THE SOLVENCY OF ELEEMOSYNARY SAVINGS-BANKS.

BY JOHN HARSEN RHOADES.

THE Eleemosynary Savings-banks, many of which exist in the Eastern States, are non-stock institutions. The trustees are paid nothing, the officers alone receiving compensation for their services. It is the general spirit and purpose of the charters of such banks that the depositors are entitled to all the pecuniary benefits arising from the deposits, less reasonable expenses chargeable thereon.

In New York State, particularly, the law covering investments is rigid, and the danger of loss through unfortunate purchases is at a minimum.

It is my purpose, however, to show that under our present savings-bank laws, if investments shrink in value, and remain for an indefinite period on a higher income yield, or if deposits increase too rapidly, there is a grave danger not only to individual banks in New York State, but to the whole Eleemosynary Savings-bank System. I wish to state emphatically that up to October, 1907, no officer nor trustee could be censured—it has taken a panic to open our eyes; but I believe they could be severely criticised if they permit the present state of affairs to continue. I wish to say also that the danger to the depositor at the moment is infinitesimal, for during the next six months deposits are not likely to increase, and bonds are almost certain to rise in value.

To raise the question, Should an eleemosynary savings-bank be kept solvent? would seem absurd to the mind of the average banker; yet, among savings-bank trustees, in New York State at least, there must be a confused idea upon the subject; for the law leaves it to their discretion to maintain a surplus or not. In its application to savings-banks the word "surplus" is misused; in the State of Massachusetts it is called a "guarantee fund," which undoubtedly is a better term. Furthermore, at the last session of the New York Legislature a law was enacted providing, in a manner approved by the Superintendent, for the amortization or gradual extinction of premiums or discounts of securities, and, with its passage, the old law, which compelled banks to appraise their securities at their estimated market value, was abrogated. That the new law was passed by both branches of the Legislature without opposition on the part of the banks would indicate that they either approved of the results attendant upon the change, or else looked upon the law as an emergency measure.

The Superintendent of Banks of the State of New York wisely decided that the correct manner of amortizing securities is at cost; so the banks, as a result, are now compelled by law to report to the Banking Department their surplus, based upon investment value, which, to all intents and purposes, means that they are reporting their surplus based upon the original cost of their securities, and are no longer, except at the discretion of the Superintendent, reporting a surplus based upon the market value.

For the purpose of arriving at the actual income for any six months' period, it cannot be denied that it is an excellent law which compels all savings institutions semi-annually to amortize their bonds by the same method, *but such a law is useless as a means of determining solvency.* The fact that the Superintendent can demand a market report (which, to his credit, he did in July) does not answer the purpose, unless such a report be published and placed before the depositors.

However, it would seem that the law should make it mandatory upon officers and trustees to compute their surplus on the basis of the estimated market value of their securities, that a condition of insolvency may not come upon them unawares and, furthermore, that the law should be so framed that reports based upon market values should be published, so that the people of the State of New York will know whether a bank be solvent, and not leave the question of insolvency, a matter of such vital importance, to the discretionary investigation of the Superintendent.

If we admit that all earnings above necessary expenses belong to the depositors, it goes without saying that trustees are powerless to prevent insolvency; but it is my purpose to show that such an admission is unwarranted, although made by many to-day.

Cases of insolvency have been known in the past, and, where the bank was small, the trustees were disposed to come to the rescue and make up the deficiency until a state of solvency could be re-established. By this means, in their infancy our gigantic savings-banks of the present day could have been tided over with comparative ease; but, with the great growth in deposits, amounting in some institutions to $100,000,000, it is now impracticable for trustees to put their hands in their pockets to save an institution from insolvency.

An eleemosynary savings-bank must necessarily be established by philanthropic men. There being no capital paid in, every trustee knows that such a bank should be protected until it reaches the point of independence. If the moral responsibility existed at the beginning, should it not hold good to-day?

For many years the question of solvency had never been discussed by officers and trustees, for the reason that, through the rise in the value of savings-bank securities, for which the banks themselves were responsible—the scope of investment for years being too small—and a general dividend rate of three and one-half per cent., the percentage of surplus on the market value had either been increasing or had remained stationary; but in the last ten years there has been a change so pronounced as to make the following statistics relating to savings-banks in the State of New York pertinent and interesting:

January 1st, 1883—Total Deposits, $412,147,213; Estimated Market Surplus, $60,630,827—14.71 per cent.

January 1st, 1885—Total Deposits, $437,107,501; Estimated Market Surplus, $68,669,001—16.70 per cent.

