank assets, was undoubtedly important, but it may be presumed that the Michigan legislature would have done precisely the same thing under similar circumstances. Also, during 1840-42 the New York fund was able for a time to pay the claims of insured creditors. When additional failures gave rise to claims far in excess of the amount available in the fund, the legislature permitted the fund to borrow, not only because it could observe the beneficial effects of paying these claims but also because it was clear that assessments paid by surviving banks would be sufficient to eventually redeem the securities issued. In Michigan, on the other hand, the entire banking system was wrecked within a very short time, while the fund was hopelessly insolvent with the failure of the first participating bank.

A more interesting comparison can be made with the Indiana insurance system. This is so because the Indiana system was in operation only a little more than two years before the panic of 1837 and had not much more time to prepare than had the Michigan insurance system. Also, it will be recalled from Chapter IV that the Indiana plan was one of mutual guarantee by participating banks with no fund and no borrowing power, except insofar as each individual bank could or would borrow when it was called upon to make a contribution. Yet only one Indiana bank became involved in serious financial difficulty and in this case prompt action by insurance authorities resulted in complete protection for insured creditors.

The explanation lies in the character of supervision given Indiana participating banks. In ability, the Michigan supervisory personnel were at least the equal of those in Indiana, but they did not possess the broad authority which Indiana supervisory officials were given. Because of their power to control the volume of bank operations and, to some extent, the direction of bank lending, supervisory officials in Indiana were able to keep participating banks free from involvement in the speculative land boom of the time. In addition, they were able to force participating banks to follow a contractive policy during the period of suspension of specie payments.

In fairness to the Michigan system, it must also be added that even with respect to supervision timing was of some importance. The speculative land boom in Michigan reached dizzying proportions during 1836. Had adequate supervision been accorded Michigan banking a year or two earlier, as was the case in Indiana, it is possible that Michigan banks would have been in a better position when the panic of 1837 occurred. Still, it is extremely unlikely that even this would have been sufficient under the circumstances which prevailed

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in Michigan as a consequence of the passage of the Free Banking Act. If Michigan had adopted an insurance plan similar to that of Indiana it would probably have failed even if the free banks had not been included in insurance; it would certainly have failed if they had been included. 1/

Conclusion. As the only insurance system (of the six adopted prior to the Civil War) which completely failed to protect bank creditors, Michigan's system offers little in the way of constructive lessons to be gained from its operating experience. What its history clearly demonstrates is that bank-obligation insurance cannot operate in a vacuum; that there are basic causes for bank failures which are still beyond the immediate influence of bank-obligation insurance.

1/ In 1839 Michigan did, in fact, attempt to establish a banking system and insurance plan similar to that in Indiana. However, sufficient capital could not be secured to enable the banks to begin operations.

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Appendix, Chapter V

Free Banks Organized under Act of March 15, 1837

Banks	Month and year commencement of operations	Month and year of suspension of operations
Adrian, Bank of	February 1838	1/
Allegan, Bank of	December 1837	January 1839 2/
Ann Arbor, Bank of	3/	3/
Auburn, Bank of	3/	3/
Battle Creek, Bank of	January 1838	January 1839
Berrien County Bank	May 1838	September 1838
Branch County Bank	November 1837	4/
Brest, Bank of	September 1837	August 1838
Chippeway, Bank of	3/	3/
Chippeway County Bank	3/	3/
Citizens Bank of Ann Arbor	3/	3/
Clinton Canal Bank	December 1837	January 1839 2/
Clinton River Bank	3/	3/
Coldwater, Bank of	November 1837	January 1839 2/
Commercial Bank, Gratiot	3/	3/
Commercial Bank, Harre	3/	3/
Commercial Bank of Michigan	January 1838	4/
Commercial Bank, Portsmouth	3/	3/
Commonwealth Bank, Tecumseh	3/	3/
Detroit City Bank	December 1837	4/
Detroit and St. Joseph Railroad Bank	January 1838	5/
Exchange Bank, Ann Arbor	3/	3/
Exchange Bank, Shiawassee	February 1838	March 1838
Farmers Bank of Genesee County	December 1837	March 1838
Farmers Bank of Homer	August 1837	January 1839
Farmers Bank of Hudson	3/	3/
Farmers Bank of Oakland	December 1837	July 1838
Farmers Bank of Prairie Road	3/	3/
Farmers Bank of Romeo	3/	3/
Farmers Bank of Sandstone	January 1838	February 1838
Farmers Bank of Sharon	December 1837	September 1838
F & M Bank of Centreville	3/	3/
F & M Bank of Monroe	October 1837	4/
F & M Bank of Pontiac	December 1837	July 1838
F & M Bank of St. Joseph	3/	3/
Genesee County Bank	December 1837	4/
Gibralter, Bank of	January 1838	July 1838
Goodrich Bank	January 1838	January 1839 2/
Grand River Bank	September 1837	4/
Huron River Bank	January 1838	4/

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Jackson County Bank	November 1837	February 1838
Kalamazoo River Bank	3/	3/
Kensington, Bank of	December 1837	July 1838
Lake St. Clair, Bank of	3/	3/
Lapeer, Bank of	December 1837	March 1838
Lapeer County Bank	3/	3/
Lenawee County Bank	December 1837	April 1838
Manchester, Bank of	November 1837	January 1839
Marshall, Bank of	October 1837	5/
Merchants Bank of Jackson County	January 1838	5/
Merchants Bank of St. Joseph	3/	3/
Merchants and Mechanics Bank of Monroe	November 1837	4/
Michigan Centre Bank	3/	3/
Millers Bank of Washtenaw	December 1837	January 1839
Niles, Bank of	December 1837	4/
Oakland, Bank of	September 1837	January 1839 2/
Owasso, Bank of	3/	3/
Peoples Bank of Grand River	February 1838	August 1838
Saginaw City Bank	December 1837	January 1839 2/
Saginaw County, Bank of	3/	3/
St. Joseph County Bank	December 1837	September 1838
Saline, Bank of	December 1837	August 1838
Shiawasse, Bank of	December 1837	4/
Shiawasse County Bank	3/	3/
Singapore, Bank of	February 1838	4/
Superior, Bank of	January 1838	January 1839
Utica, Bank of	September 1837	January 1839 2/
Van Buren County Bank	3/	3/
Wayne County Bank	December 1837	March 1838
White Pigeon, Bank of	3/	3/

1/ Unknown; last condition report dated August 1839.

2/ Injunction reported as having been secured by this date; actual date of closing possibly earlier.

3/ No conclusive evidence exists to show that this bank was ever actually in operation.

4/ Unknown; presumably before end of 1840.

5/ Unknown; last condition report dated September 1839.

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CHAPTER VI

INSURANCE OF BANK OBLIGATIONS IN OHIO, 1845-1866

Ohio was the fifth State to make use of the insurance principle in providing for the protection of bank creditors before the Civil War. The Ohio plan was put into effect in 1845 and was to expire in 1866. However, it became inoperative with the conversion of most of the participating banks to national banks after 1863.

Review of Ohio Banking History to 1865

Unlike the two western States which had previously adopted insurance programs for the protection of bank creditors, Ohio at the time of adoption of the program was relatively far advanced in its economic development and had a banking history dating back almost to the beginning of the century. Ohio was the first State carved from the Old Northwest, in 1803. 1/ By 1840, following the great migration from the eastern States, it had become the third most populous State in the union. It was the leading agricultural State, producing, for example, about a fourth of the country's output of wheat. Cincinnati was not only the great metropolis of the State but also one of the leading cities in the nation, and Cleveland was rapidly becoming a commercial center of importance.

Banking prior to 1845. The first bank in Ohio, the Miami Exporting Company of Cincinnati, was formed in 1803, shortly after statehood was attained. It had not been specifically chartered as a bank but its proprietors interpreted several provisions of the charter as granting such rights and almost from the beginning engaged in none but a banking business. The first bank charter, as such, was granted by the State legislature in 1808, to the Bank of Marietta.

Banking spread rapidly in Ohio, particularly after expiration of the charter of the first Bank of the United States in 1811, and by 1819 it appears that 25 banks were in operation. However, the depression of that year led to the failure of a number of banks and the restraining influence of the second Bank of the United States, which had been chartered in 1816, kept the number of banks from expanding throughout the 1820's. Indeed, only 11 banks were doing business in the State in 1830, although as settlers continued to arrive and new towns started there was an increasing demand for bank facilities.

Andrew Jackson's veto in 1832 of the bill rechartering the second Bank of the United States was correctly interpreted as

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1/ The Old Northwest roughly included the area north of the Ohio River between the Mississippi and the Alleghenies. Out of it was eventually formed the States of Ohio, Indiana, Illinois, Michigan, and Wisconsin.

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as foreshadowing the demise of the federally chartered bank with its nationwide system of branches, one of the most important of which was at Cincinnati. As a consequence, 13 new banks were chartered by the State between 1830 and 1834. In addition, a number of banks which had failed earlier but whose charters had not expired, among them the Miami Exporting Company, reorganized and resumed business. The panic of 1837 checked but did not completely halt the increase in the number of banks and by 1839 at least 35 chartered banks, with aggregate capital exceeding $10 million, were doing business. 1/

At the same time there was substantial growth in the number of unauthorized banks. Banks could only be chartered by special act of the State legislature, and it was not always possible to satisfy all groups or localities believing themselves deserving of charters. Consequently, unauthorized banks (such as the Stark County Orphans Institute and the Granville Alexandrian Society) were numerous. Attempts to legislate them out of existence were futile and probably a few were operated as well as the chartered banks.

1839 was the peak year for the number of authorized banks in this period. In that year the largest part of Ohio's $10 million banking capital was concentrated in Cincinnati, with four of that city's banks accounting for more than one-third of the total. 2/ Nevertheless, banking facilities were well-distributed throughout the State. Both Columbus and Cleveland had two relatively large banks and almost every town of any size had at least one medium or small-sized bank.

The banking structure was weakened by the panic of 1837, and the recovery of 1838-39 was short-lived, tailing off into severe depression. Also, many bank charters expired in 1843-44. With the banks closing both because of failure and of expiration of charters, Ohio was left at the beginning of 1845 with only eight authorized banks and few, if any, of the unauthorized banks.

Banking from 1845 to 1865. Because of the small number of banks operating in the State in 1845, and the difficulties which had been met under the previous system of permitting only chartered banks, the legislature in 1845 reorganized the entire banking system. Legislation in 1845 and later makes it possible to characterize this second period as "banking under general laws", as contrasted with the earlier period of "banking under special charters". 3/

The banking legislation of 1845 was "An Act to incorporate the State Bank of Ohio and other banking companies" which became law February 24, 1845. This law was an attempt to combine the leading features of banking codes in other States, notably those of New York and Indiana.

1/ Bank capital as reported in the early years often was authorized capital. Paid-in capital may have been substantially less.

2/ Authorized capital. Capital data for unauthorized banks are unavailable.

3/ C. C. Huntington, A History of Banking and Currency in Ohio before the Civil War (Columbus: Ohio Archaeological and Historical Society, 1915), p. 411.

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Under the 1845 law, which remained the basic banking law of the State for twenty years, any five persons might form a bank with capital not less than $50,000 nor more than $500,000, at least 30 percent of which had to be paid in gold or silver coin. A Board of Bank Commissioners was provided to examine all applications. To prevent a concentration of banks the State was divided into twelve districts and the number of banks in each was limited. Further, the aggregate capital of all banks formed under the act was limited to $6,150,000. Banks organized under provisions of this law were incorporated until May 1, 1866, at which time they were to cease operations.

Two kinds of banks could be organized under the 1845 law: Branch Banks of the State Bank of Ohio and Independent Banks. The difference between them was primarily the nature of the security provided for the notes which the banks issued. Circulating notes of the Branch Banks were protected through establishment of an insurance program, the details and operation of which are discussed in later sections, while notes of Independent Banks were secured by deposit of Federal or State bonds with the State Treasurer to amounts at least equal to the value of the notes. Branch Banks also differed from Independent Banks in that their minimum capital was $100,000 instead of $50,000, and they were supervised by a Board of Control appointed by themselves rather than by State officers.

The Branch Banks of Ohio were copies of those of Indiana. That is, they were independent banks, with their own stockholders and officers, but collectively they constituted the State Bank. It seems likely that Ohio adopted this structure and terminology in a deliberate attempt to secure immediate public acceptance for its new banking system. During the depression years of the early 1840's, when many Ohio banks had failed, notes of the various Indiana Branch Banks served as the "par" currency of Ohio.

The Ohio legislature was therefore not introducing a novel system in 1845, although present day writers have occasionally been led to assume from the bank titles that branch banking, in the modern sense, was authorized in Ohio in 1845. Indeed, even residents of distant States were sometimes confused, as the following letter from the president of the Board of Control (the supervisory agency) indicates:

> Your communication of the 31 ult. addressed to the "Cashier of the State Bank of Ohio" is received. The corporation known as the "State Bank of Ohio" is peculiar in its organization ... The State Bank, as such, has no capital, transacts no proper banking business, receives no deposits, makes no discounts, declares no dividends. All this is done by the several Branches ... 1/

1/ January 2, 1863, Letterbooks of the Board of Control, MSS, Ohio State Museum, Columbus (hereafter referred to as "Ohio Letters").

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New banks were soon organized under the 1845 law, and by 1850 fifty-seven banks, with capital exceeding $7 million, were in operation. 1/ Almost three-fourths of the banks in that year were Branch Banks.

Because there was a limit to the number of banks which could be formed under the 1845 law, both in total and by district, there was an increasing demand in some sections of the State - notably in Cincinnati - for a general banking law. Consequently, another class of bank was provided for in the Free Banking Law of March 21, 1851. Capital of the new banks was set at a minimum of $25,000 and a maximum of $500,000, and provisions regarding note security were similar to those in force for the Independent Banks. A number of banks were formed under the new law and, by the end of 1851, seventy banks were in operation in Ohio. This represented the peak number for the entire period as the depressions of 1854 and 1857 were marked by numerous bank failures.

From 1857 until establishment of the National Banking System in 1863, no major bank legislation was enacted in the State and the number of banks remained fairly stable. However, after 1863 many Ohio banks converted to national banks, spurred on in part by the impending expiration of legal authorization for the Branch Banks and the Independent Banks. As a result there was little need to extend the General Banking Law of 1845 so that by the end of 1865 banking in Ohio was conducted by national banks and by banks operating under the Free Banking Law of 1851.

Character of the Guaranty Legislation

When reorganization of Ohio's banking system and the adoption of an insurance plan were under consideration in the early 1840's the legislators were able to draw upon the experiences of the States which had preceded them in the insurance field by at least a decade. As described in Chapter IV, Indiana's mutual guaranty system began operating in 1834 and by 1844 it must have been clear to the Ohio legislators that this plan had successfully weathered the great depression of the early forties. New York's insurance system described in Chapter II, had been in operation for about 15 years. It is not surprising therefore that the insurance plan finally adopted in Ohio was a blend of the Indiana and New York plans.

As was the case in Indiana, Ohio's plan embraced only the Branch Banks of the State Bank system. 2/ On the other hand, only circulating notes were protected rather than all bank obligations. This was very possibly due to the fact that the New York plan, which had at first covered both circulating notes and deposits, had run into difficulty in 1842 with the result that insurance in that State

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1/ Includes capital of banks chartered prior to 1845 which continued to operate after that date.

2/ No provision was made for the inclusion in the insurance program of any banks to be organized at a later date, with the exception of new Branch Banks.

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was thereafter limited to circulating notes.

Objectives. One of the few statements which could be located regarding the purpose of the 1845 legislation is by the legislative committee which drafted the law:

> The committee entertain no doubt that a large majority of the people of the state desire the enactment ... of some law authorizing the establishment of banks which will furnish them with a safe and convenient currency ... In framing this bill the committee have constantly in view the great landmarks of entire security to the bill holder, reasonable security to dealers with the banks, and proper inducements to the capitalist ... 1/

This statement would appear to reflect concern over both the circulating mediu, as such, and the safety of the individual bank creditor, particularly the noteholder. It is thus in accord with the general conclusion as to the function of bank-obligation insurance, found in Chapter I.

Insurance fund. The insurance fund, or "safety fund" as it was called in the act creating the State Bank, was not built up through annual assessments. Instead, each Branch Bank was required to "pay over, or deposit to the credit of said board [of Control], 2/ as said board shall order, money or [bonds] of this state, or of the United States, at their current value in the city of New York, but in no instance above their par value, [in] an amount equal to ten per centum on the amount of the notes for circulation, which shall be delivered to such branch." 3/ This sum was to be paid before any notes were delivered to the Branch Bank, i.e,, before it opened for business, and additional payments were to be made only if the amount of notes delivered was later increased due to an increase in capital or because the entire authorized issue had not been delivered at the commencement of business.

The insurance fund was to be invested by the Branch Banks, under the direction of the Board of Control, in Federal or State bonds or in mortgages. Interest thereafter received was to be paid to the Branch Banks in proportion to the amounts they had contributed. 4/ While the fund was the "property of said board, [it was held] in trust for the benefit of the several branches of the State Bank of Ohio, and as a fund for the redemption of the notes of circulation [of a failing Branch Bank]". 5/ In practice, the Branch Banks carried the

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1/ As quoted by C. C. Huntington, A History of Banking and Currency in Ohio before the Civil War (Columbus: Ohio State Archaeological and Historical Society, 1915), p. 421.

2/ A description of the composition and functions of the Board of Control is given in the following section.

3/ An Act to Incorporate the State Bank of Ohio and other Banking Companies, February 24, 1845, section 21.

4/ Ibid., section 22.

5/ Ibid., section 21.

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amount they had paid on the assets side of their statements of condition.

Payment of insured obligations. The method of paying creditors of failed banks under Ohio's plan provides additional evidence that it was the Indiana plan, rather than that of New York, which served as the model for Ohio legislators. The insurance fund was not essential to the Ohio plan and, in fact, did not stand for the immediate and direct payment of creditors of a failing bank. Instead, this function was served by a mutual guaranty system. When a Branch Bank became insolvent, i.e., was unable to redeem its notes in specie 1/the Board of Control was required to place it in receivership and to "immediately provide money, and place the same in such solvent branch or branches, as may be most convenient for the purpose of redeeming the notes of such failing branch ..." 2/ The amount provided was not taken from the fund but from new assessments levied on the solvent Branch Banks in proportion to the amount of circulation each had outstanding. These sums were then repaid to the solvent Branch Banks through liquidation of securities comprising the insurance fund. 3/

The role of the insurance fund was clearly described by the President of the Board of Control in a letter to a Cincinnati newspaper in 1862:

> It is a very common mistake ... to suppose that the "Safety Fund" is ... especially provided to secure the circulation, but such is not the fact. The entire capital, with all the means of every description belonging to each and all the Branches ... are the security provided for the circulation of each Branch. It is the Branches themselves, and not the public, that are to look to the "Safety Fund" for their security ... The basis of security provided ... is that of mutual liability ... 4/

Upon liquidation of the assets of a failing bank by receivers, payments were to be made first to the other Branch Banks to cover any amount not already returned from the insurance fund and, second, to the insurance fund to reimburse it for all moneys advanced except for that portion originally contributed by the failing Branch Bank. Following this, the receiver could meet the claims of depositors and other creditors and, finally, distribute any remaining funds among the stockholders. 5/ No provision was made for replenishing the fund in the event it was permanently diminished.

1/ Ibid., section 24. If for some reason the Board of Control failed to take action any creditor of a bank failing to redeem its notes in specie could secure a court order requiring such action to be taken. Contrariwise, a Branch Bank falsely accused of being insolvent could appeal to the courts. (sections 28 and 29).

2/ Ibid., section 25.

3/ Ibid., section 26.

4/ March 18, 1862, Ohio Letters, op. cit..

5/ An Act to incorporate ..., section 27.

