REPORT

to the

Legislature of New Jersey

of the

Commission Created Under Joint Resolution Number One

As amended by Joint Resolution
Number Sixteen, Session of 1928

Authorizing Investigation of Bank, Trust Company, and Building and Loan Charters and All Other Matters Relating to Department of Banking and Insurance and Mergers and Consolidation of Banks and Trust Companies and the Purchase of Control Thereof and Investment Trusts and All Matters Connected Therewith

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REPORT

To the Legislature of the State of New Jersey:

This Commission was organized pursuant to Joint Resolution No. 1, Laws of 1928, to conduct an investigation of the Department of Banking and Insurance, concerning the issuance or rejection by the Commissioner of charters to trust companies, State banks and building and loan associations, and into any and all other matters relating to said Department.

Joint Resolution No. 16, Laws of 1928, conferred additional authority to investigate all matters pertaining to mergers and consolidations of banks and trust companies, and the purchase of control thereof; and further to investigate the subject of investment trusts, and all matters connected therewith.

We selected Francis B. Davis as Chairman, and Guy George Gabrielson as Secretary. We have been attended throughout by D. Frederick Burnett as Counsel, and Nicholas W. Bindseil as Stenographer.

Besides executive sessions, we have held thirty-three public hearings, and taken about 5,500 pages of testimony.

We find and report:

BANK CHARTERS—EXERCISE OF ARBITRARY POWER

The presentation to the Commissioner of a duly executed certificate of incorporation constitutes the application for charter of a bank or trust company. The generic term—bank—will be used for convenience to include either or both. If it appears to the Commissioner that the establishment of such bank will be of public service, he endorses his approval thereon, signifying that the charter is granted. His refusal to do so constitutes rejection.

The power thus delegated to decide whether or not establishment of a proposed bank will be of public service, is arbitrary and absolute. It is inherently, like any autocratic uncontrolled

power, subject to abuse without recourse. There are no checks or safeguards. His decision is final and not subject to appeal or to review by anybody or any court. The Commissioner is not required to and does not assign, like the judges of our courts, any reasons for his decision. No notice is given or required of a charter application. Hearings may but are not required to be given to either the applicants or to those in opposition.

The Commissioner conceives that in granting or refusing charters he is exercising a quasi judicial function. We conclude, however, that it is the exercise of absolute bureaucratic power, alien to any kind of judicial proceedings and contrary to the most elementary concepts of what constitutes due process of law. Such uncontrolled power, without checks or balances, does not exist in any other body or department in the State.

The granting of a bank charter is affected with a public interest. Hence the power to organize should not be conferred generally. The function is legislative—not judicial. The Legislature makes the grant and prescribes the terms. If charters were granted by special act there would be publicity at least and probably debate. Our Constitution forbids special acts of incorporation. Hence discretionary power should continue to be confided in the Department as a special tribunal to ascertain the fact of public service, but the exercise of the power should be attended with salutary publicity and be subject to reasonable review.

BANK CHARTERS—ABUSE OF POWER

We find that approvals have been made, and, in other instances, withheld, without regard to public service and in cases where:

1. Political and/or personal influence has been avowedly availed of by the incorporators;

2. Such influence has been the motivating reason for the selection of counsel or of associate counsel, so called;

3. Such influence has been bartered and sold by lawyers, usually business strangers to the incorporators, for excessive fees entirely out of proportion to the nature and value of the legal work involved, or, in lieu of fees, for large allot-

ments of stock, possessing, or believed to possess, potential value greatly above the subscription price;

4. Such influence has been invoked by a bank desiring the establishment of another, in preference to its own permanently retained staff of highly competent counsel;

5. Such influence has been successfully exercised in obtaining the charter where lawyers of equal calibre and standing at bar and in community have previously failed on the same facts;

6. Agreements have been made for fees, as high as the traffic would bear and the client was willing to pay, contingent upon obtaining the charter, and, in one case, the money was deposited in escrow to abide the event;

7. Sub-associate counsel has been secretly instrumental in obtaining the charter, although such employment was unknown to the client, and had been previously declined on direct request, and the nature of his services was unknown and unexplainable by the associate counsel who split fees with him;

8. Application by a highly representative group of citizens was turned down without any investigation of merits being made because the Commissioner deemed it unnecessary as he was personally conversant with the conditions thereabout, but nevertheless charter was granted to another group at substantially the same location within four months later;

9. Charter was granted on condition that the legal services of a lawyer in another and previous charter matter and the expenses of his clients therein be paid by the applicants for the instant charter, which condition was performed. While, in most cases, approvals have been tardy and long delayed, the Commissioner acted with egregious celerity in this case by approving the certificate of incorporation, the largest bank chartered by him, on the same day it was presented, and this without causing the usual investigation to be made;

10. Charter was promised to a personal friend by a politically prominent gentleman who interceded with the Commissioner;

11. The Commissioner promised approval of a charter to a politically prominent lawyer whose services had been invoked by the promoters and were successfully utilized without any knowledge of the attorney of record of the applicants; but, despite such promise, withheld approval until after confirmation of his reappointment for another term as Commissioner. This promise was made two months before the attorney of record was informed by the Commissioner that the charter would be granted; this political lawyer on subsequently becoming a director of the bank was able, though the president had previously tried and failed, to induce a certain large public utility company to open an account and maintain a standing balance of $40,000 on which it received but 2 per cent although the bank, to its profit, has been able to employ this money in the call loan market in New York at high rates of interest such as 7, 8 and 10 per cent.