January 1st, 1887—Total Deposits, $482,486,730; Estimated Market Surplus, $85,633,329—17.74 per cent.

January 1st, 1889—Total Deposits, $523,677,515; Estimated Market Surplus, $92,009,091—17.57 per cent.

January 1st, 1891—Total Deposits, $574,669,972; Estimated Market Surplus, $89,741,231—15.61 per cent.

January 1st, 1893—Total Deposits, $629,358,273; Estimated Market Surplus, $88,752,443—14.10 per cent.

January 1st, 1895—Total Deposits, $643,873,574; Estimated Market Surplus, $91,574,734—14.22 per cent.

January 1st, 1897—Total Deposits, $718,176,888; Estimated Market Surplus, $93,653,237—13.03 per cent.

January 1st, 1899—Total Deposits, $816,144,367; Estimated Market Surplus, $106,896,623—13.09 per cent.

January 1st, 1901—Total Deposits, $947,129,638; Estimated Market Surplus, $118,294,674—12.49 per cent.

January 1st, 1903—Total Deposits, $1,077,383,743; Estimated Market Surplus, $113,286,775—10.51 per cent.

January 1st, 1905—Total Deposits, $1,198,583,142; Estimated Market Surplus, $112,853,766—9.41 per cent.

January 1st, 1907—Total Deposits, $1,362,035,836; Estimated Market Surplus, $102,192,265—7.50 per cent.

January 1st, 1908—Total Deposits, $1,380,399,090; Estimated Market Surplus, $83,255,275—6.03 per cent.

If the above statistics are carefully studied, it will be seen that, from 1887 down to the present date, there were many years when the market surplus in dollars actually increased, and yet the percentage of market surplus to total deposits was reduced, and it is the percentage of market surplus which is the *indicator*. If the indicator register too high, it signifies that the savings-bank is keeping from the depositor his rightful income; if too low, it signifies that the savings-bank is jeopardizing the principal of the depositor; if it stands below the zero mark, it means insolvency.

On careful analysis we find that the last occasion, when the banks as a whole held so low a market surplus as six per cent., was in the year 1872; but at that time total deposits were only $267,905,826, while in 1908 they stand at $1,380,399,090.

The crisis of 1893 was reached in August, and that of 1907 in October. The savings-banks entered the panic of 1893 with a market surplus equivalent to fourteen per cent. of deposits, and the panic of 1907 with but seven and one-half per cent. If deposits increase too rapidly and securities fail to advance sufficiently in value the banks may be forced to enter a future panic with even less, and it is the future, and not the present, that gives cause for anxiety.

When we realize that another change in money rates, sufficient to cause savings-banks securities to sell on a five-per-cent. income basis, would mean a decline of about four and one-half per cent. in the percentage of the market surplus, provided the deposits remain the same, the question of solvency is brought home to us. And, as I have intimated, if such change be coincident with an increase in deposits, that question will face us the more quickly.

Within the ten years from 1896 to 1906 the annual production of gold was more than doubled. To this impressive fact many ascribe the extraordinary rise in prices of commodities, and there are able-minded men to-day who believe in much higher money rates for the future.

If, on January 1st, 1907, every savings-bank in New York State had had a seven-and-one-half-per-cent. market surplus, or in 1908 a six-per-cent. market surplus, this article might not have been written; but it must be remembered that the figures given represent the average. As a matter of fact, on January 1st, 1907, sixty per cent. of the banks had a market surplus of less than seven and one-half per cent., and on January 1st, 1908, fifty-five per cent. had a market surplus of less than six per cent. We may infer that to-day twenty per cent. hold a market surplus of less than five per cent.

It is evident that the shrinkage in the percentage of market surplus has been brought about by two causes—the decline in value of the resources of the banks (owing to a change in money rates), and the great growth in deposits. In regard to the former, it is all very well to assert that savings-banks securities will never sell on a five-per-cent. income basis, for a five-per-cent. basis seems absurd; but the danger lies in the impossibility of forecasting the future. In 1899, the Equitable Life wrote to one hundred and fifty prominent financiers, asking their opinion as to what rate of income high-grade securities would realize during the ensuing twenty years. The answer, to a man, was—from three to three and one-half per cent., and a large number predicted the smaller figure.

As to the growth in deposits, an increase in itself could never throw a bank into insolvency, but it could reduce the percentage of market surplus to such a low point that the slightest decline thereafter in the value of a bank's resources would bring insolvency.