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However, it was probably expected that the Branch Banks would at all times have an amount equal to ten percent of their circulation deposited in the fund, so that if it were diminished new assessments would have been required.

In essence, therefore, Ohio's plan meant that participating banks collectively guaranteed the circulation of any one of their number but gave to the supervisory authority, i.e., the Board of Control, the right to determine which of their assets - from among a selected group deposited with the Board - would be liquidated if it became necessary to make any payments. For to return the sums advanced by the solvent Branch Banks, the Board simply sold bonds which were held in trust for the Branch Banks and which were counted by them as part of their investment portfolios.

Statutory Provisions Relating to Supervision and Regulation of Branch Banks

In providing a supervisory authority for banks participating in the insurance program, the Ohio legislature again drew upon Indiana's experience. Provisions dealing with bank regulation were similar to those then in general use in the country.

Supervisory agency. The Board of Control, the supervisory authority similar to the Board of Directors of the State Bank of Indiana, was located at Columbus. It consisted of one representative from each Branch Bank, chosen by the various Branch Bank boards for a term of one year. Each member on the Board of Control had one vote, with an additional vote for each $50,000 of circulating notes assigned to his Branch Bank. 1/

The burden of the Board's work fell on the president, vice-president, secretary, and an executive committee of not less than five members. 2/ The president was chosen by the Board from outside its membership and did not become a member of the Board upon election. The same was true of the vice-president, provision for whom was not made by the legislature until 1851 with passage of an amendatory act. Salaries of the three executive officers, along with other expenses, were provided by assessments levied on the Branch Banks. 3/

Admission to insured status. Application to start a Branch Bank automatically constituted application for insurance, since all Branch Banks were part of the mutual guaranty and safety fund system. Investigation of the first applications was the responsibility of five Bank Commissioners, appointed and named in the act authorizing

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1/ Ibid., section 17.
2/ Ibid., section 14.
3/ Ibid., section 15. Assessments for most expenses varied with the capital stock of the Branch Banks, but those to meet expenses incurred in the printing of circulating notes were in the ratio of the circulating notes assigned to each.

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the Branch Banks. 1/ The act also outlined the procedure which was to be followed in determining whether an application was to be granted. 2/ Primary emphasis was placed on verifying the amount of specie claimed to have been paid in, seeing that bank facilities were well-distributed among the various counties, and investigating the character and responsibility of the new stockholders. When at least seven Branch Banks had been accepted by the Commissioners, the directors of each were notified and were then to select their representatives to the first Board of Control. 3/

Under terms of the original act this exercise of the power of admission was to revert to the Auditor, Treasurer, and Secretary of State after one year. 4/ However, in an act of January 6, 1846, an amendment gave the Board of Control the powers exercised by the Bank Commissioners. The Bank Commissioners were continued in office with power to review decisions of the Board of Control resulting in denial of admission to any bank. In the event that the Commissioners disagreed with the Board the Governor was authorized to make the final decision.

Powers of Board of Control. Regular examination of the Branch Banks was made by at least one member of the Board of Control, or an appointed agent, as often as the Board desired. Ample power was given examiners to determine the condition of the Branch Banks. Also, each Branch Bank was required to submit condition reports to the Board as often and whenever requested, the form for which was determined by the Board. 5/

In addition to its powers of examination, and its duties in the event of failure of a Branch Bank, the Board was charged with general supervision of the banking system. This involved such duties as making rules for the settlement of balances among the Branch Banks and the printing of circulating notes. 6/ Most important, the Board had the power to order a Branch Bank to do, or cease doing, anything which it deemed necessary for the protection of that bank or other banks in the system. 7/ This included specific authority to compel a Branch Bank to reduce its circulation or other liabilities to whatever level was deemed necessary for the safety of the bank or the system. 8/ Thus, the Board had a power similar to that enjoyed by the Federal Reserve today, in that it could influence the circulating medium of the community, albeit directly rather than through changes in reserves. 9/

1/ Ibid., section 5.
2/ Ibid., sections 10 and 11.
3/ Ibid., section 13.
4/ Ibid., section 5.
5/ Ibid., section 14.
6/ Ibid., section 14.
7/ Ibid.. In 1848 the legislature strengthened this provision by giving the Board the right to an injunction against any Branch Bank which failed to comply with its orders. After allowance of the injunction the Board could then appoint a receiver and proceed as in the case of an insolvent bank.
8/ Ibid., section 14.
9/ While this particular provision was, in practice, used only to enforce orders of the Board in the cases of recalcitrant Branch

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Restrictions on operations of insured banks. Statutory limitations on the operations of the Branch Banks were, for the most part, similar to regulations governing banks in other western States at that time. Many of these limitations related to the note issue function of the Branch Banks, since deposit banking was just beginning to assume importance in Ohio.

Circulating notes of the Branch Banks had to be paid on demand in gold or silver coin; failure to do so was deemed an act of insolvency. 1/ However, the legislature suspended this requirement in January of 1862 as a consequence of the nationwide suspension of specie payments during the Civil War.

By 1845 it had become clear that provisions limiting circulation and other bank obligations to a multiple of capital did not by themselves provide a precise rule as to the proportion that specie reserves should bear to such obligations. Consequently, the Ohio act required that each Branch Bank maintain a specie reserve equal to 30 percent of its circulating notes. 2/ At least 50 percent of this reserve was to consist of gold and silver coin in the bank's vaults, while the remainder could consist of demand deposits in specie-paying banks located in New York, Boston, Philadelphia, or Baltimore. Whenever this ratio was below the minimum for 12 days, or as soon as it fell below 20 percent, a bank was prohibited from putting new notes in circulation or increasing its liabilities by making new loans and discounts except on bills of exchange. 3/

Note circulation of each Branch Bank was also limited to a multiple of paid-in capital, the multiple decreasing as capital increased. Specifically, circulation could not exceed twice the first $100,000 of capital; once and one-half the second $100,000; once and one-fourth the third $100,000; once the fourth $100,000; and for any amount over $400,000, not more than three-fourths the amount of such capital. In addition, notes could be issued to an amount equal to the bank's deposit with the safety fund. 4/ Thus a Branch Bank with a maximum authorized capital of $500,000 could have a circulation of about $700,000, for which it had to maintain a specie reserve of approximately $215,000.

Other provisions dealing with circulating notes included: notes could be issued by any Branch Bank, were to be signed by the President of the Board of Control, countersigned by the cashier of the issuing bank, made payable to bearer and negotiable by delivery; 5/ they were not to be of smaller denomination than one dollar nor larger than $100 and the proportion of each denomination was pro-

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Banks, the Board did find a way by which it could influence the circulating medium through changes in reserves. See below, pp. VI-41.

1/ Ibid., sections 18 and 24.
2/ Ibid., section 55.
3/ Ibid..
4/ Ibid., section 19.
5/ Ibid., section 18.

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vided for; 1/ notes of out-of-State banks which were not redeemable in specie, or which were of smaller denominations than five dollars, could not be paid over the counter of a Branch Bank in the course of its daily business; 2/ notes of each Branch Bank had to be accepted at par by all other Branch Banks. 3/

Deposits were specifically exempted from maximum amount limitations, perhaps reflecting the then current opinion that they were not a function of bank lending operations. However, Branch Bank indebtedness, which was defined as excluding deposits, was limited to two-thirds of capital stock paid in. 4/

Excessive favoritism shown stockholders and directors had long been a source of weakness in many western banks and a number of provisions of the act creating the State Bank of Ohio were directed toward this problem. Included among such provisions were: limitation of the amount for which the stockholders, collectively, of any Branch Bank could be indebted to it, either as principals or by endorsement, to not more than one-third of the Branch Bank's capital; 5/ a similar limitation for directors except that the collective amount could not exceed one-fourth the amount of capital stock owned by the directors. 6/ Directors were personally and individually liable for damages incurred by stockholders or creditors of the bank as a consequence of violation of this or any other provision of the act. 7/ Also, loans in which stock of the Branch Bank served as security were prohibited. 8/

Interest charged by the Branch Banks was limited to six percent. Under the original act *bona fide* purchases, discounts, or sales of bills of exchange payable at other than the place of purchase could include normal exchange charges without violating the above restrictions. 9/ An 1850 amendment eased the interest restriction somewhat further by permitting in addition to the six percent the "actual cost to ... the bank of converting the proceeds of such note or bill of exchange into available funds at par, when the current rate of exchange is not in favor of the place of payment ... 10/ On the other hand, the same amendment authorized, and made it the duty of, the county prosecuting attorney to sue for the cancellation of a debt to a bank, if the debtor had not himself brought suit within six months, whenever a bank charged more than the legal rate of interest. Formerly, the bringing of such a suit was at the option

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1/ *Ibid.*, section 52.
2/ *Ibid.*, section 63.
3/ *Ibid.*, Section 54.
4/ *Ibid.*, section 56.
5/ *Ibid.*, section 23.
6/ *Ibid.*. These limitations were raised to one-half and one-third respectively, if indebtedness included bills of exchange drawn in Ohio and payable outside of the State.
7/ *Ibid.*, section 66.
8/ *Ibid.*, section 47.
9/ *Ibid.*, section 61.
10/ *Laws, By-laws and Resolutions relative to the State Bank of Ohio*, (Columbus: 1855). However, total receipts to the bank could not exceed 12 percent.

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of the borrower. 1/

No person or firm could be indebted to a Branch Bank to an amount exceeding one-half of its circulation. If liabilities on account of bills of exchange were excluded, this limitation was raised to one-tenth of the same base. 2/ Branch Banks were prohibited from dealing in or owning real estate except as was necessary to provide banking facilities or in conducting normal bank operations. 3/

Number and Obligations of Ohio Banks, 1845-65

During the twenty years following passage of the General Banking Law of 1845 Ohio had what may be described as a multiple banking system. That is, banks fell into four classes, distinguishable by the type of charter or other official sanction under which they operated. 4/ These were: Old Banks, which possessed unexpired charters in 1845 and continued to operate under provisions of those charters, 5/ Branch Banks and Independent Banks formed in accordance with the 1845 law, and free banks formed and operated in accordance with provisions of the Free Banking Law of 1851. As noted previously, only the Branch Banks participated in the insurance system.

The twenty years may be divided into three periods, determined by the various classes of banks in operation. The first, 1845-50, ends just prior to the entry of free banks into the general system; the second, 1851-57, includes the years when banks of all four classes were in operation; while the third, 1858-65, includes years in which there were again banks of only three classes in operation.

Number of operating banks. The number of banks operating under State law in Ohio increased rapidly after 1845 and reached a peak of 70 by 1851. Following a decline during the next several years, the number stablized at upwards of 50 banks until the end of the period, when most banks began to convert to national banks. During all of this period banks participating in the insurance system never constituted less than 50 percent of all operating banks, and for most years, comprised two-thirds or more of all operating banks. Table 31 shows the number of banks in operation in Ohio at the end of each year, with the banks grouped by class and insurance status.

Eight Old Banks were in operation in Ohio when the act authorizing the formation of Branch and Independent banks was passed in February of 1845. By the end of the year 16 Branch Banks and seven Independent Banks had been organized and placed in operation. With

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1/ An Act to incorporate ..., section 61.

2/ Ibid., section 62.

3/ Ibid., section 51.

4/ Only banks operating under State law are included. National banks, many of which had formerly been Branch, Independent, or free banks, are not included in this survey. Private banks and brokers are also excluded.

5/ The charters of 15 banks had expired in 1843-44 but the 1845 law permitted five of these to reorganize and continue. Of the four which took advantage of this provision, two became Independent Banks, one a Branch Bank, and one an Old Bank.

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Table 31. Number and Percentage Distribution of Operating Banks, by Insurance Status, Ohio, 1844-65 1/

End of year	Number of banks 2/ Total	Participating in insurance Branch	Not participating in insurance Old	Independent	Free	Percentage distribution Total	Participating in insurance Branch	Not participating in insurance Old	Independent	Free
1844	8	--	8	--	--	100.0	--	100.0	--	--
1845	31	16	8	7	--	100.0	51.6	25.8	22.6	--
1846	35	18	8	9	--	100.0	51.4	22.9	25.7	--
1847	48	30	8	10	--	100.0	62.5	16.7	20.8	--
1848	54	38	5	11	--	100.0	70.4	9.2	20.4	--
1849	57	41	5	11	--	100.0	71.9	8.8	19.3	--
1850	57	41	5	11	--	100.0	71.9	8.8	19.3	--
1851	70	41	5	12	12 3/	100.0	58.6	7.2	17.1	17.1
1852	67	39	5	11	12	100.0	58.2	7.5	16.4	17.9
1853	66	39	4	11	12	100.0	59.1	6.0	16.7	18.2
1854	57	36	1	9	11	100.0	63.1	1.8	15.8	19.3
1855	58	36	1	10	11	100.0	62.1	1.7	17.2	19.0
1856	57	36	1	10	10	100.0	63.2	1.8	17.5	17.5
1857	53	36	--	7	10	100.0	67.9	--	13.2	18.9
1858	54	36	--	7	11	100.0	66.7	--	12.9	20.4
1859	54	36	--	7	11	100.0	66.7	--	12.9	20.4
1860	55	36	--	7	12	100.0	65.5	--	12.7	21.8
1861	53	36	--	7	10	100.0	67.9	--	13.2	18.9
1862	53	36	--	6	11	100.0	67.9	--	11.3	20.8
1863	51	36	--	4	11	100.0	70.6	--	7.8	21.6
1864	43	34 4/	--	3	6	100.0	79.1	--	7.0	13.9
1865	12	8 5/	--	1 5/	3	100.0	66.7	--	8.3	25.0

1/ Omits unauthorized banks, private bbanks, and brokers. For 1863-65 omits national banks, as follows: 38 in 1863, 84 in 1864, and 136 in 1865.

2/ Data are partially estimated by the writer based on Reports of Auditor of State; C. C. Huntington, History of Banking and Currency in Ohio Before the Civil War, (Columbus; 1915); and monthly condition reports of the Branch Banks. The Organization Division of the Office of the Comptroller of the Currency kindly provided information on the conversion of Branch, free, and Independent Banks to national banks. Conversions have been estimated as follows: in 1863, one Independent Bank and one free bank; in 1864 eight Branch Banks; in 1865, twenty Branch Banks, two Independent Banks and one free bank.

3/ Free banks were not authorized until this year.

4/ Reports were made by these banks but it is known that at least six were in the process of converting during that period.

5/ The law under which these banks operated expired May 1, 1866. Several may have converted to national banks at that time.

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the eight Old Banks remaining in operation, this meant that within one year the number of Ohio banks was increased almost fourfold. 1/

As shown in Table 31, the number of operating banks continued to increase, reaching 57 by the end of 1850. The growth in the number of Branch Banks was primarily responsible for this increase in the total, as the number of Independent Banks increased more slowly and the number of Old Banks declined. Consequently, more than seven-tenths of all banks operating in the State were participating in insurance at the end of 1850, compared with just over half in 1845.

Passage of the Free Banking Law in March of 1851 led to the formation of 12 free banks before the year was out and a consequent rise in the number of Ohio banks to the peak for the entire period. This increase in the number of banks left participating banks, i.e., Branch Banks, constituting just under 60 percent of all operating banks at the close of 1851.

Neither the number of operating banks nor their distribution by class stabilized at the 1851 levels. In the following six years 18 banks ceased operations, at least 13 by reason of insolvency, while only one new bank was formed. 2/ All of the Old Banks closed during this period and there were declines in the number of banks in each of the remaining three classes. Percentagewise, the position of the Branch Banks was improved and they constituted almost 70 percent of all operating banks by the end of 1857.

From 1857 until passage of the National Banking Act in 1863, the number and distribution of Ohio banks was relatively stable. About two-thirds of all operating banks were participating in insurance, while the remaining third consisted of free and Independent Banks. The last of the Old Banks had closed in 1857.

Many new banks were formed in Ohio under national charters in 1863, but few of the banks operating under State law converted in that year. However, it soon became apparent that the Ohio legislature would not extend the 1845 law when it expired in May of 1866. As a result, an estimated 28 Branch Banks and three Independent Banks relinquished their State charters in 1864-65 and organized as national banks. Several free banks also converted so that by the end of 1865 there remained only 12 banks in Ohio operating under State law, and nine of these were required by law to cease operations within the following few months. 3/

1/ The Bank of Xenia, whose charter did not expire until 1850, apparently elected to become a Branch Bank in 1845. However, the number of Old Banks remained at eight in that year since the charter of the Ohio Life Insurance and Trust Company, which had previously expired, was extended by the legislature. See p. VI-11, note 1.

2/ Actually, 19 banks closed during this period, but the Dayton Bank, an Independent Bank, resumed operations in 1855 so that it does not affect the count given above.

3/ Information on the conversion of Ohio State banks to national banks for 1863-1865 was provided by the Organization Division of the Office of the Comptroller of the Currency. In a number of cases the fact of actual conversion or succession could not be definitely established, hence the necessity of estimating the total number.

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Bank obligations. Table 32 shows total bank obligations, which consisted largely of circulating notes and deposits but also included miscellaneous liabilities, for each year and by class of bank from 1845 through 1864. Data for 1865 are of doubtful validity because of the conversion to national bank status of so many of the banks operating under State law.

As would be expected, total obligations reached a peak during the Civil War, in 1862. The previous high had been achieved ten years earlier, following which total obligations had fallen off substantially, remaining at relatively low levels until 1860. The decline in the totals for 1863 and 1864 shown in the table is due to the conversion of some banks to national banks. For these years the figures in the table do not reflect changes in circulation and deposits of all bank operations in the State.

Except during the early years of insurance, participating banks (Branch Banks) typically accounted for two-thirds or more of total bank obligations. This proportion is about of the same order of magnitude as the proportion of all banks participating in insurance, shown in Table 31. It suggests that, on the average, Branch Banks were neither larger nor smaller than the average bank not participating in the insurance system.

During the first of the periods noted earlier, 1845 to 1850, the obligations of Ohio banks doubled. This development reflects the emergence of the State from the depression of 1839-43, as well as the establishment of new banks under the 1845 law.

It will be noted that Old Banks supplied the major portion of total bank obligations during the first two years of this period. This was to be expected since they were already in operation when Branch and Independent Banks were just being started. However, there were only eight Old Banks, and the failure of three in 1848 is reflected in the data for that and succeeding years. By the close of 1850 more than two-thirds of total bank obligations were attributable to the Branch Banks.

The second period, which includes the depression of 1854-55 and ends with the year of the panic of 1857, shows a substantial decline in total bank obligations after 1852-53. However, Branch Banks continued to furnish about two-thirds of circulation plus deposits during this period. The most severe decline naturally occurred in the case of the Old Banks, all of which had closed or failed by the end of 1857.

Total bank obligations during the last period not only reflect the impact of Civil War financing, but also the emergence from the depression which followed the panic of 1857 and, in the final two years, the preparations many of the banks were making to convert to national banks. The proportion of total bank obligations attributable to Branch Banks declined in each year of this period as free banks, not faced with the expiration of their charters, continued to expand their operations. Whereas in 1858 almost three-fourths of

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Table 32. Amount and Percentage Distribution of Bank Obligations Operating Banks by Insurance Status, Ohio, 1845-1864 1/
(Amount in thousands of dollars)

Year 3/	Amount of obligations 2/					Percentage distribution				
	All banks	Participating in insurance	Not participating in insurance			All banks	Participating in insurance	Not participating in insurance		
		Branches	Old	Independent	Free		Branches	Old	Independent	Free
1845	9,104	2,595	5,193	1,316	--	100.0	28.5	57.0	14.5	--
1846	9,393	3,728	4,298	1,367	--	100.0	39.7	45.8	14.5	--
1847	12,103	5,280 4/	5,140	1,683 5/	--	100.0	43.6	42.5	13.9	--
1848	15,929	9,370	4,409	2,150	--	100.0	58.8	27.7	13.5	--
1849	15,749	10,309	3,126	2,314	--	100.0	65.5	19.8	14.7	--
1850	17,503	11,655	3,047	2,801	--	100.0	66.6	17.4	16.0	--
1851	18,935	12,114	3,643	2,895	283	100.0	64.0	19.2	15.3	1.5
1852	20,241	12,204	3,621	2,771	1,645	100.0	60.3	17.9	13.7	8.1
1853	19,717	12,403	2,116 6/	2,706	2,492 7/	100.0	62.9	10.8	13.7	12.6
1854	16,809	10,585	1,393	2,555	2,276	100.0	63.0	8.3	15.2	13.5
1855	17,375	11,075	2,420	2,141	1,739 8/	100.0	63.8	13.9	12.3	10.0
1856	17,314	10,953	2,122	2,318 9/	1,921	100.0	63.2	12.3	13.4	11.1
1857	11,615	8,499	--	1,537	1,579	100.0	73.2	--	13.2	13.6
1858	12,999	9,399	--	1,597 10/	2,003	100.0	72.3	--	12.3	15.4
1859	12,696	9,108	--	1,505	2,083	100.0	71.7	--	11.9	16.4
1860	14,929	10,501	--	1,690	2,738	100.0	70.3	--	11.3	18.4
1861	16,059	11,210	--	2,039	2,810 11/	100.0	69.8	--	12.7	17.5
1862	20,702	13,852	--	2,527	4,323	100.0	66.9	--	12.2	20.9
1863	19,114	12,302	--	2,024	4,788 12/	100.0	64.4	--	10.5	25.1
1864	17,513	10,957	--	1,839	4,717	100.0	62.6	--	10.5	26.9

Sources: Auditor of State Reports; Huntington, op. cit.; Reports of Condition published monthly and on file at the library of the Ohio State Archaeological and Historical Society.

1/ Excludes obligations of private, savings, and national banks.

2/ Includes individual, business, and interbank deposits; circulating notes; miscellaneous liabilities. Partially estimated for nonparticipating banks.

3/ For most years data are for November or nearest year-end dates. Data for 1847 are for May; for 1849 are for August. Year-end data are available only for Branch Banks. Though available, these data were not used in order to make possible comparison with obligations of nonparticipating banks.

4/ Excludes data for seven Branch Banks in operation by end of year but apparently not in operation at time of report.

5/ Excludes data for one Independent Bank in operation by end of year but apparently not in operation at time of report.

6/ Includes data for Bank of Massillon which failed before end of year.

7/ Data for 13 banks, presumably including the Miami Valley Bank of Dayton which failed before end of year.

8/ Apparently includes data for one bank which had ceased business.

9/ Report from City Bank of Columbus not available.

10/ Includes six banks, data for Dayton Bank not available.

11/ Includes nine banks, report from Marine Bank of Toledo not available.

12/ Data for Iron City Bank of Ironton not available.

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total bank obligations were attributable to the Branch Banks, by 1864 Branch Banks had less than two-thirds of total bank obligations.

Obligations of participating banks. As the only banks included in the insurance system, the distribution of Branch Bank obligations is of more importance than a similar distribution for nonparticipating banks. Table 33 provides such information.

During almost the entire period of insurance the Ohio Branch Banks were primarily "banks of issue". That is, the volume of circulating notes was typically two to three times the amount of deposits. Only in the final few years did deposits exceed circulation and this may have reflected the approaching termination of the banks' charters.

Deposits of individuals, partnerships, and corporations composed the largest part of total deposits. Interbank deposits were relatively small. Miscellaneous liabilities were relatively large in some years because of borrowings among the various Branch Banks.

Relative size of participating banks. The average Ohio Branch Bank was of medium size for the area and time, typically having between $200,000 and $300,000 of deposits plus circulation. Although a few Branch Banks were of fairly large size, none was ever as large as the Ohio Life Insurance and Trust Company, with deposits and circulation in excesss of $2 million, or the Bank of the Ohio Valley, a free bank with obligations of more than $1 million. Table 34 shows the obligaions of Branch Banks on three dates with the banks grouped by size as measured by the amount of deposits plus circulation.

The data in Table 34 reveal that there was only a very slight tendency towards a concentration of risk under the Ohio insurance system. In general, Branch Banks in each size group tended to have insured obligations, i.e., circulating notes, in about the same proportion as their number was to the total. In 1846 the single bank with more than $400,000 of deposits and circulation comprised six percent of all Branch Banks but had only four percent of total circulation. In 1855 banks with obligations in excess of $400,000 were 14 percent of all Branch Banks and had 17 percent of total circulation; the comparable percentages for 1861 were 17 and 23. For purposes of comparison in this connection, the largest 14 percent of banks participating in Federal deposit insurance today hold more than 70 percent of all insured deposits.

The tendency towards concentration of risk would have been more marked had deposits been included in insurance coverage. Banks with more than $400,000 of deposits plus circulation had 12 percent of total deposits and circulation in 1846, but 27 percent in 1861. This is a reflection of the fact that deposit banking tended to be relatively more popular in larger sized banks in the more populous cities.

Insured obligations. By restricting insurance protection to the circulating notes of Branch Banks the architects of the 1845 law provided such protection for about half of total bank obligations during most of the insurance period. Table 35 shows that, except for the few years at the beginning and end of the insurance period,

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Table 33. Obligations of Banks Participating in Insurance by Type of Obligations, Ohio Branch Banks, 1845-1864
(Amounts in thousands of dollars)

Year 1/	Total obligations	Circulating notes	Deposits: Total	Deposits: Individual, partnerships, and corporations	Deposits: Inter-banks	Miscellaneous liabilities
1845	2,595	1,576	950	870	80	69
1846	3,728	2,655	1,026	884	142	47
1847	5,280	3,679	1,421	1,295	126	180
1848	9,370	6,867	2,395	2,099	296	108
1849	10,309	7,601	2,549	2,226	323	159
1850	11,655	8,395	3,049	2,751	298	211
1851	12,114	8,460	3,442	3,058	384	212
1852	12,204	8,117	3,834	3,479	355	253
1853	12,403	8,293	3,810	3,401	409	300
1854	10,585	6,994	3,349	2,970	379	242
1855	11,075	7,520	3,271	3,055	216	284
1856	10,953	7,417	3,426	3,151	275	110
1857	8,499	6,401	2,050	1,864	186	48
1858	9,399	6,862	2,454	2,280	174	83
1859	9,108	6,528	2,508	2,264	244	72
1860	10,501	7,404	3,057	2,848	209	40
1861	11,210	8,136	3,031	2,864	167	43
1862	13,852	8,103	5,734	5,491	243	15
1863	12,302	5,739	6,539	6,324	215	24
1864	10,957	4,668	6,228	5,989	239	61

Source: Monthly condition reports; library of the Ohio State Archaeological and Historical Society.

1/ Data are for same dates as in Table 32. See note 3 of that table.

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Table 34. Number, Deposits and Circulation of Branch Banks, by Size of Bank, Ohio, 1846, 1855, 1861
(Amounts in thousands of dollars)

Size of bank	Number of banks	November 1846 Deposits and circulation Total	Deposits	Circulation	Number of banks	November 1855 Deposits and circulation Total	Deposits	Circulation	Number of banks	November 1861 Deposits and circulation Total	Deposits	Circulation
Number or amount - Total	17	3,681	1,026	2,655	36	10,791	3,271	7,520	36	11,167	3,031	8,136
Banks with deposits plus circulation (in thousands of dollars) of:												
Less than 100	1	83	5	78	--	--	--	--	--	--	--	--
100 to 200	5	784	196	588	3	560	98	462	1	184	35	149
200 to 300	10	2,381	508	1,873	22	5,419	1,088	4,331	22	5,592	1,024	4,568
300 to 400	--	--	--	--	6	1,957	686	1,271	7	2,417	884	1,533
400 to 500	1	433	317	116	1	407	215	192	4	1,702	487	1,215
500 to 600	--	--	--	--	3	1,615	660	955	1	548	211	337
600 to 700	--	--	--	--	--	--	--	--	--	--	--	--
700 and over	--	--	--	--	1	833	524	309	1	724	390	334
Percent distribution - Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Banks with deposits plus circulation (in thousands of dollars) of:												
Less than 100	5.9	2.2	.5	2.9	--	--	--	--	--	--	--	--
100 to 200	29.4	21.3	19.1	22.2	8.3	5.2	3.0	6.1	2.8	1.6	1.1	1.8
200 to 300	58.8	64.7	49.5	70.5	61.1	50.2	33.2	57.6	61.1	50.1	33.8	56.2
300 to 400	--	--	--	--	16.7	18.1	21.0	16.9	19.4	21.7	29.2	18.9
400 to 500	5.9	11.8	30.9	4.4	2.8	3.8	6.6	2.6	11.1	15.2	16.0	14.9
500 to 600	--	--	--	--	8.3	15.0	20.2	12.7	2.8	4.9	7.0	4.1
600 to 700	--	--	--	--	--	--	--	--	--	--	--	--
700 and over	--	--	--	--	2.8	7.7	16.0	4.1	2.8	6.5	12.9	4.1

Source: Monthly condition reports. Ohio State Archaeological and Historical Society.

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Table 35. Insured Obligations and Insurance Coverage, Ohio, 1845-1864
(Amounts in thousands of dollars)

Year 1/	Circulation: Branch Banks	Branch Bank circulation as percentage of: Total obligations of All banks	Total obligations of Branch Banks	All bank circulation
1845	1,576	17.3	60.7	16.9
1846	2,655	28.3	71.2	23.3
1847	3,679	30.4	69.7	25.3
1848	6,867	43.1	73.3	34.7
1849	7,601	48.3	73.7	38.6
1850	8,395	48.0	72.0	39.0
1851	8,406	44.4	69.4	36.8
1852	8,117	40.1	66.5	35.7
1853	8,293	42.1	66.9	35.6
1854	6,994	41.6	66.1	36.8
1855	7,520	43.3	67.9	41.1
1856	7,417	42.8	67.7	40.1
1857	6,401	55.1	75.3	41.9
1858	6,862	52.8	73.0	43.0
1859	6,528	51.4	71.7	42.2
1860	7,404	49.6	70.5	42.9
1861	8,136	50.7	72.6	42.7
1862	8,103	39.1	58.5	40.4
1863	5,739	30.0	46.7	43.1
1864	4,668	26.7	42.6	45.6

1/ Data are for the same dates as in Table 32. See note 3 of that table.

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Branch Bank circulation ranged from 40 to 55 percent of total obligations of all Ohio banks. Thus insurance protection was about of the same order of magnitude as has been the case under Federal deposit insurance with its maximum coverage limitations for each depositor.

Insurance protection for circulation alone was much higher, approximating 75 to 85 percent in most years. Since it was shown in Table 32 that total obligations of Branch Banks typically comprised 60 to 70 percent of all bank obligations, the high degree of protection for circulating notes alone reflects the fact that Branch Banks generally had a larger proportion of their liabilities in circulating notes than was the case for nonparticipating banks.

History of Operation of Insurance System

During its twenty years of operation, Ohio's insurance system provided protection for the creditors of participating banks to an extent previously unmatched in Ohio banking history. This was done despite a number of severe shocks occasioned by bank failures and nationwide financial panics. When the law under which the participating banks were operating was nearing expiration, and the banks began to convert to national banks, Ohio's insurance system was at the peak of its strength.

Between 1850 and 1857 ten Branch Banks became involved in financial difficulties sufficiently serious to necessitate the levying of insurance assessments on the sound participating banks. During the earlier period, 1845-49, and after 1857 no such action was required.

Table 36 shows, for each Branch Bank concerned, the cause of the difficulty and the disposition of the case. It will be noted that four banks were placed in receivership. The remaining six received financial assistance which enabled them to continue in operation during the remainder of the insurance period.

Payment of insured obligations. Circulation at time of failure of the four Branch Banks placed in receivership cannot be determined but at the dates of their last reports prior to failure it totaled $690,000. These reports were made within a few weeks prior to failure and it is assumed that this total is close to circulation at time of failure. All of the circulating notes presented for redemption were immediately paid so that no loss was suffered by a noteholder.

Losses to depositors of the four failed Branch Banks are not known. Deposits were not covered by insurance but, it will be recalled, neither did they constitute a major portion of Branch Bank obligations to the public.

Assessments levied on the solvent Branch Banks to secure funds for the redemption of notes of the failed banks are shown in Table 37. It will be noted that only about $300,000, approximately 50 percent of the estimated circulation redeemed, was required. The difference was made up by depositing with the redemption banks, i.e., the banks selected by the Board of Control to redeem the notes of the failed banks, the

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Table 36. Ohio Branch Banks in Serious Financial Difficulties, 1845-64

Branch Banks			Date of disposition of case		
Name	Insured obligations (thousands) 1/	Principal cause of difficulty	Placed in receivership 2/	Reorganized with financial aid 2/	Received aid and continued without reorganization
Sumit County	$ 197	Poor management	--	December, 1850	--
Toledo	$ 235	Poor management	--	December, 1850	--
Licking County	$ 179 3/	Defalcation	June 2, 1852	--	--
Akron	$ 188	Defalcation	November 24, 1854	--	--
Mechanics and Traders	$ 71	Asset deterioration	November 26, 1854	--	--
Commercial, Toledo	$ 252	Asset deterioration	November 27, 1854	--	--
Merchants	$ 208	Asset deterioration	--	--	August, 1857
Norwalk	$ 212	Asset deterioration	--	--	August, 1857
Guernsey	$ 190	Asset deterioration	--	--	September, 1857
Ross County	$ 262	Asset deterioration	--	--	October, 1857

1/ At date nearest failure or action taken by Board of Control.

2/ Dates are accurate to month; days, when shown, are approximate.

3/ Includes, as of date just prior to failure, notes in circulation of $156,000 plus $23,000 carried under liabilities as "sundries". The latter sum probably represented circulating notes held as security by other Branch Banks for amounts advanced in the unsuccessful attempt to sustain the Licking County Branch Bank.

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Table 37. Insurance Assessments, Ohio Branch Banks, 1850-57 1/

Date	Branch Bank involved	Total assessment by year	Assessment on behalf of operating Branch Banks 2/		Assessment for redemption of notes of failed Branch Banks	
			Rate 3/	Amount collected	Rate 3/	Amount collected
1850		$141,870	--	$141,870	--	--
December	Toledo		1 percent 10/	47,470	--	--
November	Summit County		1 percent 10/	47,200 5/	--	--
June	Toledo		1 percent 10/	47,200 5/	--	--
1851		48,518	--	48,518	--	--
June	Toledo		1 percent 10/	48,518 5/	--	--
1852		113,180	--	22,636	--	$ 90,544
December	Licking County		--	--	1/2 of 1%	45,272
June	Licking County		--	--	1/2 of 1%	45,272
March	Licking County		1/4 of 1%	22,636 5/	--	--
1853		43,984	--	--	--	43,984
July	Licking County		--	--	1/4 of 1% 8/	21,714 5/
May 9/	Licking County		--	--	1/4 of 1% 5/	22,270
1854		140,258	--	81,122	--	59,136
December	Mechanics and Traders		--	--	6/	20,000
November	Akron		1/2 of 1%	39,100 5/	--	--
	Akron		7/	42,022	--	--
	Licking County		--	--	1/4 of 1%	19,568 5/
April	Licking County		--	--	1/4 of 1%	19,568 5/
1855		58,124	--	--	--	58,124
April	Akron		--	--	1/4 of 1%	19,800 5/
January	Commercial, Toledo		--	--	1/4 of 1%	19,162
	Akron		--	--	1/4 of 1%	19,162
1856		39,600	--	--	--	39,600
June	Commercial, Toledo		--	--	1/4 of 1%	19,800 5/
February	Commercial, Toledo		--	--	1/4 of 1%	19,800 5/
1857		56,000	--	56,000	--	--
October	Ross County		4/	5,000	--	--
September	Guernsey		4/	10,000	--	--
	Norwalk		4/	5,000	--	--
	Norwalk		4/	6,000	--	--
August	Merchants		4/	15,000	--	--
	Norwalk		4/	15,000	--	--

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Table 37. Insurance Assessments, Ohio Branch Banks, 1850-57 1/ (Continued)

Date	Branch Bank involved	Total assessment by year	Assessment on behalf of operating Branch Banks 2/		Assessment for redemption of notes of failed Branch Banks	
			Rate 3/	Amount collected	Rate 3/	Amount collected
1850-57 - total		$ 641,534	--	$ 350,146	--	$ 291,388

1/ All data were secured from an examination of Board of Control correspondence and are necessarily dependent upon estimation, and upon interpretation of remarks contained in certain letters.

2/ Assessments made prior to date of failure on behalf of failed Branch Banks are classified as assessments on behalf of operating Branch Banks.

3/ Percent of authorized circulation of each Branch Bank, unless otherwise indicated.

4/ These assessments were in the form of loans made by individual Branch Banks at the order of the Board of Control officers. Of the $65,000 total, the Toledo Branch Bank contributed $16,000: Commercial Branch Bank of Cleveland $15,000, and Lorain, Farmers' of Ashtabula, Harrison County, Mt. Pleasant, and Dayton Branch Banks $5,000 each.

5/ Computed by author.

6/ Indirect assessment in the form of loan from the Board of Control clearing fund.

7/ Apparently each Branch Bank was assessed about $2,000.

8/ Evidence that this assessment was actually made is questionable.

9/ Assessment possibly made a month or two earlier.

10/ Percent of authorized capital.

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first funds secured from liquidation of the assets of the failed banks. This could be done because a portion of the notes circulated at distant points and came in slowly, while liquidation was begun as soon as the banks failed.

The procedure adopted by the Board in collecting assessments was to return to each Branch an equal quantity of the notes of the failed banks. 1/ Presumably the notes then remained as evidence of the sound bank's contribution and were cancelled as dividends were received from the liquidator.

The first Branch Bank to fail was the Licking County, at Newark, on June 2, 1852. 2/ An effort had been made to prevent failure but a large loss suffered by the bank as a consequence of the cashier's defalcation made it impossible to continue. The cashier had a private banking business and had purchased on behalf of the Branch Bank much of the doubtful and worthless paper he had acquired as a private banker. In addition, when his private bank failed it was discovered that many creditors held unrecorded claims against the Branch Bank.

When it became obvious that the bank would fail it was decided to let it continue in business while the first assessment was collected so that redemption could begin immediately upon failure. This led to protests by several of the solvent Branch Banks which pointed out, correctly, that they could not be assessed for the redemption of notes until an act of insolvency had been committed by the failed bank. Nevertheless, most of the first assessment was on hand when the bank suspended. On July 3, 1852, the President of the Board of Control noted that $30,000 had been deposited with the Exchange Branch Bank and that $11,000 of the circulating notes had already been redeemed. 3/ In all, about $175,000 was collected in seven assessments levied on behalf of the noteholders of the Licking County Branch Bank. This was just under the outstanding circulation at the last report prior to failure.

Surprisingly, the three failures which occurred in November of 1854 seem to have caused less difficulty than did that of the Licking County Branch Bank. The three banks had apparently been badly managed and, in fact, the President of the Board of Control seemed to feel that the system was strengthened by their closing. 4/

Somewhat less than $120,000 was required for these three failures. No assessment was required in the case of the Merchants and Trader's Branch Bank, but $20,000 was advanced by the Board of Control from its own clearing fund in order to meet the first applications for note redemption. Less than $100,000 was required for the

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1/ June 7, 1852, Ohio Letters, op. cit..
2/ June 2, 1852, Ohio Letters, op. cit..
3/ July 3, 1852, Ohio Letters, op. cit..
4/ December 1, 1854, Ohio Letters, op. cit..

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Akron and Commercial Branch Banks together, thus indicating that sizable amounts were obtained from liquidation of their assets soon after failure.

Aid to operating banks. More than half of the amount expended by the Board of Control by reason of the financial difficulties of participating banks went to aid operating banks, rather than for the redemption of circulating notes of failed banks. In all, eight Branch Banks received such aid and only two, the Licking County and the Akron, later failed. Table 37 lists the amounts spent in the eight cases.