Another potential factor has been operative toward the shrinkage in the percentage of market surplus, namely, the increase in the dividend rate from three and one-half per cent. to four per cent. A general four-per-cent. dividend may have been justified when the percentage of market surplus was seventeen per cent.; but, with a percentage of about seven and one-half per cent. to-day, a four-per-cent. dividend is not justified. Under present conditions, however, some officers fear that it is impossible for one savings institution alone, holding a small market surplus, to reduce its rate of interest from four to three and one-half per cent. That small market surplus might have resulted because the institution for years had been most conservative in its investments; consequently, its earning power was less. If these fears are justified, which I doubt, the present state of affairs puts a premium upon risk and a charge upon conservatism.

If it is not necessary to keep a bank solvent, the percentage of the market surplus is immaterial, and the surplus could be figured on investment, par or book value. In many Eastern States, it is computed upon book value, which I believe to be wrong, for the percentage of same to total deposits may not show the true condition of a bank.

If it be necessary to keep a savings-bank solvent, the surplus, if any, *must be based,* at least, upon the market value of the bank's resources.

What is meant by solvency? Solvency means ability to pay one's obligations in full. The statement that it is never necessary to compute market values to guard against insolvency, on the ground that every bank must of necessity be insolvent in the crisis of a panic, is preposterous. We all know that the question of insolvency must be more or less problematical, for we can never be absolutely certain whether a man or an institution be solvent unless we go through the process of liquidation. Nevertheless, we well know that we cannot dispose of our assets, even in a reasonable length of time, above their market value, and so it has been customary from time immemorial for financial institutions, generally at six months' periods, to value their resources at the market, in order to learn not only whether they be solvent, but an equally important fact whether their surplus be sufficient to insure solvency during the ensuing six months.

No sharp line of demarcation can be drawn between solvency and insolvency, and at times the trustees of an institution may conscientiously differ as to whether their institution be solvent or not; but on the financial seas insolvency represents the rocks, and the ships carrying the savings of the masses should give them a wide berth.

Bearing in mind that the eleemosynary savings-bank is a non-stock institution, and that all profits accrue to the benefit of the depositors, there are trustees who go so far as to say that the law having designated the securities in which they may invest, and they having made the investments in accordance with the law, they cannot be held responsible if the investments decline in value. In other words, they look upon themselves as the personal representatives of the depositors, for whom they are investing their funds. It is just here that I believe the error is made, for they are not acting as individuals, but as part of a system.

Permit me to illustrate: suppose a savings-bank officer, acting in the capacity of an individual, invests $2,000 for A and B; and suppose the officer purchases two $1,000 three-and-one-half-per-cent. bonds at par. Let us assume that several years later the bonds are selling in the open market at ninety. We shall assume also that the officer has turned over to A and B three and one-half per cent. interest in the mean time. Now, A calls and asks for his money. The officer will naturally say to him that he can give him the bond, or that he can sell the bond at ninety and give him $900. A decides to take the cash. B appears later, and if he demands his money the savings-bank officer will sell his bond at the then current market and give him the proceeds.

Let us take a similar case, only assuming that the savings-bank officer is acting now in the capacity of an officer of a savings-bank, and not as an individual, and we shall consider A and B as depositors of the bank, and, to better illustrate the point, we shall suggest that they are the only depositors. The savings-bank officer, in a similar manner, invests the $2,000 in two $1,000 three-and-one-half-per-cent. bonds at par. Several years later, as in the previous case, the bonds are worth ninety. In this instance the officer does not turn over the full three-and-one-half-per-cent. income, for he must reserve something to pay the expenses of the bank. A calls for his money. What amount of money does the savings-bank officer give him? He gives him $1,000. B calls later and asks for his money. What is there left for B? About $800. Can any one say that this is just to B? Yet this is exactly what a savings-bank would be forced to do if it did not keep itself in a state of solvency. The trustees may not be responsible for a decline in bonds, but they could be held responsible if they permitted a condition of insolvency to continue, for no court in the land would allow certain depositors to be paid in full to the possible detriment of others.

Hence a savings-bank differs from the individual who invests money for another, in that it has a privileged obligation to keep from its depositors sufficient funds out of earnings to build up and maintain an adequate market surplus, or rather a guarantee fund. The absolute security of the principal sum should be first guaranteed beyond doubt before an increase of distribution should be tolerated, for the savings-bank depositor, besides drawing interest on his deposit, is vitally interested in the ability of the bank to return to him on demand the principal sum of money on which interest has been paid. And the trustee—has he not the right to protect his own responsibilities?

It is this privileged obligation which the banks have taken upon themselves, sustained by law, which has enabled them to build up the Eleemosynary Savings-bank System. However, the privilege should not be abused by maintaining a surplus unnecessarily large, nor one inadequately small. Savings-banks never have paid to depositors more than the principal the depositors originally placed in their care. Nor do any ever want to be in a position where they would be obliged to pay less; and, if many were in such a position, it would mean the downfall of our Eleemosynary Savings-bank System.

Over fifty per cent. of the depositors of our banks believe that the cash is in the vaults, and one hundred per cent. believe that their principal is intact, payable on demand, except in crises, when they may be forced to wait not more than sixty days.

It would appear that the system in New York State has one serious defect—that the banks have never been compelled by law to build up and maintain a minimum surplus. We have a maximum, but no minimum.

In determining the maximum, which is fifteen per cent. of deposits, the law directs that the surplus shall be computed by valuing bonds above par, at par and below par at the market. Without doubt this is an excellent way to determine a surplus, for, although at times it does not give the actual amount, it prevents the surplus from being enlarged through an abnormal rise in bonds. It is self-evident that this process is a hardship to a bank which holds a large amount of premium bonds, yet it must be borne in mind that to mark up the percentage of market surplus by a rise in bonds is to credit the depositors with profits before they are earned.

It would be difficult, without doing an injustice to some banks, to frame a law which will compel us to build up and maintain a fixed minimum, for, while one bank could afford to put aside five per cent. of its gross earnings for a given six months' period, and continue to pay at least three and one-half per cent. interest, another could not afford to lay aside over one-fourth of one per cent. If the majority of the banks were paying three and one-half per cent., it would be a question whether the few banks paying three per cent. could live.

A bank of deposit may reduce or even pass a dividend, yet many deposits will remain, but with an eleemosynary savings-bank there is undoubtedly a limit to the reduction in dividends.

The maintenance of a fixed percentage of minimum surplus is desirable, and it is to be hoped there may be a way to secure it. If it be impracticable to frame such a law, I am of opinion that the desired results could be effected in a reasonable length of time, if the present savings-bank law, forbidding the payment of over five-per-cent. dividends, were modified to compel a uniform rate of not over three and one-half per cent., with the privilege to pay an extra dividend whenever the par and market surplus shall be equal to ten per cent. of deposits. If such a law were enacted, I doubt if more than four banks in New York State could pay an extra dividend to-day, nor, in fact, for many years.

The same result could be obtained through concerted action upon the part of the banks without recourse to law, but such action would not answer the purpose, for it is more than probable that a like state of affairs may recur at a time when concerted action may be too late to save the day. So long, however, as the banks continue to pay almost their entire earnings to depositors, unless there be a large rise in the value of their resources, a large *decrease* in deposits, or both, it will take many years to restore the percentage of market surplus which formerly existed.

When we know how impossible it is for a savings-bank to make money, and how long it takes to build up a surplus, what a pity to allow the adequate percentage of market surplus of the past to be reduced, and what folly to gamble on a rise in bonds to restore it! Assuming that the effect of a rise in bonds is offset by an increase in deposits,—a fair assumption,—it can be demonstrated that it would take ten years for many a large savings-bank, continuously paying four per cent. dividends, to increase its surplus by three per cent.

There are trustees who feel that, if, as suggested, an attempt were made to pay a uniform rate of three and one-half per cent., serious objection would be raised by depositors. This hardly appears likely when we find that The Philadelphia Saving Fund Society in the year 1907 paid only three and one-half per cent. and actually gained $645,716.29 in deposits over withdrawals, while in the same year the New York State savings-banks were paying four per cent., and lost $31,608,897.75. The Philadelphia Saving Fund Society, on January 1st, 1908, had total deposits of $89,595,955.21, while the total deposits of the New York State savings-banks were $1,380,399,090. It can readily be seen that the Society for Savings actually gained .0072 per cent., while the New York State savings-banks lost .0022 per cent.

The greatest objection will come not from depositors, nor even from the Legislature, but from those banks which hold a market surplus to-day between five and ten per cent., and which are satisfied that their surplus is adequate to permit a four-per-cent. dividend.

I do not believe for a moment, however, when the situation is put before them, in view of the charitable nature of our banks, and the high character of the men who compose our boards, that the stronger banks would oppose legislation absolutely essential to the welfare of our Savings-bank System.