In making this assistance available, the Board of Control was motivated by two factors: first, losses of the other participating banks would very likely be smaller if weak banks could be strengthened and continued in operation; second, damage to reputation of the entire system would be avoided.

Smaller losses were to be expected, according to the President of the Board of Control, because "we think that the debtors will be more likely to pay so long as there shall be any prospect of /the bank/ resuming business." 1/ This was particularly true at that time since the businessman of that day was not likely to chance the denial of future accommodation by what was very likely to be the only available bank, further, most western banks of that period made a practice of padding the interest on loans. 2/ This practice was understood, and to a certain extent accepted, by the community since it was recognized that maximum interest permitted on bank loans was much below the actual rate. However, when a bank failed and the receiver began to press debtors for payment the added charges were frequently cited as being usurious. If the courts agreed the debtor was relieved of his obligation.

Equally important to the Board of Control was the reputation of the banking system it supervised. In a period when banks were still regarded with suspicion, and when the slightest rumor could start a run, it was essential that the confidence of the noteholder be sustained. In the midst of the panic of 1857 John Andrews, the president of the Board, put it quite simply:

> Our great source of strength is public confidence and whatever tends to sustain or increase that, adds to our strength. Let us retain that, and we will pass the crisis triumphantly ... 3/

In another instance the president was called upon to justify assistance given the Akron Branch Bank in 1854. Aid received by the bank had not prevented its failure, but Andrews commented:

1/ March 27, 1852, Ohio Letters, op. cit..

2/ A typical arrangement required that a loan be repaid in the notes of eastern banks, which carried a premium, so that the bank received both premium and interest.

3/ October 9, 1857, Ohio Letters, op. cit.; underscoring in original.

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> You are aware of the circumstances under which these advances were made, the object being to sustain the Branch during a state of general alarm, when [its] failure ... would have, in all probability, carried several others with it. 1/

In addition to public confidence, the Board also had to sustain the confidence of the State legislature in the banks, many of whose members were strongly opposed to banking. Nothing contributed to their animosity so much as a bank failure, with its attendant disruptive effects upon the community. It is, therefore, not surprising that attempts had been made to sustain the Licking County Branch Bank:

> it was ... believed that the loss of the whole advancement, a calamity which was not contemplated, would be a less disaster to our confederation than a failure of a Branch ... Such an incident was only wanted [by the legislature] to carry out oppression to the utmost extremity ... 2/

Despite the fact that there were often good reasons for sustaining Branch Banks which seemed about to fail, the Board of Control did not have the express power to do so. Consequently, it not only had to count on the voluntary support of the participating banks but also had to devise a workable procedure for such cases.

The Summit County Branch Bank and the Toledo Branch Bank were the earliest and most difficult cases. Shortly after they opened in 1845 both banks were found to have seriously impaired capital and were immediately placed under close surveillance by the Board. However, it was not until 1850 that action was taken in the case of the first bank, while the Toledo Branch Bank was not finally reorganized until 1855.

In the case of the Summit County Branch Bank, the Board permitted new stockholders to organize a Branch Bank with the same name as the old bank. Following this, "the Board transferred all the assets and liabilities and paid [the new stockholders] for assuming them." 3/ This resembles the procedure followed by the Federal Deposit Insurance Corporation in assumption cases, in which a sound insured bank assumes the liabilities and assets of a failing bank with the assets including cash received from the Corporation.

The case of the Toledo Branch Bank was more complicated. In 1850, "it was ... deemed best to take this Branch from the stockholders and endeavor to manage the affairs and ultimately to make up all the losses." 4/ However, it was found that the bank was without

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1/ January 12, 1855, Ohio Letters, <u>op. cit.</u>.
2/ April 3, 1852, Ohio Letters, <u>op. cit.</u>.
3/ July 6, 1855, Ohio Letters, <u>op. cit.</u>; underscoring in original.
4/ November 14, 1850, Ohio Letters, <u>op. cit.</u>.

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capital and could not even meet its immediate liabilities. Consequently, the assessments shown in Table 37 were made, with the Branches receiving the stock of the bank as security.

In 1855 the Board interested some new investors in the bank and the following letter went out to the Branch Banks:

> There was transferred to each Branch, several years ago, a certain number of shares of stock of the Bank of Toledo -- and doubtless to your Bank also. Your Bank, as most of them had done, had probably charged up its contributions to the Bank of Toledo to Profit and Loss, and took no account of the stock, as it was really of no value. But I think you will find the stock filed away among your records. However this may be, I wish you to execute and forward the power of Atty. to Mr. Martin without delay. It only informs him to transfer any Stock outstanding in the name of your Bank, on its books; and if the books of the Bank of Toledo show none, the power will be only useless. This sale differs from that of the Summit Co. Bk. ... in this case we retain the assets and liabilities, and the purchasers pay us for the stock. The parties are very responsible. A Branch is needed at Toledo, and the sale is considered a good one. We wish to have it closed as soon as possible. 1/

In other words, the new stockholders acquired a going bank whose assets included advances previously made by the other Branch Banks. By "pay us" for the stock, the president simply meant that the payments would go into the Toledo Branch Bank to serve as its new capital.

Because in both of these cases the Board had levied assessments, only thinly disguised as loans, to aid distressed operating banks, a number of the sound banks protested. Such protests were usually met with the arguments described earlier. In the case of the Toledo Branch Bank the president wrote to one complaining cashier:

> ... I may add that the Toledo might have been treated as if it had commited an act of insolvency and then the section of the law, 26, to which you refer would apply in the contribution. But such, for the best of reasons, was deemed a very impolitic course and would have no doubt led to a much greater loss than the Branches will now be subjected to. I need not remind you that this would also have brought an irreparable discredit upon the system ... 2/

Apparently his reasoning was convincing since it appears that all such assessments were collected.

1/ July 6, 1855, Ohio Letters, op. cit.; underscoring in original.

2/ November 14, 1850, Ohio Letters, op. cit..

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As previously noted the Board of Control attempted to bolster the Licking County Branch Bank in 1852 and the Akron Branch Bank in 1854. Its action in the former case was probably influenced by the fact that a particularly severe bank tax law was then under consideration in the Ohio legislature. As the president put it, "the time is inauspicious for the failure of one of our Branches." 1/ However, neither objective was attained: the tax law was passed and a short time later the Licking County Branch Bank failed. In the case of the Akron Branch Bank, more than $80,000 was advanced, apparently on the condition that the president resign and a man selected by the Board be elected. 2/ This was not done and, on November 25, 1854, the man favored by the Board for president was appointed receiver. 3/

Panic of 1857. The experience gained in earlier cases was useful when the panic of 1857 broke. During the panic, and the depression that followed, waves of bank failures swept the country and, with very few exceptions, banks suspended redemption of their obligations in specie. However, not a single Branch Bank failed, nor did any suspend specie payments, although the Ohio Branch Banks were among the hardest hit of the nation's banks.

The basic causes of the panic of 1857 will not be explored here but it is probably correct to say that the panic was touched off by the unexpected failure of the Ohio Life Insurance and Trust Company on August 24 of that year. This company, operating under a special Ohio charter which permitted a commercial banking business, had become one of the nation's leading banks. At the time it failed its New York agency was holding the correspondent balances of the larger Ohio Branch Banks.

In the first days after its failure the President of the Board of Control was more concerned, understandably, over these deposits than over the developing panic. In a letter to the cashier of the Commercial Branch Bank, who had been in New York when the Trust Company failed, he wrote:

> Accept my thanks for your advices from N. York by teleg. and by letter. I presume you are again at your post. The blow from the failure of the Trust Co. is terrible -- but still it is so distributed that I only fear serious trouble from a few points ... it falling generally on the strongest of our Branches ... 4/

He also enclosed a copy of a resolution, adopted by the Executive Committee of the Board of Control on the previous day, which suggests that the supervisory officials were preparing for a depression:

1/ March 27, 1852, Ohio Letters, op. cit..
2/ November 16, 1854, Ohio Letters, op. cit..
3/ November 25, 1854, Ohio Letters, op. cit..
4/ August 27, 1857, Ohio Letters, op. cit.; underscoring in original.

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> Resolved: That under the existing state of affairs brought about by the unexpected suspension of the Ohio Life Insurance & Trust Co. the Com. have confidence in the ability of each Branch to protect itself but in the event any of the Branches should need assistance the President of the Board of Control is hereby authorized to draw upon such of the Branches as he may deem expedient for such sums as may be necessary to render the adequate assistance ... 1/

Only two days after the above letter was written the first request for aid appeared; and was promptly met. On August 29, the secretary addressed a letter to the Commercial Branch Bank:

> Dr. Andrews is absent at Cincinnati on business connected with this office--I am officially advised that the Merchants Branch Bank of Cleveland needs aid to sustain it and I have assumed the responsibility to telegraph to you this morning to render aid to the amount of 15,000 dollars under the resolution of the Executive Committee of 26 instant. I trust it will be convenient for you to respond favorably to this call. The President will address you further on this subject on his return from Cincinnati which will probably be on Monday next. 2/

Other requests followed and within two months assistance totaling $56,000 had been given four Branch Banks. In each case the aid was in the form of a loan. This was made clear in a letter to the cashier of the Norwalk Branch Bank, one of the aid recipients: "It is expected that any Branch which may receive aid, by way of advances from another Branch, shall furnish satisfactory security either in the form of time paper, or in the circulating notes of the Branch ... and interest paid thereon ... 3/

In only a few cases was any protest made of the action taken by the Executive Committee. Apparently, the fact that the "assessment-loans" were levied only on the Branch Banks best able to afford it irked some, but the seriousness of the situation eventually led them to comply with the order. A letter to the cashier of the Toledo Branch Bank from Andrews deals with such a situation:

> Mr. Gardiner of Norwalk Branch has returned to this office our requisition on you for $10,000, made in conformity with the resolution of the Ex. Comt. on the 26 ult. the object of which is to provide relief for any Branch which may need it in a most extraordinary and unexpected crisis brought upon us by no imprudence or improper action of one Branch but by the gross misconduct and fraud of others.

1/ Ibid..
2/ August 29, 1857, Ohio Letters, op. cit..
3/ September 4, 1857, Ohio Letters, op. cit..

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> The case presents the strongest one that can be well imagined for grounds of relief, if needed. But aside from this, we are one family, and our Branches are about as much interested in sustaining each other, as each is in sustaining itself. In fact, to sustain a sick Branch is to sustain yourself.
>
> It so happens that this calamity has fallen upon most of our strongest Branches ... Under these circumstances but one of two courses remain, either to call upon those who have escaped this misfortune, and who are well able to afford relief, or to do nothing, and let the State Bank of Ohio fail ... Is your Board of Directors known to contemplate such a result? The Elyria Branch promptly responded to our requisition in aid of Norwalk for $5,000, her capital being but half of what yours is ... but I cannot draw on you until I hear from you. 1/

The Branch Banks were also benefited in other ways during the panic as a consequence of their relationship with each other. First, the Board of Control had been able to secure bonds and mortgages from the Trust Company to secure the deposits held there. Some of these mortgages were immediately converted into cash and were thus of some help. 2/ Second, the Branch Banks were able to exchange circulating notes with each other to be used in the course of daily business. By paying out the notes of other Branch Banks rather than its own, each bank was assured that noteholders would have difficulty in returning notes for redemption. This was a common, if not entirely ethical, practice followed by banks during emergencies. And since the Board of Control was in contact with all Branch Banks, it was a relatively simple matter. The procedure apparently was that the clerk of the Board of Control, upon receiving notes from one Branch Bank, would return a mixed package of notes of other, distant, Branch Banks. 3/

By the end of 1857 it was becoming clear that the panic had been successfully met by the Branch Banks. 4/ As noted earlier, this was the last instance in which financial assistance was required by banks participating in the insurance system.

Losses to participating banks. It was pointed out earlier that assessments on participating banks to redeem the notes of an insolvent Branch Bank were to be returned to the banks from the

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1/ September 5, 1857, Ohio Letters, op. cit.; underscoring in the original.

2/ Many of the letters written during September and October of 1857 indicate that the Board's efforts to collect on mortgages secured from the Trust Company met strong resistance.

3/ October 5 and 10, 1857, Ohio Letters, op. cit..

4/ "... I hope the good ship 'State Bank of Ohio' is once more in smoother waters. But for the terrible calamity of the Trust Co. she would have passed through the crisis without the necessity of taking in a sail." November 27, 1857, Ohio Letters, op. cit..

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insurance fund. 1/ However, the fund consisted simply of a portion of the assets of each Branch Bank. Since both the assets assigned to the insurance fund and the assessments were based on the amount of circulating notes, it is clear that liquidation of the fund, or any part, to repay the banks the amounts they had been assessed would have only amounted to a shift in the composition of assets of each bank and not to a true reimbursement.

As a matter of fact, the insurance fund was never used for this purpose. This was made clear in a letter to the Cincinnati Gazette in 1862, long after the last occasion for an assessment had arisen:

> ... a "Safety Fund" is provided solely for the purpose of reimbursing the Banks for advances to each other. I would here remark, however, that the Board of Control of the State Bank of Ohio has never permitted any such reimbursement to be made from this fund; requiring such advances to be charged to the profit & loss of each Branch, thus preserving the "Safety Fund" unimpaired ... 2/

It is impossible to determine what proportion of the $291,000 disbursed on behalf of creditors of the four Branch Banks placed in receivership was eventually repaid to the contributing banks. In the monthly report made in September 1858, the item "Advances to insolvent branches" appeared for the first time among assets. The amount shown was $170,000, and since there was a somewhat comparable decline from the preceding month in the holdings of Branch Bank circulating notes it may be presumed that the new item was simply an attempt to take out of "Notes of Branches on hand" those notes of failed banks which were being held as claims against the receivers of those failed banks.

The amount shown as "Advances to insolvent Branches" fluctuated within a narrow range during the next several years reaching $182,000 in January of 1860. Thereafter it declined and in January of 1865 was $52,000. The increases in some months were probably attributable to the fact that notes of a failed bank generally came in slowly for redemption, particularly so when it was known that they would be redeemed at par. How much of the decline in this item is attributable to payments to the Branch Banks by the respective receivers and how much to charge-offs by the banks themselves cannot be determined.

Financial aid given operating Branch Banks prior to their failure did not entitle the contributing banks to a preferred position among bank creditors. This was made clear in a letter from the president to a Branch Bank cashier, dealing with advances made on behalf of the Akron Branch Bank prior to its failure:

1/ See p. VI-5.

2/ March 18, 1862, Ohio Letters, op. cit..

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> ... Nothing has been done since the meeting of the Board of Control to secure the Branches for their advances to the Akron Br. prior to its failure. From present indications I fear there will be no assets left ... from which any security can be had. At the time those advances were nearly ... $100,000, R.R. Stock held by the Bank was deposited in this office to secure the Branches for their advances. By the subsequent insolvency of the Bank this stock, is I suppose, vested in the Board of Control as part of the assets of the Bank and the proceeds may be applicable to all future redemptions of the notes of the Bank ...
>
> I have instructed the Branches from which the advances were made ... to keep the account of their advances entirely distinct from the account of contract made after the failure of the Branch. All the Branches have contributed in like proportion to these advances ... 1/

Thus, in the two cases where such aid was given, i.e., the Licking County and Akron Branch Banks, the other participating banks undoubtedly suffered losses. Also, there was apparently little or no return to the participating banks for their contributions made to assist in the reorganization of the Summit County and Toledo Branch Banks. If it is assumed that advances made during the panic of 1857 were all repaid, it may be roughly estimated that losses to the participating banks for the entire period approximated $300,000.

Appraisal of the Supervision and Regulation of Participating Banks 2/

Supervision of the Ohio Branch Banks was entrusted to the president of the Board of Control and an Executive Committee, consisting usually of four or more Board members and the president. The full Board met only twice a year, in May and November, and although it could, and did, receive appeals from actions of the Executive Committee it rarely sustained such appeals. Consequently, the bulk of the supervisory correspondence, on which the following appraisal is based, consists of letters written by the President of the Board of Control, i.e., by Gustavus Swan until 1855 and by John Andrews thereafter.

Enforcement of supervisory regulations. Four methods were available to, or developed by, supervisory officials to assure compliance by the Branch Banks with their orders. The first, and most

1/ January 12, 1855, Ohio Letters, op. cit..

2/ Almost all of the direct evidence available for appraising the supervision and regulation of the Ohio Branch Banks is contained in the correspondence records of the Board of Control covering the years 1848-64. While this is a far better source of information than is usually available for banking systems operating a century ago, it should be noted that the records consist of outgoing correspondence. Thus, information contained in incoming mail, such as letters from participating banks and reports of bank examiners, can only be inferred The lack of correspondence records for the first three years the sys-

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frequently used, was persuasion. Since the president and the members of the Executive Committee were in a position to view the system as a whole and were in receipt of daily information on banking conditions, they were frequently able to explain and justify orders which might be unpopular. This method was apparently used with great effect by both presidents but particularly by the first. Its greater use in the earlier years probably reflects in part the different personalities of the two men and in part the fact that the first president had to deal with bankers to whom the system and the principle of mutual liability was still new.

A more effective technique for stubborn cases was developed by the Executive Committee after John Andrews succeeded to the presidency of the Board. This was to limit, or forbid, the payment of dividends by the Branch Banks until a particular order was obeyed or situation corrected. Although there was no express provision for this power in the 1845 law or later amendments, it is found in the 1855 edition of the By-laws. 1/ Apparently it was based on the broad powers given the Board, and by it to the Executive Committee, to protect the interests of the system as a whole. 2/

By limiting or forbidding dividends the Executive Committee could clearly exert great pressure upon the officers of an erring Branch Bank. However, a stronger weapon was needed in a few cases and this was found in the right of the Board to require a Branch Bank to reduce its circulation or other liabilities whenever it felt that the activities of the bank threatened the system with a loss. Unlike the limitation of dividend payments, which merely postponed distribution of earnings already made, reducing circulation meant a reduction in earning assets and thus earnings *per se*. This power was used sparingly and usually only by the full Board of Control rather than the Executive Committee.

Finally, the Board could secure an injunction and close a Branch Bank which failed to obey an order. This authority was never used but its presence gave great weight to the decisions of the Board and of the Executive Committee.

Examinations and reports. The act creating the State Bank system required that participating banks be examined at intervals determined by the Board of Control. Examiners were to be either members or special agents of the Board and were given broad powers. 3/

Examination of each Branch Bank was apparently made two or three times a year during the first years the system was in operation. However, by 1848 it was felt that "unless it was supposed best by the Ex. Com. the Branches need not be examined oftener than once a year..." 4/

The policy of annual examinations, unless conditions warranted a special examination, was embodied in a section of the

tem operated, is considered a less serious deficiency because of the short time involved and the fact that no major change occurred among personnel of the supervisory agency until 1854.

1/ *Laws, By-laws and Resolutions relative to the State Bank of Ohio* (Columbus, 1855), Article 6. The Branch Banks could appeal to the Board but in the meantime had to obey the order in question.

2/ See p. VI-8.

3/ See pp. VI-8-11.

4/ June 12, 1848, Ohio Letters, *op. cit.*.

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1855 By-laws, along with a provision prohibiting notice of the time of examination. 1/ Apparently both practices had been followed for a number of years prior to 1855 and were also followed thereafter. Occasional inquiries designed to ascertain the date of forthcoming examinations were sometimes put off by the secretary of the Board in the following manner: "I know not when the Examiner will 'be on you' but suppose he will come at a time when you do not expect him, perhaps 'like a thief in the night'. Therefore 'be ye ready.'" 2/

There is no indication in the correspondence records or elsewhere that a permanent staff of examiners was ever recruited. In the early years examinations seem to have been assigned to individual members of the Board of Control who, upon completing the task, charged the bank a fee for the service. 3/ The fee was not fixed by the Board, at least in the early years, since Swan had occasion to write to one cashier who considered the charge "exorbitant": "Now if Mr. W. has charged too much under this situation it is not our fault and if we can be made sensible of it we shall take care that such a thing shall not happen again." 4/

This system was also unpopular with the appointees and on several occasions the Board was unable to persuade the person selected to accept the assignment. 5/ Consequently, after the middle 1850's most examinations were conducted by the vice-president of the Board of Control.