It would seem appropriate, at this point, to quote the closing remarks of an address made a few years ago by a late President of one of our banks:

> "Let us remember that the savings-bank, in its essence, was founded as a means to lessen pauperism and to encourage thrift. Let us not forget that it rests upon foundations built upon philanthropy. No selfishness, no greed, no profit to ourselves, shall be the motto of this great and solemn trust. Our trustees are chosen from those who are willing to serve the public for the public's good, and the well-doing of the charge we have thus assumed is the only reward we can expect or desire. Let us therefore work not for the day, but for the morrow, remembering that what we build we build for the day and the morrow. It is in this spirit and with this aim in view that our work should go on, and unless we do this work unselfishly, we will sow the seeds of distrust among the people, and eventually the system itself will break down."

To return to our subject—without doubt twenty per cent. of our banks have a market surplus of less than five per cent. to-day. The failure of twenty per cent. might mean the failure of our entire system. At the moment there is little danger, for every man believes that a rise in bonds is pending, but the danger lies in the future. Let us not forget that in 1899 one hundred and fifty prominent financiers made a bad guess; prominent financiers may do the same to-day.

The trouble has been that the attention of trustees has been centred upon the increased earning power of their investments, and they have paid dividends accordingly, regardless of the fact that the great growth in deposits and the shrinkage in the value of securities on hand, have each played an important part toward causing an impairment in their percentage of market surplus in many cases of as much as fifty per cent.

I often wonder if savings-bank trustees in general thoroughly appreciate what a very small surplus ten per cent. really is, notwithstanding the high character of our investments, as an insurance against insolvency, especially in the case of a large bank. We have been so anxious to pay over all earnings to our depositors in the form of dividends that we have forgotten the word "insolvency" and what it means. If banks holding a market surplus of seven and one-half per cent., which they believe sufficient, would for a moment recall the panic of October, 1907, and the situation which developed among the trust companies, they might conceive of a similar condition arising among the savings-banks of New York State. Before the recent panic, many strong and conservative trust companies were absolutely indifferent to the welfare of a few sister institutions which were badly managed; but, when the crisis came, those in authority decided, in order to save the situation, that it was imperative to lend assistance to their weak neighbors by loaning millions of dollars at a time when they needed every dollar for themselves. Can any one suppose that a savings-bank, with a market surplus to-day of only seven and one-half per cent. of deposits, could materially aid its neighbor at such a time? In such a contingency, the right to use the sixty-day clause, which is absurdly but a by-law among our savings institutions, could be questioned. The purpose of the sixty-day clause is to give the banks time to sell such securities as they deem expedient, and depositors to recover from unwarranted fright. In a case of insolvency, the fright of the depositor is warranted, and trustees are aware of the fact. Such a state of affairs puts a different complexion upon the situation.

The eleemosynary system, which now obtains, with some changes can be made perfect. And when we realize that the stock savings-bank, unless managed with conspicuous ability, is unsafe, that the postal savings-bank is not adaptable to our form of government and for the present should not be established, what a mistake it will be if we do not use every endeavor to make our eleemosynary system impregnable!

A savings-bank should be impregnable to an increase in deposits and a mere decline in bonds.

The seeming apathy with which many trustees appear to regard the matter of an increased market surplus as important to the great majority of the savings-banks of New York State is amazing. The difficulty is to reach a decision as to the best method to bring about the desired results. I am of opinion that these results can be achieved only through an educational process and free discussion of the problems presented. It is to this end that the above article has been written.

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THE PROBLEM OF THE NAVY PERSONNEL.

BY COMMANDER ROY C. SMITH, U. S. N.

THERE has been much reference during the last few years, in Congress and in the press, to the condition of the navy personnel. No one doubts that the personnel is all right, as far as individuals are concerned; but there seems to be trouble about numbers and arrangement, and especially about the age of the higher officers.

The question of numbers is in the way of settlement by means of the large classes now passing through Annapolis. The other matters are not in so satisfactory a state. The public, perhaps, has not paid much attention to the subject. They may have thought it an agitation on the part of the officers to secure quicker promotion. If this were true, it would not be a matter of serious consequence. But there is more in it. If it were only a question of what officers thought they were entitled to, and if they could bring Congress to their way of thinking, the public would be satisfied, but would not feel called on to take part. It may as well be stated, however, that in what follows the results to officers are left entirely out of consideration. The question goes beyond individuals.

The principal trouble with the personnel at this time is that admirals reach their grade on the average at from sixty to sixty-one years of age and retire by law at sixty-two. But, it may be said, if this is a drawback, why is it not perfectly easy to correct it? Why cannot admirals be promoted as early as may be necessary? It seems simple, but it cannot be done without changing the existing law, in which the present conditions are inherent. Then the law should be changed.

So far, so good; but, on trying to devise a suitable change, complications seem to arise on every side. One serious compli-