Numerous letters to examiners were found among the correspondence records of the Board. The instructions included with two such letters, the first written by Swan and the second by Andrews, are reproduced here to show what the supervisory officials expected of their examiners. Swan's letter included the following list:

1. Ascertain by count or weight ... the amount of specie on hand.
2. Compare bills and notes with books ...
3. Ascertain and report overdue paper and on the oaths of the president and cashier the real cash value thereof.
4. Interrogate the officers under oath as to what amount the directors and stockholders directly or indirectly are indebted to the Branch and whether the terms and conditions of the loans are more favorable than to customers in general.
5. Ascertain what agent the Branch employs in or out of the State and what is the principle or main object of employing him or them.

1/ Article 8, section 10, Laws ... op. cit..

2/ August 30, 1855, Ohio Letters, op. cit..

3/ It goes without saying that a Branch was never examined by its own representative on the Board of Control.

4/ December 7, 1849, Ohio Letters, op. cit..

5/ For example: "We hardly deem the reason assigned by you for declining the duties ... sufficient. With a view to the thorough examination of the Branches we selected those whose experience of business ... best qualified them ... We have no doubt but [that it is] more or less [an] inconvenience ...", Letters, September 4, 1852.

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6. Whether any of the stock of the Branch, other than what appears upon the books is held in trust or is incumbered in any way ...

7. Whether debts due the Bank deemed not sure and collectable in whole or in part, and which have been past due for six months or more, have been carried to Profit & Loss.

8. Ascertain by interrogatories to the cashiers and other officers what per cent upon the capital, or the amount in gross in addition to what has heretofore been carried to Profit & Loss, in their judgment will be loss on the present debts due the Branch.

9. Whether the Branch is in the habit of discounting or purchasing bills of exchange payable at another place than the place of such discount or purchase and if so what is the premium or exchange usually taken ...

10. Has the Branch in any case renewed bills or notes with the sole view of diminishing the overdue list.

11. Has the Branch knowingly suffered any individual or individuals to overdraw his or their deposit account and if so whom and to what amount.

12. Does the Branch make loans to brokers or others whose business is in whole or in part to return notes of the Branches for redemption.

You will please give in your report your opinion as to the manner of keeping the books ... and whether they are attended to as to daily detect errors, and whether there is promptness or negligence in answering letters of business. You will also ascertain and report the amount of specie drawn from the Branch since the last meeting of the Board, the sources from which the Branches mainly supply themselves with specie and the expense of procuring it.

The agent is not limited in his investigations to the particular points enumerated but is to use his own discretion ... to the fullest extent. 1/

Andrews' letter was somewhat less formal:

At a meeting of the Ex. Comt. this day you were appointed an Agent to examine, prior to the next meeting of the Board of Control, the Union Bank, Massillon; The Knox County Bank; and the Hocking Valley Bank. You are requested to examine carefully the character, security and probable prompt payment of the bills Receivable of each of these Banks, a list of which you will return with your report, with marginal remarks. You will also carefully examine their books and accounts and reports, not only as to their accuracy, but as to the time when their accounts, general and individual, can be settled. It is desirable also to know whether either of these Banks has any arrangements, either through the Bank, or their officers, in official or private capacities, to procure and maintain in circulation the notes of other Banks in or out of the State; and if so the nature of such arrangements, the security given, and whether any of the assets of the Bank are hypothicated or

1/ September 10, 1851, Ohio Letters, op. cit..

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pledged to secure the same.

You will not confine your examinations to the points indicated, but make them full and thorough so as to present a true and actual condition of the Bank. 1/

Apparently the examination reports were laid before the Board at its semi-annual meetings. Typical of the action taken at one meeting was the following:

> Dayton Branch Bank: Resolved: That the Dayton Branch be required to make quarterly trial balances of its individual ledger, to correspond with the general ledger, and that a record of the same be kept on file for the inspection of the examiner.
>
> Resolved: That the Dayton Branch be required to so change its mode of bookkeeping that any variation of the cash shall not prevent balancing of its general ledger.
>
> Jefferson Branch Bank: Resolved: That the Directors of the Jefferson Branch, in making a dividend on the First of Nov., 1858 of four percent, in violation of a resolution of the Board of Control after their attention had been called to the same by the President of this Board, are censurable for such violation, and that said Branch be restrained from making any dividend until permitted to do so by the Executive Committee.
>
> Farmers Branch Bank, Mansfield: Resolved: That the Farmers Branch at Mansfield be required to ascertain and correct the discrepancy which existed at the time of the Examiner's report between its individual and general ledgers.
>
> Miami County Branch Bank: Resolved: That the Miami Co. Branch be required to cause the loans to ____, ____, ____, and ____ to be reduced at the rate of 10 percent on the present amount, as the same matures, each sixty days, until the debt is reduced to at least $30,000 in the aggregate, of active paper.
>
> Mt. Pleasant Branch Bank: Resolved: That the Directors of the Mt. Pleasant Branch in making a dividend on the 1st of Nov. 1858 of eight percent in violation of a resolution of this Board, and an order of the Executive Committee allowing only a 3 percent dividend, are clearly censurable by this Board; and that said Branch be restrained from making any dividend until permitted to do so by the Executive Committee.
>
> Athens Branch Bank: Resolved: That the Athens Branch be required to enter the $10,000 time drafts given to the Conway Bank of Massachussets, upon their books.
>
> Resolved: That the Athens Branch be required to reduce the loans to their directors so as to bring them within the limits prescribed by the Charter.
>
> Resolved: That the Athens Branch be required to adjust the discrepancy between it and the Ross Co. Branch.
>
> Marietta Branch Bank: Resolved: That this Branch be required to reduce its loans to directors so as to bring the amount within the limits required by the Charter.
>
> Ross County Branch Bank: Resolved: That the Ross County Branch be required to adjust the discrepancy in the amounts betwen it and the Athens Branch. 2/

1/ March 23, 1855, Ohio Letters, op. cit..
2/ November 18, 1858, Ohio Letters, op. cit..

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It seems fair, on the basis of these and similar letters, to conclude that high examination standards were laid down and that examinations were diligently conducted. It also appears that the supervisory authorities did not hesitate to take action on the basis of information secured from examination reports.

The 1845 law gave to the Board of Control the right to determine how often, and in what form, participatings banks would submit reports of condition. The By-laws published in 1855 show that monthly condition reports were required and, in addition, names and addresses of all persons indebted to the Branch Banks were sent to the Board four times in each year. 1/ It is probable that both of these practices were followed from the time the system began until it closed.

The form of the condition reports was not described in the By-laws. Probably it was the same as the "accurate statement of the condition" which the 1845 law required of each Branch Bank at the time dividends were paid. 2/ This statement was quite detailed including, for example, a distinction between specie in the bank's possession and "specie" deposits in other banks. Also, amounts owed by directors and stockholders had to be segregated in these reports. Many of the Board of Control letters indicate that such information was included in the reports of condition submitted monthly by the Branch Banks.

Operation of individual banks. In their dealings with individual Branch Banks supervisory officials were responsible for seeing that statutory provisions were not violated and that each bank conducted its business in a sound manner. This naturally required a wide range of activities but study of the correspondence records indicates that officials were diligent in meeting their responsibility. This may be illustrated by examining their record for several of the more important areas of supervision.

One of the most important of the statutory provisions was the requirement that each Branch Bank maintain a specie reserve for circulation. 3/ In 1845 such a requirement was still novel and the tendency of bankers to ignore it was strong. The situation was further complicated in Ohio by the activities of private bankers and brokers who demanded exorbitant premiums for specie or its equivalent, particularly on the days just prior to the submission of condition reports. 4/ Nevertheless, the supervisory officials were prompt to require compliance in each instance, even where the infraction was minor, as indicated in the following letter:

1/ Article 8, sections 1 and 4, Laws ..., op. cit..
2/ An Act to incorporate ..., section 59.
3/ See page VI-9.
4/ August 12, 1851, Ohio Letters, op. cit..

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We observe by your last monthly report that your specie is ... less than thirty percent. The deficiency is a trifling sum and doubtless its occurence was accidental ... I write merely to comply with the spirit of the /law/. 1/

Letters from supervisory officials regarding violations of the specie reserve requirement were equalled in number only by those dealing with excessive accommodations granted stockholders and directors. The tradition that these persons were particularly deserving of bank loans stil persisted and probably no other statutory limitation relating to banks, in other States as well as Ohio, was more consistently violated. However, the practice was dangerous because of the concentration of risk to which the bank became subject; and because anti-bank legislators were quick to point to it in justifying laws detrimental to banking.

An illustration of the concern evidenced by supervisory officials is seen in the following letter:

> ... I do not presume that /the liability of your directors and stockholders/ swelled as it is, exceeds the limits of the latter clause of the 12th Sec. but I may be permitted to say that this large accommodation, if publicly enough known and it is very apt to get out, will leave an unfavorable impression as to the management of the Branch. It will give confirmation to what is often charged upon banks, that those interested monopolize the means to the exclusion of those without. I would therefore respectfully suggest to your directors whether it would not be a measure of policy to curtail some of their stockholder borrowers, the better to enable the Branch to extend accommodations to the business portions of the community ... Stockholders should be lenders, not borrowers ... 2/

Swan and Andrews were equally concerned with excessive loans to stockholders and directors but whereas Swan preferred, or perhaps was required, to use persuasion, Andrews did not hesitate to impose more stringent penalties. Indeed, one Branch Bank was compelled to retire $50,000 of its circulation. 3/ By early 1857 Andrews claimed that such action had solved the problem: "we have ... so far succeeded in enforcing an observance ... that it rarely is necessary to allude to the matter." 4/ However, the practice was never completely eliminated and even as late as 1863 Andrews was reminding a bank:

1/ October 17, 1848, Ohio Letters, op. cit..
2/ April 5, 1849, Ohio Letters, op. cit..
3/ May 13, 1857, Ohio Letters, op. cit..
4/ February 17, 1857, Ohio Letters, op. cit..

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"Of course we all know this debt is safe ... but that is not the question. It is a violation of the charter ..." 1/

The quality of bank assets, as revealed by examination reports, frequently drew criticism from supervisory officials. This seems to have been particularly true after Andrews became president of the Board of Control. However, individual banks were usually permitted a large degree of independence in the acquisition of assets and supervisory officials were content merely to point out certain errors. A typical letter from Andrews to the Union Branch Bank indicates little inclination to take action unless absolutely necessary:

> The present condition of the bills receivable of the Union Bank really alarms me. If anything should occur to send your circulation homeward I do not see how the Bank could sustain itself ... when will bankers learn that the wiping off of an old debt by creating a new one is not a payment? ... I did hope the "Union" had seen its worst days but I fear that time is before, and not behind it. 2/

The problem of failure to maintain adequate capitalization was not as pressing at that time as it is today. The ratio of capital stock paid in to total assets was typically 25 to 30 percent and supervisory officials were most frequently concerned with seeing that capital was actually paid-in and that stockholders were not permitted to borrow money with their stock serving as security. Nevertheless, the Board of Control did substantially strengthen the capital position of the Branch Banks by requiring that each bank establish a contingent fund equal to its contribution to the safety fund, i.e., equal to ten percent of its circulation. 3/ If a bank failed to maintain the contingent fund at the stated level its circulation was to be reduced accordingly.

Operation of the banking system. In seeking to achieve a strong banking system, supervisory officials were often required to look beyond the condition of individual Branch Banks. The insurance framework within which the banks operated was novel for Ohio and, in addition, there was the ever-present hostility of a portion of the State legislature and of the public.

The attitude of the State legislature was of crucial importance to the welfare of the banking system and supervisory officials devoted considerable time to placating the legislature. Indeed, among the motives for a particular action it is sometimes difficult to distinguish between those arising from the application of sound banking principles and those related to fear of the legislature. An excellent illustration of this is found in the previously cited letter dealing with loans to stockholders and directors. 4/

1/ October 26, 1863, Ohio Letters, op. cit..
2/ August 14, 1861, Ohio Letters, op. cit..
3/ Article 8, section 17, Laws ..., op. cit..
4/ See p. VI-38.

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It is clear that the supervisory officials would go to great lengths to appease the legislature. Reference has already been made to the unsuccessful attempt to forestall the passage of a particularly severe tax law by delaying the failure of the Licking County Branch Bank. 1/ In another instance, after the failure of the Commercial Branch Bank of Toledo the State was given a preferred position among creditors "to prevent a great noise on the part of the hards, /i.e, the "hard money" or "anti-bank" legislators/" 2/ In general, it is difficult to assess the policy adopted towards the legislature because it was designed to forestall, rather than precipitate, legislation. That it was not successful in the case of the 1852 tax law does not, of course, mean that it was unsuccessful at other times.

In at least once instance the State was of direct assistance to the Branch Banks. During the panic of 1857 the State treasurer publicly announced that he would receive in payment of public dues only those banknotes issued by the Branch Banks and certain other Ohio banks. 3/ This announcement, which was of great value in maintaining public confidence in the banks, was the State's part of a bargain, under which the supervisory authorities had promised to have the banks furnish the State with eastern exchange, needed to pay interest on the State debt, at par, i.e., without exchange charges. This was one of those actions which at first met the strong disapproval of individual bankers but which was finally accepted when supervisory officials explained its importance. 4/

During the earlier years supervisory authorities also had to deal with a danger internal to the system: antagonism among the Branch Banks. As Swan put it in one instance: "Our Branches are exceedingly jealous of each other and ... no slight danger exists of actual hostility ... It is possible /the Executive Committee/ can derive some measures to avert hostility, so disgraceful among brothers." 5/

Apparently, it was difficult for bankers who had operated in prior years under extremely competitive conditions to become accustomed to a system whose great strength was in the principle of mutual responsibility. Under such circumstances the slightest indication of favoritism on the part of supervisory officials could have been disastrous. What was needed was patient, tactful handling of the banks and, on this score, supervisory officials acquitted themselves well. The extreme delicacy of the situation, and the approach used by Swan, is best illustrated by the following letter to a Branch Bank cashier:

> I regret to learn from a reliable source that your Branch has recently returned for coin to the Xenia Branch a large amount, say 15,000 of their issues. I do not of course claim any right to interfere in such matters, but I deem it of very great importance

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1/ See p. VI-28.
2/ December 1, 1854, Ohio Letters, op. cit..
3/ October 21, 1857, Ohio Letters, op. cit..
4/ See p. VI-32.
5/ September 2, 1850, Ohio Letters, op. cit..

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> that the harmony of the Branches not be interrupted in any way and I must say that unless impelled by an absolute necessity I think a run by one Branch on another is particularly calculated to create unpleasant feelings ... Information has reached this office by way of rumor only that the Xenia Branch is in the habit of discounting domestic bills payable in your city in coin. If these rumors are well founded it is but an indirect way of drawing specie from your bank and necessarily in part from other Branches. If such a practice exists to any great extent or perhaps even in a single instance I should deem it unfair ... I again repeat that I claim no right whatever officially to interfere with the business of the Branches in such matters and what I have said I fear may be deemed ... what does not concern me and if this should be the case I most assuredly will not complain. 1/

Another example of the broadening of supervisory horizons is seen in the concern shown by officials over the effect of bank operations on the circulating medium and on the economic life of the State. The law, of course, did not provide for supervision in this area but from scattered bits of evidence it appears that supervisory officials in Ohio developed a method of controlling the volume of bank obligations similar to that available today to the Board of Governors of the Federal Reserve System.

In providing for a specie reserve equal to thirty percent of circulating notes the Ohio legislature merely required that at least half of the reserve consist of gold and silver coin in the various Branch Bank vaults and permitted the remainder to be in the form of deposits in banks of certain eastern cities. However, supervisory officials took the position that they could vary the proportion of the specie reserve required to be in coin-in-vault so that, at the maximum, the entire reserve could be so constituted. Thus, orders varying the proportions which might have appeared at first to be simply routine became, in fact, of utmost importance. This was because the Branch Banks frequently could not afford to draw down their eastern balances too far and, as a result, could only meet an increased specie-in-vault requirement by contracting their circulation.

The record of the use of this power by supervisory officials is not complete. At some time prior to 1855 they required that 20 percent of the circulation consist of coin-in-vault since such a regulation is included in an edition of the By-laws published in that year. 2/ A letter written by the president of the Board of Control in the summer of 1852 may provide a clue as to the date of this provision and the reason for its adoption:

1/ June 30, 1849, Ohio Letters, op. cit..
2/ Article 8, section 18. Laws ..., op. cit..

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> Below is a copy of a Resolution of the Ex. Com. passed this day. I shall be happy to have your opinion as soon as convenient ...
>
> "Resolved: That the President ... ascertain whether it is deemed best in view of the cheapness and abundance of money to enforce the orders of the Board at last session directing a withdrawal of circulation and an increase of specie basis." 1/

Apparently, the ratio of coin-in-vault to circulation was permitted to fall to 15 percent again during the panic of 1857 since, as the panic subsided, the president of the Board of Control wrote that one of the resolutions adopted at his recommendation required the banks to "bring up the coin to 20 percent on circulation in 60 days and thereafter $2\frac{1}{2}$ percent per month until the amount is to 30 percent and hereafter we will have no 'equivalent' but count only 'coin in vault' as the basis of circulation ..." 2/

Later changes in the ratio cannot be determined, although between 1857 and 1860 the portion of the specie reserve consisting of coin-in-vault was again allowed to fall to half, or fiteen percent of circulation. In general, it appears that the supervisory officials exercised their power over the circulating medium, or that portion consisting of Branch Bank circulation, whenever they felt that the strength of the State Bank system would be increased by a contraction of circulating medium, or restraint upon expansion.

Because information is insufficient regarding the various dates at which changes in the vault specie reserve were ordered, or became effective, it is difficult to demonstrate the effect of such orders upon bank operations. The November 1857 resolution noted above is the only order which can be assigned a precise date and in this case it appears to have been quite effective. In October 1857, the ratio of specie to circulation was less than 17 percent. Following the November order the ratio increased rapidly, exceeding 28 percent in March 1858. This rise was due to an increase in specie and to a sharp contraction in circulation. Individual deposits also declined sharply following the November order.

Appraisal of the Insurance Plan

Ohio's bank-obligation insurance plan had two closely related but distinguishable objectives: to protect the creditors of failed banks from loss and, second, to prevent a collapse in the State's circulating medium as a result of bank failures. Only a limited attainment of these objectives was possible since insurance was restricted to circulating notes of participating banks. Within these limits, the objectives were attained. No noteholder of a failed participating bank suffered a loss and, in addition, a number

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1/ August 23, 1852, Ohio Letters, op. cit..
2/ November 21, 1857, Ohio Letters, op. cit..

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of banks in financial difficulties were enabled to continue operations as a consequence of both direct and indirect aid from the insurance system. This section deals with the measure of success enjoyed by the insurance plan as well as with its shortcomings.

Comparison with nonparticipating banks. During the twenty years of bank-obligation insurance in Ohio thirteen nonparticipating banks failed, with total obligations in excess of $5 million. About two-fifths of this amount was attributable to the Ohio Life Insurance and Trust Company. It will be recalled that only ten Branch Banks became involved in serious financial difficulties and of these four were closed. The total obligations of the ten Branch Banks were less than $2 million. Since the Branch Banks composed well over half of all operating banks and were responsible for 60 to 70 percent of total obligations, their record, whether in terms of number of banks in difficulty or obligations involved, was considerably better than that of the nonparticipating banks.

Losses to creditors of failed nonparticipating banks are not known, but it appears certain that they were considerably larger, both in absolute amount and in relation to total obligations of the failed banks, than was the case for creditors of the Branch Banks. In the case of the Branch Banks there was no loss to any bank creditor, whether depositor or noteholder, in the six banks restored to solvency through insurance disbursements. There was no loss to noteholders of the four Branch Banks placed in receivership but there was very probably some loss to depositors of those banks. Total deposits in these four Branch Banks were just over $500,000 at about time of failure. However, only $35,000 of this amount was in the Licking County Branch Bank, probably the most disastrous failure of the four. If it is assumed that depositor losses in the other three failed Branch Banks were 50 percent - probably too high a proportion - then losses to all creditors of Branch Banks in financial difficulty may be estimated at $250,000.

The 13 nonparticipating banks which failed included six Old Banks, five Independent Banks and two free banks. No special protection was provided holders of circulating notes of the six Old Banks, and such protection in the other seven cases was in the form of bond security posted by the banks. From the record of similar bond protection plans in other States it may be assumed that not all payments to noteholders of Independent and free banks were at par.

Scattered pieces of information indicate that losses to creditors of the Old Banks were substantial. For example, Huntington quotes a contemporary estimate to the effect that losses in the case of the Bank of Wooster, which had total obligations at time of failure in excess of $500,000, were not less than $250,000.1/ In the case of two other Old Banks which failed with circulation outstanding of

1/ Huntington, op. cit., p. 433.

$455,000 quotations from banknote reporters suggest a minimum loss of 25 percent, or more than $100,000. Thus, in the cases of only three Old Banks it appears that losses to creditors were larger than those for all Branch Banks in difficulty. Taking all thirteen failed nonparticipating banks together and applying the same ratio of 50 percent to depositor losses as was applied in the case of the Branch Banks, total losses to creditors of failed nonparticipating banks would approach $2 million.

Method of paying insured obligations. The fact that noteholders could secure gold or silver coin immediately after failure of a participating bank undoubtedly contributed to the maintenance of public confidence, and thus to the strength of the entire system. However, it will be recalled that sums required for immediate note redemption were secured by special assessments, levied as needed, on the sound participating banks. Since the need for assessments was greatest during depression periods, the sound banks were subject to drains on their resources at the very times when they could least afford it. In addition, the banks could not know how often, and for how much, they would be assessed since that depended to a large extent on the rapidity with which notes were returned to the redeeming bank.

Thus, public confidence in the insurance system was sustained in periods of crisis at a cost to both the community and the banks. The community suffered because the sound banks were undoubtedly forced to contract even further than would be customary in order to be able to meet assessments that might arise. The banks suffered because liquidation of failed banks could not proceed at an orderly pace. That is, the receiver was under strong pressure to turn assets into cash as fast as possible in order that there be no need for further assessments.

An alternative would have been to provide for the establishment of an independent insurance fund, under the control of the supervisory authorities, from which payments to noteholders could be made. The legislature may have had some such plan in mind when it established the safety fund but, as was shown earlier, that was not a fund at all, a fact which was so apparent that it was never used by the supervisory authorities for the purposes for which it had been intended. 1/

Had an independent insurance fund been established it is clear that substantially larger assessment rates than are paid today by insured banks would have been necessary. Table 38 shows that a fund created from assessments at rates equal to those levied under Federal deposit insurance would have been wiped out in 1850, the first year in which payments were required. But had such a fund been supplemented by adequate borrowing power assessments throughout its twenty years of operation of ½ of 1 percent of total circulation would have met the losses which occurred in the banks which failed.

1/ See p. VI-6

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Table 38. Adequacy of Safety Fund and Extent of Insurance Coverage
Ohio Branch Banks, 1845-64
(Amounts in thousands of dollars)

Year	Claims applicable against Safety Fund 1/	Branch Bank safety fund		Hypothetical insurance fund 3/	
		Amount 2/	Percent of insured obligations	Amount	Percent of insured obligations
1845	--	$ 136	8.6	$ 27	1.7
1846	--	342	12.9	29	1.1
1847	--	537	14.5	32	0.9
1848	--	730	10.6	37	0.5
1849	--	855	11.2	43	0.6
1850	142	907	10.8	50	0.6
1851	49	894	10.6	57	0.7
1852	113	906	11.2	64	0.8
1853	44	875	10.6	70	0.8
1854	140	860	12.3	76	1.1
1855	58	836	11.1	82	1.1
1856	40	813	11.0	88	1.2
1857	56	815	12.7	93	1.5
1858	--	815	12.9	99	1.4
1859	--	815	12.5	104	1.6
1860	--	815	11.0	110	1.5
1861	--	815	10.0	117	1.4
1862	--	815	10.1	124	1.5
1863	--	815	14.2	129	2.2
1864	--	774	16.6	133	2.8

1/ From Table 37, "Total assessments by year." Excludes insured obligations of failed banks which were redeemed with funds secured from liquidation of said banks.

2/ From monthly condition reports, library of the Ohio State Arachaeological and Historical Society.

3/ Computed by assuming an original fund of $26,000, approximately equal in relative size to original capital of FDIC, plus additions for each year equal to one-twelfth of one percent of total circulation. No deductions were made for claims against fund.

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Had the safety fund, also shown in Table 38, actually been an independent insurance fund it would have been adequate, but it would have required annual assessments of about one percent on insured obligations.

Supervision of participating banks. Equal in importance to immediate payment of creditors in accounting for the success of the insurance system was the supervision of participating banks. As previously indicated, supervisory officials were diligent and thorough in seeing that the banks complied with the law and that the system was protected from attack or loss. Most important, this was accomplished through self-regulation, i.e., supervisory officials were named, paid, and subject to dismissal, by the participating banks.

Undoubtedly, there were numerous factors which account for the quality of supervision, not the least of which was the ability of the two presidents. However, it is submitted that the major factor was the principle of mutual liability. The Board of Control, consisting of representatives from each Branch Bank, could not afford to relax its vigilance or limit the authority of the president, lest it be faced with a failed bank and the necessity of levying assessments on the banks it represented.

Before 1845 there was relatively little bank supervision in Ohio and its development between 1845 and 1865 marked a great step forward in Ohio banking history. Nevertheless, it is proper to suggest that the pressure on supervisory officials may have been too great. Although the correspondence records indicate that officials paid some attention to the credit requirements of the State, in most cases their concern was understandably directed towards guarding participating banks against losses which would arise from insurance assessments. Consequently, there may have been a tendency to be too conservative, to contract earlier and more sharply than was warranted in adversity and to expand too slowly during other periods.

While the available data are not sufficient to demonstrate this proposition, it is significant that in changing the specie reserve requirements officials were concerned in each instance with contraction of the amount of circulating notes. 1/ There is no evidence that reserve requirements were ever lowered for other than negative reasons: that is, that contraction was no longer necessary. On the other hand, there were several instances where expansion of the circulating medium to the benefit of the public was prohibited while there was the slightest possibility of danger to banks. 2/

Adequacy of insurance coverage. When the Ohio legislature, following New York's lead, restricted insurance to circulating notes, it limited, but did not do violence to, the objectives of the insurance plan. However, it appears that the exclusion of deposits from coverage was developing into an important defect of the insurance system by the 1860's.

1/ See pp. VI-41-42.
2/ February 8, 1858, Ohio Letters, op. cit..

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The growing importance of deposit banking is reflected in the extent of insurance coverage, as shown in Table 35. It is true that a substantial portion of total Ohio circulation remained insured during most of the period. For example, in 1863 more than two-fifths of Ohio's circulation was insured, i.e., it had been issued by Branch Banks. However, whereas this insured circulation had constituted about half of total obligations of all Ohio banks for much of the period, by 1863 it was less than one-third of these obligations. In other words, as the insurance system was near its end it was protecting a minor segment of Ohio bank creditors and was becoming inadequate as a safeguard for circulating medium provided by Ohio banks.

Although this situation was due in large part to the growth of deposit banking, it also points up another defect of the insurance system, i.e., it applied to only a portion of the State's banks. To fully attain the objectives sought in the insurance legislation it would have been necessary that all banks participate in the plan. As Andrews put it in a letter contrasting the State Bank system with the Independent Bank system in Ohio:

> ... Each system continues to have its advocates, and both seem to work satisfactorily when well managed. The disturbing feature between them is in the nature of the security furnished for their circulation. That of the Independent Banks, being Ohio and U. S. Stocks, affords ultimate security without doubt; that of the State Bank being mutually liable for each others circulation secures immediate redemption. Such a system as that of the State Bank of Ohio can only be made successful when it is made general ... 1/

The exclusion of deposits from insurance coverage was also given importance by changes in the distribution of deposits as well as changes in amount. Whereas in earlier years deposits tended to be held by relatively few people and were little used as means of payment, by 1865 the use of checks was much more widespread. Consequently, to simply maintain the confidence of the noteholder was not sufficient in periods of panic. It is significant that in 1854 it was a run by depositors, not noteholders, which necessitated giving aid to the Akron Branch Bank. 2/ An increasing awareness of the importance of protecting depositors was shown by Andrews in 1863, when he commented: "Of the various forms of liabilities banks have, there is no one which can be brought to bear upon them with such sudden concentration of power as their deposits; and no one <u>less</u> susceptible of concentration and immediate demand than their notes in circulation, ..." 3/

Summary. The limitations of Ohio's insurance plan should not be permitted to obscure the fact that, on balance, it was a remarkable success. It was one of the pioneer insurance plans, launched at a time when banking was developing and changing rapidly. Undoubtedly many of the defects would have been eliminated had it

1/ December 17, 1855, Ohio Letters, op. cit..
2/ November 15, 1854, Ohio Letters, op. cit..
3/ January 24, 1863, Ohio Letters, op. cit..

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been permitted to continue after 1865.

The success of the insurance plan is reflected in the fact that the State Bank of Ohio has come to be recognized as one of the great banking systems of the pre-Civil War period. Time has not altered the appraisal of the system of the insurance plan made by its long-time secretary in 1855:

> The State Bank of Ohio demonstrated the wisdom of its founders. It lived through some troublous times but kept its integrity. It did what it was designed to do, furnish a safe circulating medium for the people of the State 1/

1/ John J. Janney, "State Bank of Ohio", Magazine of Western History, II (1885), p. 174.

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CHAPTER VII

INSURANCE OF BANK OBLIGATIONS IN IOWA, 1858-1865

Iowa was the sixth State, and the last prior to the Civil War, to make use of the insurance principle in providing for the protection of bank creditors. The plan was put into operation in 1858 and became inoperative in 1865 when most of the participating banks converted to national banks.

Review of Iowa Banking History to 1865

Prior to 1858, only one authorized bank was formed in Iowa. The legislature of the Wisconsin Territory, which included the present State of Iowa, approved the establishment of the Miners Bank of Dubuque on November 30, 1836. The authorized capital was $200,000 and about a year after its charter date the bank opened for business.

Almost from the beginning there was hostility towards the Miners Bank on the part of the legislature, becoming more intense after the Iowa Territory was formed in 1838. Suspension of specie payments by the bank in 1841 added still further to its difficulties and in 1845 an act repealing its charter was passed. After an unsuccessful court battle the bank passed out of existence in 1849.

In retrospect, it appears that the Miners Bank of Dubuque was no worse, and no better, than the typical western bank of the time. Except in its early years, its business was not extensive and note circulation probably never exceeded $175,000. In the years just prior to closing it did little business and it is doubtful that the community was affected by its demise.

Attacks on the Miners Bank reflected a general hostility in Iowa towards all banking. When the first State constitution was adopted in 1846 the West was recovering from a severe depression and many Iowa residents had come from areas in which bank failures had been numerous. Article IX of the constitution illustrates their attitude toward banks:

1. No corporate body shall hereafter be created, renewed or extended, with the privilege of making, issuing or putting in circulation, any bill, check, certificate, promissory note, or other paper, or the paper of any bank, to circulate as money. The General Assembly of this State shall prohibit, by law, any person or persons, association, company or corporation, from exercising the privileges of banking, or creating paper to circulate as money.

2. Corporations shall not be created in this State by special laws, except for political or municipal purposes, but the General Assembly shall provide, by general laws, for the organization of all other corporations, except corporations with banking privileges, the creation of which is prohibited ...

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Prohibition of banking did not prevent persons from meeting the demends for bank facilities which naturally were present in a rapidly developing State. Private banks were numerous. Although they were not permitted to issue notes, they found it profitable to finance immigrant land purchases and to buy and sell eastern exchange. Information on these private banks is slight, but apparently by the middle 1850's every town of consequence had at least one firm which offered some bank facilities.

Nor did the new State lack for banks of issue. Beginning in 1855 a number of banks secured charters from the territorial legislature of Nebraska. These were controlled by Iowa residents and although their home offices were nominally in Nebraska they were, in fact, Iowa banks. Some of the better known were the Western Exchange, Fire and Marine Insurance Company, the Bank of Florence, the Bank of Nebraska, and the Bank of Fontanelle. 1/ However, the life of these extra-legal banks was short, as not one was able to survive the panic of 1857.

Faced with the collapse of the Iowa-Nebraska banks and burdened with a circulating medium made up of much of the worst bank paper in the West, Iowa reconsidered her earlier position on banking. A new constitution was adopted which permitted the legislature to enact banking legislation. However, a trace of anti-bank feeling remained in the requirement that before taking effect all such laws had to be approved in a general election.

In 1858 two banking bills were enacted into law and overwhelmingly approved by the voters. A Free Banking Act permitted individuals to establish banks provided that they complied with rather strict provisions regarding capitalization and note issue. How strict were these provisions is shown by the fact that when the law was repealed in 1870 not a single free bank had been organized.

The other piece of banking legislation was more successful. "An Act to Incorporate the State Bank of Iowa" was passed on March 20, 1858, and, after receiving the approval of the voters, was declared in force on July 29 of the same year. In the absence of free banks, the banking history of Iowa from this date until 1865 centers on the State Bank system.

In structure the State Bank of Iowa was directly descended from the State Banks of Indiana and Ohio. The head office was located at Iowa City, then the State capital, but its function was solely that of exercising general supervision over the Branch Banks, which could not exceed 30 in number. The maximum capital was $6 million, all of which was to be divided among the Branch Banks, which were limited to not less than $50,000 nor more than $300,000 capital. Fifty percent of the authorized capital of each Branch Bank was to be paid in specie prior to the opening of the bank, with the remainder

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1/ It is probable that the name Western Exchange, Fire and Marine Insurance Company was designed to resemble that of the best known bank in the area, the Wisconsin Marine and Fire Insurance Company of Milwaukee. To the extent that noteholders confused the two, the Nebraska bank benefited from the excellent reputation of the older bank.

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due in installments of specie spaced at four-month intervals. Each Branch Bank had its own officers and divided its profits among its own stockholders. Thus the State Bank of Iowa, like those of Indiana and Ohio, was a federation of independent banks.

The life of the State Bank was short but successful. In addition to providing the State with muchneeded banking facilities, it assisted the State government in financing its contribution to the war effort. Although it would undoubtedly have continued after the Civil War, passage of the National Banking Act, followed by the prohibitive tax on State banknotes, led most of the Branch Banks to convert to national banks in 1865.

Character of the Insurance Plan

Iowa's insurance plan for the protection of bank creditors was very similar to that adopted in 1845 by Ohio. The successful operation of Ohio's plan and the fact that several Iowans prominent in State affairs had previously resided in Ohio account for this similarity. For example, Ralph Phillips Lowe, Governor of Iowa when the State Bank was established, was a former resident of Ohio. Also, the key individual on the standing committee on banking in the Iowa senate when the act was passed was Samuel Jordan Kirkwood, (later Iowa's war governor) a former Ohio resident who had taken an active interest in the State Bank of Ohio.

Bank participation and obligations insured. As in Ohio, the plan embraced only Branch Banks comprising the State Bank, made use of the mutual guaranty principle as well as an insurance fund and, finally, covered only the circulating notes of the participating banks. Deposits and other liabilities of the participating banks were not covered, nor was any provision made for the inclusion in the system of such other banks as might be established in the State.

Assessments and insurance fund. The insurance fund, or "Safety Fund" as it was called in the act creating the State Bank, was not built up through annual assessments. Instead, each Branch Bank paid to the State Bank "money or United States [bonds] or interest paying State [bonds] at their current value in the city of New York but in no instance above their par value, an amount equal to twelve and one-half per cent on the amount of the notes for circulation, which shall be delivered to such branch." 1/ This sum had to be paid before any notes were delivered to the Branch Bank, i.e., before it opened for business, and additional payments had to be made only if the amount of notes delivered was later increased due to an increase in capital or because the entire authorized issue had not been delivered at the commencement of business.

1/ An Act to incorporate the State Bank of Iowa, March 20, 1858, section 7.

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All money deposited to the account of the insurance fund was to be invested in Federal or State bonds by the State Bank and interest thereafter received was to be paid to the Branch Banks in proportion to the amounts they had contributed. 1/ While the State Bank had custody of the insurance fund, ownership remained with the Branch Banks, each of which carried the amount it had paid on the assets side of its statement of condition. 2/

Payment of insured creditors. The insurance fund did not stand for the immediate and direct payment of creditors of a failing bank. When a Branch Bank became insolvent, i.e., was unable to redeem its notes in specie, 3/ the State Bank was required to place it in receivership 4/ and to "immediately provide money ... and place the same in such solvent branch or branches, as may be most convenient for the purpose of redeeming the notes of such failing branch ..." 5/ The amount provided was not taken from the insurance fund but from new assessments levied on the solvent Branch Banks in proportion to the amount of circulation each had outstanding. These sums were then repaid the solvent Branch Banks through liquidation of securities comprising the insurance fund. 6/

Upon liquidation of the assets of a failing bank by receivers, payment had to be made first to the other Branch Banks to cover any amount not already returned from the insurance fund and, second, to the insurance fund to reimburse it for all moneys advanced except for that portion originally contributed by the failing Branch Bank. Following this, the receiver could meet the claims of depositors and other creditors and, finally, distribute among the stockholders any remaining funds. 7/ No specific provision was made for replenishing the insurance fund in the event that it was diminished but it was undoubtedly expected that the Branch Banks would at all times have an amount equal to twelve and one-half percent of their circulation deposited in the insurance fund. Thus if the fund was drawn down new assessments would have been required.

In essence, the Iowa plan meant that participating banks collectively guaranteed the circulation of any one of their number but gave to the supervisory authorities, i.e., the officials of the State Bank, the right to determine which of their assets would be liquidated if it became necessary to make any payments. That is, to return the sums advanced by the solvent Branch Banks, the State Bank simply sold bonds which were already the property of the Branch Banks.

1/ Ibid., section 8.

2/ The amount contributed by a Branch Bank was "held by the /State/ Bank as the property of said branch for the benefit of the several branches ...", Ibid., section 7.

3/ Ibid., section 10. If for some reason the State Banks failed to take action any creditor of a bank failing to redeem its notes in specie could secure a court order requiring such action to be taken. Contrariwise, a Branch Bank falsely accused of being insolvent could appeal to the courts (sections 14 and 15).

4/ Ibid., sections 10 and 11.

5/ Ibid., section 11.

6/ Ibid., section 12.

7/ Ibid., section 13.

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Statutory Provisions Relating to Supervision and Regulation of Insured Banks

In providing for bank supervision and operating regulations Iowa drew heavily upon Indiana and Ohio legislation, although the Iowa regulations were generally based on more conservative standards than in either of the other States.

Supervisory agency. Responsibility for operation of the insurance system and supervision of the Branch Banks was given the directors of the State Bank. This was, in fact, their only function since it will be recalled that all banking was done by the Branch Banks, which collectively constituted the State Bank.

The Board of Directors of the State Bank, or State Board as it was frequently called, was composed of one representative from each Branch Bank 1/ and three members elected by the State legislature. 2/ Branch Bank members served one-year terms while terms of State members were two years. The Board was required to maintain its head office at Iowa City.

Each director on the State Board had two votes but those representing the Branch Banks were allowed an additional vote for each $50,000 of capital paid into the particular Branch Bank in excess of $100,000. 3/ Since the State did not hold any stock in the Branch Banks, and consequently had no power to influence the selection of those members of the State Board representing the Branch Banks, it will be seen that control of the banking system was firmly in the hands of its owners. 4/

Apparently the burden of the State Board's work fell on the president, secretary, and executive committee of three or more members, one of whom was the vice-president. 5/ With the exception of the secretary, these officials were chosen by the State Board from among its own number and received compensation for their services. Except for the salaries of the State representatives, which were paid by the legislature, 6/ all expenses were met by the Branch Banks in the ratio of the circulating notes assigned to each. 7/

New bank investigations. Application to start a Branch Bank automatically constituted application for insurance, since all Branch Banks were participants in the insurance system. Investigation of the first applications was the responsibility of ten Bank Commissioners, appointed and named in the act creating the State Bank. 8/ The act also outlined the procedure which was to be followed in determining whether an application was to be granted. 9/ When at least five

1/ Ibid., section 2.
2/ Ibid., section 51.
3/ Ibid., section 5.
4/ Section 3 provided for the right of the Governor and General Assembly to inspect the records of the State Bank at any time.
5/ Ibid., section 3.
6/ Ibid., section 51.
7/ Ibid., section 4.
8/ Ibid., section 52.
9/ Ibid., section 52.

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Branch Banks had been accepted by the Commissioners, and the Governor was so notified, 1/ representatives to the State Board were chosen who, together with the three State representatives, were thereafter charged with the admission of additional Branch Banks. The Bank Commissioners were then excused from further service.

Whether by the Bank Commissioners or by the State Board, the act required thorough investigation of applications to form Branch Banks. Primary emphasis was placed upon verifying the amount of specie claimed to have been paid in and upon investigating the character and responsibility of the new stockholders. 2/

Bank examination and condition reports. Examination of the Branch Banks was made by at least one member of the State Board, or an appointed agent, as often as the State Board desired. 3/ Ample power was given examiners to determine the condition of the Branch Banks.

There is no indication in Iowa records of the frequency of examination during the first several years. In 1860 the State Board made it the duty of the president to examine each Branch Bank once in each six-month period and it is likely that the practice of semi-annual examinations was thereafter followed. 4/

Each Branch Bank was required to submit monthly condition reports to the State Board, the form for which was carefully outlined in the law. 5/ Such reports were required to be published by each Branch Bank in a local newspaper and copies sent to each of the other participating banks. 6/ Also a consolidated statement was to be published monthly by the State Board. 7/

Sixteen items were required to be included in the condition reports and the State Board had the right to add to these items. Among the more important of those listed in the original law were: (Liabilities) 1) capital stock, 2) circulation, 3) interbank deposits broken down to show deposits of other Branch Banks, other Iowa banks, and banks outside of the State 4) individual, business, and government deposits combined, i.e., without distinction as to the types listed here; (Assets) 5) amount of gold and silver coin or bullion, 6) amounts due from banks, broken down as in (3) above and, in the case of sight balances, containing in each case the name of the city or town in which deposited, 7) loans, discounts, and securities without distinction except for loans to directors and to stockholders. 8/

Bank operations. Statutory limitations on the operations of the Branch Banks were similar to regulations governing banks in other western States at that time. Since deposit banking was only

1/ Ibid., section 53.
2/ Ibid., section 52.
3/ Ibid., section 3.
4/ Resolution adopted May 17, 1860; Record of the Board of Directors, MS, State Historical Society of Iowa.
5/ An Act to incorporate ..., op. cit., section 35.
6/ Ibid..
7/ Ibid., section 3.
8/ Ibid., section 35.

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just beginning to assume importance, many of these limitations related to the note issue function of the Branch Banks.

Circulating notes of the Branch Banks had to be paid on demand in gold or silver coin; failure to do so was deemed an act of insolvency. 1/ However, the Branch Banks did not, in fact, pay specie after 1862 since, along with other State Banks, and as a consequence of the Legal Tender Act, specie payments were suspended and bank notes were redeemable in United States notes.

By the time Iowa considered authorizing banks it was becoming clear that provisions limiting circulation and other bank obligations to a multiple of capital did not by themselves provide a precise rule as to the proportion that specie reserves should bear to such obligations. Consequently, the Iowa Act of 1858 required that each Branch Bank maintain a specie reserve equal to 25 percent of its circulating notes. 2/ In addition, each Branch Bank had to retain in its vaults "at least twenty-five percent of its current deposits ... over and above the amount required to be kept for the protection and redemption of its circulation." 3/ It is not clear whether this wording meant that the deposit reserve must consist of specie or whether it could be partially or wholly in other kinds of cash, e.g., notes of other banks.

Note circulation of each Branch Bank was further limited to a multiple of paid-in capital, the multiple decreasing as capital increased. Specifically, circulation could not exceed twice the first $100,000 of capital, once and three-fourths the second $100,000 and once and one-half the third $100,000. 4/ A Branch Bank with its full complement of authorized capital could have a circulation of not more than $525,000, for which it had to maintain a reserve of approximately $130,000. It should be emphasized that this reserve was in addition to its deposit in the insurance fund, maintained for ultimate note redemption in the event of failure.

Other provisions dealing with circulating notes included: notes were prepared, registered, and countersigned by the State Bank before distribution to the Branch Banks; 5/ Branch Banks could not include in their own circulation any but their own notes 6/ and also could not exchange their notes with those of an out-of-State bank for circulation reasons; 7/ notes of out-of-State banks which were known to be not redeemable in specie could not be paid over the counter of a Branch Bank in the course of its daily business; 8/ notes of each Branch Bank had to be accepted at par by all other Branch Banks. 9/

1/ Ibid., section 10.
2/ Ibid., section 31.
3/ Ibid., section 32.
4/ Ibid., section 9.
5/ Ibid., sections 3 and 6.
6/ Ibid., section 29.
7/ Ibid., section 47.
8/ Ibid., section 38.
9/ Ibid., section 30.

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Deposits were specifically exempted from maximum amount 1/ limitations, probably reflecting the then current opinion that they were not a function of bank lending operations. While this was in fact the case in earlier years, and may still have been substantially true in Iowa in 1858, it will be seen from statements of condition presented in the next section that deposit banking soon became important in Iowa.

A number of provisions of the act creating the State Bank of Iowa were directed toward the problem of stockholders' and directors' loans. Included among such provisions were: 1) limitation of the amount for which the stockholders, collectively, of any Branch Bank could be indebted to it, either as principals or by endorsement, to not more than three-fifths of the Branch Bank's capital; 2/ a similar limitation for directors except that the collective amount could not exceed one-twentieth the amount of capital stock possessed by the directors; 3/ double liability for stockholders; 4/ prohibition of dividend payments to stockholders whose notes were overdue; 5/ prohibition of making any loan in which stock of the Branch Bank served as security. 6/

Interest charged by the Branch Banks was limited to ten percent until January 1863, at which time eight percent became the legal maximum. The Branch Banks were permitted to make bona fide purchases of bills of exchange and could add normal exchange charges when discounting such bills without violating the above restrictions. If a debtor could prove usury the act required that the debt be cancelled. 7/

Loans of the Branch Banks were limited in duration to four months 8/ and no person or firm could be indebted to a Branch Bank to an amount exceeding one-fourth of its circulation. If liabilities on account of bills of exchange were excluded, this limitation was raised to one-twentieth of the same base. 9/ Branch Banks were prohibited from dealing in or owning real estate except as it was necessary to locate the bank building or in conducting normal bank operations. 10/

Enforcement powers of supervisory officials. A participating bank could be closed by the State Board because of discovery of insolvency or of illegal operation. More important, it could be closed if it refused to comply with an order by supervisory officials. Since the State Board was charged with safeguarding the interests of the entire system, such orders could well relate to unsafe and unsound

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1/ Ibid., section 33.
2/ Ibid., section 26.
3/ Ibid..
4/ Ibid., section 42.
5/ Ibid., section 22.
6/ Ibid., section 23.
7/ Ibid., section 37.
8/ Ibid., section 28.
9/ Ibid., section 38.
10/ Ibid., section 28.

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banking practices, regardless of the legality of such practices or of the solvency of the bank. 1/

In addition to giving supervisory officials the right to use the suspension power in circumstances other than illegal or insolvent operation, Iowa law provided the State Board with less severe penalties applicable to banks operating in an unsafe and unsound manner. These included authority to prohibit or regulate dividend payments and the power to compel a bank to contract the amount of its assets and liabilities. In the case of dividends the law stated that the directors of each participating bank would semiannually declare such dividend "as they shall judge expedient and as shall be approved by the State Bank [i.e., supervisory officials]." 2/ Control over the volume of bank assets and liabilities was contained in the section giving the State Board the right "to require any branch to reduce its circulation, or other liabilities, within such limits as [the State Board] shall, after full inquiry into its condition, deem necessary to secure from loss, either the dealers with such branch, or the other branches." 3/

Number and Obligations of Insured Banks

Number of banks. The number of banks included in Iowa's insurance system was fixed during the entire period of its operation by the number of Branch Banks of the State Bank of Iowa. These banks constituted the only incorporated commercial banks in the State and no provision was made for the inclusion of private banks or banks which might be formed under the Free Banking Law of 1858. It is not known whether any savings banks operated in Iowa during the insurance period.

Within six months after passage of the act creating the State Bank, applications for 19 Branch Banks were submitted. In October 1858, eight applications were approved and seven of the Branch Banks concerned apparently opened for business by the end of that year. Establishment of four additional Branch Banks was permitted in 1859, two in 1860 and one in 1864, so that the peak number of banks participating in the insurance program was 15, of which 14 were in operation during most of the period 1858-65. Table 39 shows the number of banks operating in each year; the names of the various banks are shown in Table 40.

With the failure of the so-called Iowa-Nebraska banks in the panic of 1857 and the absence of any effort to start banks under the Free Banking Law, the Branch Banks of the State Bank of Iowa had as competitors only those private banks which continued after 1858. These were not banks of issue and apparently in earlier years their business was simply an adjunct of real estate transactions. By 1858, however, private banks were probably accepting deposits and discounting notes and bills of exchange. 4/

1/ Ibid., section 16.
2/ Ibid., section 35.
3/ Ibid., section 3.
4/ Howard H. Preston, History of Banking in Iowa (Iowa City: State Historical Society of Iowa, 1922), p. 56.

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Table 39. Number and Obligations of Iowa Branch Banks, 1858-1864
(Amounts in thousands of dollars)

End of year	Number of banks	Obligations					
		Total	Circulation	Deposits			Miscellaneous liabilities 3/
				Total	Business and individual 1/	Interbank 2/	
Number or amount							
1858	7	$ 170	5	163	163	4/	2
1859	12	$ 1,347	668	637	618	19	42
1860	13	$ 1,943	880	993	966	27	70
1861 5/	14	$ 2,084	652	1,327	1,279	48	105
1862	14	$ 2,706	1,249	1,336	1,287	49	121
1863	14	$ 3,830	1,526	2,140	2,097	43	164
1864 6/	15	$ 4,572	1,440	2,886	2,851	35	246
Percentage distribution							
1858	..	100.0%	2.9	95.9	95.9	..	1.2
1859	..	100.0%	49.6	47.3	45.9	1.4	3.1
1860	..	100.0%	45.3	51.1	49.7	1.4	3.6
1861	..	100.0%	31.3	63.7	61.4	2.3	5.0
1862	..	100.0%	46.1	49.4	47.6	1.8	4.5
1863	..	100.0%	39.8	55.9	54.8	1.1	4.3
1864 6/	..	100.0%	31.5	63.1	62.4	.7	5.4

Sources: Consolidated statements published in Iowa City Republican, library of the State Historical Society of Iowa; issues of January 19, 1859; January 18, 1860; December 19, 1860; February 20, 1861; December 17, 1862; January 20, 1864; January 18, 1865.

1/ Shown as "depositors" in statements.
2/ Shown as "due other banks" in statements.
3/ Shown as "other items" in statements.
4/ $474.
5/ February 4, 1861.
6/ Although the insurance system operated during the first part of 1865, the last year end data available are for 1864.

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Table 40. Circulation and Total Obligations of Iowa Branch Banks, December 5, 1859; December 5, 1864
(Amounts in thousands of dollars)

Bank	December 5, 1859				December 5, 1864			
	Obligations		Circulation		Obligations		Circulation	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
All Branch Banks - total	$1,131	100.0%	$ 565	100.0%	$4,269	100.0%	$1,431	100.0%
Branch Bank at:								
Burlington	241	21.3	88	15.6	781	18.3	271	18.9
Council Bluffs	--	--	--	--	161	3.8	86	6.0
Davenport	95	8.4	16	2.8	453	10.6	2	.1
Des Moines	64	5.7	48	8.5	246	5.8	141	9.8
Dubuque	82	7.2	28	5.0	683	16.0	284	19.8
Fort Madison	53	4.7	34	6.0	112	2.6	69	4.8
Iowa City	73	6.4	37	6.5	185	4.3	33	2.3
Keokuk	169	14.9	112	19.9	302	7.1	134	9.4
Lyons City	38	3.4	8	1.4	210	4.9	81	5.7
Macquaketa	--	--	--	--	87	2.0	31	2.2
McGregor	--	--	--	--	31	.7	20	1.4
Mt. Pleasant	63	5.6	37	6.5	306	7.2	88	6.2
Muscatine	89	7.9	52	9.2	242	5.7	64	4.5
Oskaloosa	74	6.5	47	8.3	157	3.7	83	5.8
Washington	90	8.0	58	10.3	313	7.3	44	3.1

Sources: Iowa City Republican, issues of December 21, 1859; December 21, 1864.

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It is impossible to accurately determine the number of private banks in operation in Iowa contemporaneously with the Branch Banks. Indicative of the discrepancy in what little information is available is the fact that whereas Thompson's Bank Note and Commercial Reporter lists only one private bank for Iowa on December 31, 1859, Homan's Bankers Directory shows 76 in operation about January 1, 1860.1/ It is probable that part of the explanation lies in the fact that Thompson's reported only private banks engaged exclusively in banking while Homan's may have included concerns doing a real estate or insurance business and which also, as a sideline, loaned some money or bought and sold out-of-state bank notes.

Bank obligations. Total obligations, i.e., circulating notes, deposits, and miscellaneous liabilities, of Iowa Branch Banks increased substantially during each year of the insurance period. It will be noted from Table 39 that from the end of 1859 (the first full year of operation) to the end of 1864 there was almost a fourfold rise in total obligations. This large and unbroken rise reflected the need for commercial banking facilities in the State, the absence of a serious economic downturn, and the effects of wartime financial operations by the State and the Federal government.

As noted earlier, circulating notes were the only obligations covered by insurance under the Iowa system. These insured obligations constituted about half of all Branch Bank obligations near the beginning of the insurance period but by the end of 1864 were less than a third of such obligations. It appears that had the insurance system survived the proportion of obligations insured would have continued to decline since the increase in deposits during the insurance period was generally at a much more rapid rate than that of circulating notes.

The relative importance of deposits among the obligations of Iowa banks is somewhat surprising. Although in the rest of the country the volume of deposits had exceeded the amount of circulating notes some time previously, one would nevertheless have expected that in Iowa, a predominately agricultural area and, in addition, one which had not long been settled, circulating notes would have comprised by far the largest share of total banking obligations. That this was not the case is evident from Table 39, which shows that during the insurance period (excluding the data for the end of 1858, when the Branch Banks had just opened for business) deposits ranged from slightly less than half to almost two-thirds of all obligations.

Relative size of participating banks. During the insurance period some size differentials developed among the Branch Banks. As a consequence, there was a risk to the insurance system arising out of the concentration of insured obligations in several banks. Table 40 shows the distribution of total obligations and of circulation among Iowa Branch Banks at the conclusion of the first and the last full year of operation.

1/ The same directory reported the number of private banks in succeeding years as follows: 1861 - 75; 1862 - 65; 1863 - 54; 1864 - 53; 1865 - 42.

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At the close of 1859 the Branch Bank at Burlington held over one-fifth of the total obligations of all Branch Banks, while the Branch Bank at Keokuk held about 15 percent of such obligations. Thus these two banks, comprising one-sixth of the total number of banks, had well over one-third of the obligations, with the remainder fairly well distributed among the other ten Branch Banks. Five years later, at the close of 1864, the two largest banks (that at Dubuque replacing the Keokuk bank) still held more than a third of all obligations and, in addition, a third Branch Bank, at Davenport, had grown relatively large. Together, these three banks accounted for only a little less than half of the obligations of the 15 Iowa Branch Banks.

Insured obligations, i.e., circulating notes, were concentrated in much the same fashion. In 1859 the two largest banks as measured by total obligations, held over a third of the insured obligations of the entire system, while in 1864 the two largest banks held almost 40 percent of all insured obligations. In both years the proportion of insured obligations attributable to each of the two largest banks was larger than the twelve and one-half percent of insured obligations which, by law, was the minimum size of the insurance fund.

History of Operation of Insurance System

During the seven years of operation of Iowa's insurance system no participating bank failed so that the procedure for the payment of insured obligations of a failing bank was never put into practice. Nevertheless, insurance operations were partly responsible for the excellent record of bank creditor protection.

Insurance operations for the protection of bank creditors. Two Iowa Branch Banks became involved in financial difficulties sufficiently serious to warrant special action by supervisory officials. In one case some loss was suffered by stockholders and an insurance disbursement was required; in the other case neither a stockholder loss nor insurance disbursement resulted, but special arrangements were made to guarantee the solvency of the bank concerned.

In 1859 the State Board became aware of rumors regarding unsafe banking practices on the part of officials of the Muscatine Branch Bank. At the Board meeting of August 10, 1859, a report of a special examination of the bank found "some departures of a minor character ... the most prominent of which is the allowing of accounts to be overdrawn." 1/ This report recommended no further action and was placed on file by order of the Board.

1/ Record of the Board of Directors, MS, State Historical Society of Iowa, August 10, 1859.

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The situation of the Muscatine Branch Bank continued to deteriorate and on January 5, 1860, the executive committee of the State Board conducted a special examination of the bank. At this examination it was found that the obligations of the bank exceeded the volume of good assets by more than $20,000. The shortage was due to a defalcation on the part of the cashier, whose firm (in which the president of the bank was apparently a partner) had overdrafts of considerable volume in the bank. It was believed that the cashier's bond would be sufficient to make up most of the losses resulting from his self-dealing and fraudulent operations.

The executive committee reported that it was at first their "unanimous decision ... that the Branch should go into liquidation and wind up its affairs," but because the "directors and stockholders ... were anxious to go on" another arrangement was made. Specifically: the president and cashier resigned and temporary control of the operations of the bank passed to the executive committee of the State Board; the principal bondsman of the cashier (who was also an official of the bank) deposited $45,000 with the executive committee as security for his pledge to "clear the institution within one year of all the indebtedness /of the cashier and president/ and other bad paper and make its stock ... as originally ... paid up and unencumbered"; the executive committee pledged "the cooperation and assistance of the Branches to sustain the /Muscatine Branch Bank/ by depositing money therein until its consummation /i.e., until the capital of the bank was restored/". 1/

It appears that on this occasion the sound participating banks agreed to make, and did in fact make, deferred deposits in the Muscatine Branch Bank. Management of the bank was later returned to the stockholders and it became one of the more profitable banks in the insurance system.

In 1863 a special examination of the Fort Madison Branch Bank recommended that a receiver be appointed but that liquidation not be started until a more detailed examination revealed whether or not the bank was solvent. There is no indication from the records of the State Board as to the cause of the bank's difficulty but it was apparently a case of asset deterioration. This is suggested by the fact that management was left in the hands of the officers but the cashier agreed to post $120,000, which was kept as security by the president of the State Board. It was agreed that the security would be gradually released as the condition of the bank improved and this, in fact, was what happened.

Insurance fund and assessments. Iowa's insurance fund increased during each year of the insurance period as a consequence of the expansion of the business of the Iowa banks described earlier. Table 41 shows the amount in the insurance fund at the end of each year of insurance operation. In addition, the table contains ratios of the insurance fund to total and to insured obligations and makes possible a comparison of Iowa's assessments with those paid by banks in other States having insurance systems and under Federal deposit insurance today.

1/ *Ibid.*, February 16, 1860.

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Table 41. Insurance Fund and Assessments, Iowa, 1858-1864
(Amounts in thousands of dollars)

End of Year	Insurance fund				Assessments: equivalent average annual rate on: 3/	
	Total	As percentage of: Total obligations	Authorized insured 1/ obligations	Actual insured obligations 2/	Total obligations	Insured obligations
1858	29	17.1	7.6	580.0	2.4	80.0
1859	105	7.8	11.3	15.7	1.1	2.2
1860	135	6.9	11.5	15.3	1.0	2.2
1861 4/	147	7.1	12.0	22.5	1.0	3.2
1862	226	8.4	14.2	18.1	1.2	2.6
1863	243	6.3	12.7	15.9	.9	2.3
1864	309	6.8	14.9	21.5	1.0	3.1

Sources: See Table 39.

1/ Authorized circulation was related to the amount of capital stock paid in, as described above, p. VII-7. Amounts from which these ratios were computed are (in thousands of dollars): 1858 - \$381; 1859 - \$930; 1860 - \$1,177; 1861 - \$1,227; 1862 - \$1,596; 1863 - \$1,914; 1864 - \$2,071.

2/ Circulating notes, as shown in Table 39.

3/ Hypothetical assessment rate on total or insured obligations necessary to achieve over a seven year period an insurance fund equal to that existing at the end of each year.

4/ February, 1861.

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The insurance fund maintained by the Iowa Branch Banks was larger relative to total and to insured obligations than the insurance funds maintained in any other bank-obligation insurance system operated prior to 1866. It will be observed that Iowa's insurance fund was typically about seven percent of total obligations and between 15 and 20 percent of insured obligations. By way of comparison, the insurance funds of New York and Vermont were approximately one or two percent of total obligations and the insurance fund of the Federal Deposit Insurance Corporation is about three-fourths of one percent of total deposits. However, it should be remarked again that Iowa's insurance fund was not an amount apart from the banking system and available for use in the event of a bank failure; rather, it was the total of portions of the assets of each participation bank, which total was held in trust by insurance authorities.

It was noted earlier that the law required that each bank contribute to the insurance fund an amount equal to twelve and one-half percent of the circulation it received (and presumably thereupon issued) from the State Board. As a practical matter, the Iowa banks kept a larger than required fund, as is shown in Table 41 and as was described above. Apparently the fund was maintained at approximately the level which would have been required had the Branch Banks issued all of the circulating notes to which they were entitled by reason of their volume of capital. Thus Table 41 shows that although the insurance fund was in general substantially in excess of twelve and one-half percent of actual circulation it was usually near twelve and one-half percent of authorized circulation.

Assessments paid by the Iowa Branch Banks were made before the bank opened for business, and thereafter only if an additional volume of circulating notes was delivered by the State Board. Assessments were therefore not paid regularly but a rough comparison can nevertheless be made of the assessments paid by Iowa Branch Banks with assesments paid by banks operating under other insurance systems or today. Keeping in mind the fact that the Iowa banks received the income from the investment of their assessments - a factor not reflected in Table 41 - it will be observed that the computed annual assesment on Iowa banks was equivalent during the insurance period to about one percent of total obligations and 2.5 percent of insured obligations. This rate was therefore much higher than those paid by banks in New York and Vermont, in particular, and also is considerably higher than the rate paid today under Federal deposit insurance.

Appraisal of Insurance System

Judged by the protection it provided bank creditors, Iowa's insurance system was an unqualified success. The two most important factors contributing towards this record were: 1) operation during a period of generally good times, 2) good bank supervision. Because of the brief period during which the insurance system was in operation it is difficult to distinguish other factors of consequence which account for the success of the system, nor is it easy to illustrate deficiencies in the system.

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Period of operation. Iowa's insurance system became operative just at the beginning of the recovery from the depression which began in 1857. From its start in 1858 to its close in 1865 the insurance system was not faced with any general economic downturn except for the very mild and short depression of 1861. On the contrary, most of the years included in the Iowa insurance period were war years, marked by rising prices and profits and relatively few failures in any line of business.

Participating banks also found their operations easier as a consequence of the Legal Tender Act of 1862. When United States currency became legal tender the banks were able to redeem their own notes in that currency, if they so chose, and specie payments were, as a result, generally suspended. Attempts on the part of noteholders to force the Iowa banks to redeem in specie were successfully combatted by the State Board. For example, at a meeting of the State Board of May 1862 it was resolved that any Branch Bank sued for redeeming in legal tender notes rather than specie would have the court costs borne by the Board, which in turn would be reimbursed from assessments levied on all participating banks. 1/

It also appears from the records of the State Board that the required specie reserve for circulating notes was allowed to fall below the legal minimum as a consequence of the policy described above. This is reflected in the fact that, on one occasion, it was only "recommended" that the Iowa City Branch Bank increase its specie "to at least the legal amount on their circulation". 2/

Supervision and regulation. On the basis of a study of the records of the State Board no substantial criticism can be directed at the quality of supervisory activities under Iowa's insurance system. Examinations were apparently regular and thorough, the growth of bank capital was stimulated, condition reports were carefully studied, there was thorough investigation of applications for admission to the system, and, finally, good interbank relationships were zealously promoted.

That examinations were thoroughly conducted is primarily evidenced by the fact that the two cases of bank difficulty were located and acted upon in sufficient time to prevent the closing of either bank. As was noted earlier, semiannual examinations were apparently the rule. In addition, directors and officers of the respective Branch Banks were ordered by the State Board to make their own examinations at the time of each monthly report.

The ratio of capital stock to total assets of the Iowa Branch Banks was on the order of 20 to 30 percent during the insurance period. This capital position, which would of course be considered very high today, was further improved by the State Board through a resolution adopted during the first year of insurance:

1/ Record of the Board of Directors, op. cit., May 14, 1862.
2/ Ibid., February 10, 1864.

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> That the branches be instructed to declare no dividends hereafter without first setting apart a contingent fund of one percent on their paid-up capital, until otherwise ordered by the State Board, such contingent fund to remain a permanent fund, subject to be diminished only by actual losses charged to said fund. 1/

During the next year (1860) several dividend declarations were approved by the State Board only if an amount equal to one percent of capital stock paid-in was first placed into the contingent fund. It is presumed that this rule was not changed during the insurance period so that in each of the following years similar amounts were credited to this fund. The amounts involved were not shown on published condition reports but they probably account for the growth in the volume of "other items" in such reports (shown as "miscellaneous liabilities" in Table 39).

The power of the State Board to approve or disapprove dividend declarations was apparently used to secure compliance with directives aimed at the elimination of unsafe and unsound banking practices. For example, a resolution in 1864 stated that no dividend would be allowed by any bank "which has failed to comply strictly" with any order of the Board. 2/

The records of the State Board indicate that there was very close study of the monthly statements prepared by the individual Branch Banks. The by-laws adopted by the State Board made such task the responsibility of the executive committee by stating: "It shall be their duty at their regular meetings in each month carefully to examine the monthly statements made by the several Branches and if upon such examination they determine it necessary so to do to cause a personal examination to be made by the president or the vice-president of the condition of any Branch". 3/ At meetings of the full State Board the records show that consideration of statements of condition and proposed dividend declarations was usually the first item of business.

After organization of the State Bank system by the Bank Commissioners it will be recalled that responsibility for the acceptance of new banks into the system passed to the State Board. The records of the latter organization indicate that applications for admission were carefully considered. The caution with which the Board acted is perhaps best illustrated by the unfavorable report made by the committee which investigated an application by the proposed "Farmers Branch Bank of the State Bank of Iowa". This application was rejected after the committee stated:

> From all the information we were able to obtain we believe the Directors and Stockholders (a list of which accompanies this report) to be men of responsibility and integrity and worthy of public confidence.

1/ _Ibid._, November 17, 1859.
2/ _Ibid._, November 16, 1864.
3/ _Ibid._.

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> While bearing this testimony however, to the character and responsibility of the parties connected with the organization, we feel compelled in justice, to what we deem the true interests of the Branches now organized, and to be organized under the Law creating the State Bank, to call the attention of the board of control to the large proportion of Stock held by persons not residing adjacent to the location at which the Branch is proposed to be established and at points remote from those presumed to be benefitted by its establishment.
>
> For these reasons your committee while favourably impressed with the advantages possessed by the point named for the legitimate support of a Branch of the State Bank, feel constrained, to advise the non acceptance for the present of the application. 1/

Supervisory officials were also alert during the insurance system to guard the reputation of the participating banks and to develop favorable relations among the banks. At one of the earliest meetings of the State Board it was declared that it be the "policy of the several Branches of the State Bank to hold and protect each others circulating notes, to as great an extent as possible ... and that the cashiers of the several Branches be requested to do so". 2/ This type of arrangement, whereby banks assisted each other in order to prevent any one bank from becoming embarrassed as a consequence of large and unexpected demands for note redemption, was fairly common among groups of banks in various States throughout the country. However, it was not unusual for banks to refuse to participate in such an arrangement and, as a matter of fact even banks as closely related as the Ohio Branch Banks were found, in the earlier years of operation of the Ohio insurance system, to be more interested in manufacturing difficulties for other participating banks than in cooperation.

Interbank relations were further strengthened by the Board's policy of refusing to interfere in the operations of any Branch Bank unless the solvency of that bank was threatened. Thus, when a quarrel among stockholders of the Branch Bank at Mount Pleasant led to an appeal to the Board by one side it was resolved: "Where the safety and good standing of the Branch is not endangered, it is not a matter requiring the attention or interference of this Board".3/

Other factors contributing to successful insurance operations. Had the Iowa insurance system existed for a longer period it is probable that more than good supervision would have been required to continue the excellent record of the first seven years. In particular, supervisory officials would undoubtedly have had to make judicious

1/ *Ibid.*, August 10, 1859.
2/ *Ibid.*, May 11, 1859.
3/ *Ibid.*, May 15, 1861.

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use of their "central bank" powers. Although these powers did not become of practical importance during the insurance period their very existence may well have contributed to its successful operation.

That the State Board intended to make use of this power is clear from the records of their meetings. As early as 1858 a resolution was presented which stated: "It is the duty of the president ... to order any Branch to reduce its circulation, or to do any other matter ... when in his opinion the interests of the State Bank require it, and in case of refusal to proceed in his discretion as directed in said section 16 [of the law]." 1/

Comparison with other banking systems. The record of the Iowa Branch Banks cannot be compared with that of other Iowa banks since there was only an unknown number of private banks operating during the same period. Comparison of the Iowa record with that of banking systems in neighboring States suggests that the insurance system in Iowa, together with sound supervision, may have been responsible for that State's more favorable experience.

Between 1859 and 1865 the typical experience of banking systems in the States bordering Iowa seems to have been disruption of banking operations as a consequence of the war and the closing - but not necessarily failure - of a number of banks. This appears to have been particularly true of the Illinois and Missouri banking systems.

Deficiencies of the insurance system. An insurance system which operated as successfully as did Iowa's provides almost no evidence as to defects which may have existed but never had the opportunity to reveal themselves. The most that can be said on this subject is that, with a system almost identical to that of Ohio, insurance operations in Iowa would have inevitably found the same problems as in the former State had the period been longer. In particular, Iowa authorities would have found that assessments levied on participating banks would usually come at precisely the wrong time, i.e., during a general monetary contraction and, as happened in Ohio, attempts to promptly reimburse the banks through quick liquidation of assets would result in smaller recoveries and further depreciation of values. In addition, insurance in Iowa embraced a diminishing segment of bank obligations, so that had operations continued after 1865 serious consideration would have had to be given to the extension of insurance coverage to deposits.

Supervisory operations in Iowa were of the same pattern as in Indiana and Ohio; very sound, very thorough, and very conservative. There seems no question that in Iowa, as in the two other States with similar systems, the nature of supervisory operations was greatly affected by the existence of mutual responsibility among the banks and the method of selection of State Board members. Thus it is again proper to suggest that such an arrangement may have blinded supervisory officials to anything but the maintenance of sound banks.

1/ Ibid., December 18, 1859.

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Conclusions. Although the Iowa insurance system compiled the best record of bank creditor protection of any of the pre-1866 systems, it was scarcely tested and therefore cannot be said to have been as successful as the insurance systems from which it descended - those of Indiana and Ohio. Nevertheless, it is clear that insurance operations in Iowa drew upon the Indiana and Ohio experiences and there is at least some reason to believe that its history during a more normal period would have been similarly praiseworthy.

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CHAPTER VIII

THE CONTINUITY OF BANK-OBLIGATION INSURANCE PROBLEMS

The histories of the bank-obligation insurance systems operated in six States prior to 1866 constitute merely the first part of an insurance story which has not yet ended. Although a half century was to pass before another State was to follow Iowa in adopting bank-obligation insurance, there was no real cessation in the effort to use the insurance principle in guarding against the destructive consequences of bank failure.

By the terms of the National Banking Act in 1863 the guaranty of the Federal government was given the notes of national banks, and this became a guaranty of all circulating banknotes after 1865 when notes of State chartered banks were taxed out of existence. Then, as bank deposits became increasingly important in the conduct of the nation's business, proposals began to appear in the Congress for deposit insurance on a national scale.

Without question, the early suggestions for nationwide deposit insurance drew upon the experience of the State plans described in this volume. As a matter of fact, the first bill for deposit insurance known to have been introduced in the Congress, in 1886, was by a Wisconsin Congressman who had been a resident of Iowa at the time the Iowa system was in operation. It is likely that agitation at about the turn of the century for deposit insurance in certain States was also influenced by these early experiments. That part of them had not been forgotten is shown by the fact that one of the studies authorized and published by the National Monetary Commission in 1910 was an analysis of New York's experience in insuring bank obligations between 1829 and 1866; and that the New York, Vermont, and Indiana systems were described in issues of the monthly periodical, Sound Currency, published in 1895 and 1898.

By 1917 at least 80 bills had been introduced in the Congress calling for nationwide deposit insurance, and in eight States deposit insurance systems were in operation. Thrity more bills were introduced in the Congress by 1929 and then, as it became painfully clear during the bank crisis of 1930-33 that State-wide insurance was not the answer, 40 additional bills were introduced. The last of these became law on June 16, 1933, and the Federal Deposit Insurance Corporation was established.

The record of bank-obligation insurance prior to 1866 is of more than historical interest. Notwithstanding the time which has passed since these first State plans ceased operation, many of the lessons which were, or could have been, learned then are equally applicable today. For after all, none of the essentials has changed: then as today, banks were institutions with obligations for the most part payable on demand and assets for the most part not immediately redeemable in cash; then as today, a bank failure destroyed a portion of the circulating medium and not only brought loss or ruin to individual bank creditors but also great distress to the community served by the bank.

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Before proceeding with a discussion of the lessons revealed by the bank-obligation insurance systems operated before the Civil War, a few words should be said regarding the extent to which any such insurance system - then or today - can guard against destruction of circulating medium due to bank failure. Under most circumstances an insurance system cannot prevent destruction of circulating medium in the economy as a whole; but it can prevent such destruction in the locality in which the bank is located. That is to say when disbursements are made to the creditors of a failed bank out of an insurance fund, there is no net addition to assets in the banking system which will offset the decline resulting from bank failure. Accordingly, there must be a net decline in circulating medium, but that decline will be spread over the entire economy, with probably negligible effects rather then concentrated at one point. Not only will the effect probably be negligible for the economy as a whole, but also the confidence engendered, generally, by the payment of deposits in the affected community will strengthen the entire economy and help prevent additional failures. There are, it should be noted, certain circumstances in which bank assets can be replaced or restored under insurance procedures and when this is done there is little or no destruction of circulating medium, either in the affected community or the nation as a whole. This can occur, for example, when insurance disbursements are used to restore a bank to solvency, or to facilitate a merger with another insured bank, or when funds for the payment to creditors of failed banks are secured by insurance authorities through the sale of securities to commercial banks.

One of the important lessons taught by the experiences of the six States reviewed in this volume is the need for an adequate insurance fund. Such a fund must be sufficient, either in itself or combined with an assured borrowing power that can be quickly exercised, to make the necessary disbursements to insured bank creditors as soon as possible after a bank failure. In each of the three State systems which relied upon an insurance fund the amount of the fund was too small. It is interesting to recall that in two of these States (New York and Vermont) this was not because the assessment rate did not provide sufficient income to cover losses but because the rate did not make possible the accumulation of a large enough reserve fund to make disbursements when needed. In New York creditors of many of the failed banks had to wait until arrangements could be made to borrow, and in Vermont some of the insured creditors had to wait for years while income was accruing to the fund. In both cases insurance protection was thereby made incomplete. 1/

Another important lesson taught by the events of 1829-66 relates to assessments and was demonstrated in five of the six cases. As was pointed out in Chapter I, more by happenstance than by design

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1/ As noted in Chapter III, some Vermont creditors were never paid, but this was largely because of refunds illegally made to some withdrawing banks.

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assessments paid by the banks tended to be larger - sometimes in absolute amounts and sometimes relative to total obligations - during periods of crisis and depression than during good times. In each State this led to difficulties which disrupted the course of insurance operations. It is clear from the experience of these early States that it is unwise to have insurance assessments so arranged that the amounts paid become relatively more burdensome during depression years; yet this is exactly what is proposed in some quarters today for Federal deposit insurance. That is, proposals that deposit insurance assessments should be repaid to the banks in years during which insurance losses and expenses are low are equivalent to advocating that full assessments should be paid only when insurance losses are high. Losses will almost certainly be high only during depression periods.

The conclusion as to the need for an adequate insurance fund may seem, at first glance, to run counter to the statement in Chapter I that the most successful systems were those of Indiana, Ohio, and Iowa, for it will be recalled that none of these systems placed primary reliance upon an insurance fund, and Indiana had no fund at all. However, the functioning of these insurance systems was greatly affected by the fact that the insurance authorities were also bank supervisory authorities with far more extensive powers than the Federal Deposit Insurance Corporation; and in addition, those authorities exercised certain central bank functions. That is, the insurance authorities in those three States were not only charged with the duty of paying insured creditors after a bank failure, but also were charged with anticipating and, as far as possible offsetting, financial developments which might result in bank failures. The Indiana system would not have survived the panic of 1837 and the serious depression which followed if insurance authorities had not possessed some central bank powers. The Michigan experience also suggests that good bank supervision cannot, by itself, be adequate in the face of destructive monetary developments. The experience of all these States indicates that bank-obligation insurance, if it is to be permanently successful, should operate in an institutional framework that provides good bank supervision and wise and effective monetary policy.

Bank-obligation insurance in Indiana, Ohio, and Iowa also illustrates the importance of mutual responsibility. In those systems the number of banks was sufficiently small so that each bank could see that its long run interest was best served by a stable banking system. Since each of the participating banks was also represented on the respective supervisory boards this meant that bank supervision was thorough and effective. Today, with thousands of banks participating in Federal deposit insurance, it is clearly impractical to have each bank directly represented in the administration of the Corporation and the supervision of the banks. However, the Corporation has endeavored to work closely with banking organizations and State and national supervisory agencies in an effort to promote understanding of the basic mutual responsibility which underlies Federal deposit insurance, and to stimulate participation by the insured banks in the development of the policies of the Corporation. The record of bank-obligation insurance prior to 1866 suggests that this is a thoroughly appropriate policy.

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