The Commissioner himself testified that the Department had always been a political department. Others, apparently, have shared this belief and sought to capitalize it by endeavoring to inculcate the belief in applicants or attorney that the charter cause would be furthered if their services were engaged or stock allotments were promised.

We further find:

1. Charters have been approved despite adverse reports by department examiners specially delegated to find the facts, and have been declined despite highly favorable reports by such examiners;

2. Charters have been approved despite written, filed protests of banks in the immediate neighborhood requesting a hearing without affording those banks any opportunity to be heard;

3. Charters have been approved without any examination by the Commissioner of the pertinent matter in the department files—in one case where confined at home by illness and such examination would have disclosed request for a hearing which he had promised to grant;

4. After adverse examiners' reports have been rendered, promises have been made by the Commissioner to representatives of a Clearing House Association that given applications, opposed by the Association, will not be approved, but later the promises were revoked without affording opportunity for hearing and the charters were approved;

5. Color, if not justification, for the excessive counsel fees demanded in charter matters is afforded by the failure of the Commissioner to promptly render final decisions after examiners' reports are filed. This creates wasteful delay, necessitates repeated conferences, and leads to uncertainty and unfairness. If the application were one that should be denied, it is no justification to allege that by tiring applicants out they often withdrew. The tiring out process in lieu of reasonably prompt, definite decision inevitably leads to the retention of substituted or associated counsel who possess the requisite influence, or are believed to possess it. This begets an atmosphere about the charter function which is unhealthy and provocative of lack of confidence in a department whose every act should be above suspicion;

6. The Commissioner knew as far back as 1924 that influence was being capitalized by certain lawyers and he was specifically warned by a personal friend in November, 1926, of the rumors then and since current that money was being paid for bank charters—that to get a charter it was necessary to retain certain lawyers with whom it was thought the Commissioner was splitting fees. The Commissioner contented himself with the thought that his friends would not sell him out, but studiously avoided all inquiries about the amount of fees received by the attorneys in any case. This attitude is further exemplified by the official report of an examiner that a certain charter previously granted was being peddled about and could be bought by any one who was willing to pay $5,000 bonus for it. Similar information, without naming the price, was given him in another case. But nothing further was done by the Commissioner—no action, no inquiries, nothing. We find that the Commissioner has not shared in those fees and

that he personally has not received any money or anything of value for the granting of any charter. His inertia and utter lack of initiative, however, in making the inquiries which any reasonable man would be prompted by such notice to make, have resulted in a deplorable situation which gave rise to this investigation and which this investigation has confirmed.

We do not advocate the extreme measure of denying charters because of payment of legal fees. Clients have a right to be represented by counsel. Fees commensurate with services rendered may properly be charged. But full and frank disclosure to the Commissioner should be required of all fees paid or agreed to be paid in charter matters, whether payable in money or requited by stock allotments or any other form of compensation. On the other hand, promotion fees for securing subscriptions for or selling stock in the proposed bank should be absolutely forbidden.

BANK CHARTERS—BRANCH OFFICES

The Laws of 1925 provided for branch banking in New Jersey, but withheld from the Commissioner the authority to grant permission for branches until such time as national banking associations located in New Jersey should, by act of Congress, be enabled to originally establish branch offices or agencies in this State. As a result of the enactment of the McFadden Branch Banking Act by Congress on February 18, 1927, approved by the President, February 25, 1927, as well as by reason of our legislation, branch banking became duly legalized in this State.

Prior thereto, the Commissioner, knowing that branch banking was not then the prescribed legislative policy of this State, approved bank charters where the bank, in one case, was to be controlled as to its stock directly by another bank, and, in another case, indirectly by stock control by the directors of another bank. These apparently independent banks were intended as branch offices as soon as branch banking became effective. Such intention has since been accomplished in each case. The approvals of those charters were in effect the establishment of branch banking contrary to the express legislative intent subsisting at that time.

The present requirement for the establishment of branch offices, aside from restrictions as to capitalization and location, is the finding by the Commissioner that the establishment of such branch office will be of public service. The act should be amended by requiring the same notice, publication, opportunity to be heard and review we have recommended in respect to the granting of charters.

BANK CHARTERS—CO-OPERATION WITH FEDERAL AUTHORITIES

We find an entire lack of co-operation and co-ordination between our Department and the Federal authorities having to do with the establishment of national banks or branches. While the granting of State charters is exclusively a State function and not in any wise dependent upon the demands and desires of the Federal authorities, we believe that the public interest is best served by intelligent and fair-minded co-operation and comity with the Federal authorities. As a step in that direction, they should be extended at least the courtesy of notice and opportunity for hearing.

BANK CHARTERS—ILLEGAL ALTERATIONS

We find several instances of material alterations in charter applications over the signatures and acknowledgments of the incorporators but nevertheless approved by the Commissioner. Such alterations were apparent on the face of the instruments. The Commissioner testified that he would not have approved if these matters had been brought to his attention. The statute, however, imposes the affirmative duty on him not only of determining that the establishment of the trust company will be of public service, but also of approving the form of the certificate. The exercise of but ordinary care would have instantly disclosed the several matters of this kind brought to light during the investigation.

BANK CHARTERS—CERTIFICATES OF AUTHORITY IMPROPERLY ISSUED

No bank, although its charter has been approved, may transact any business other than formation and organization until the

Commissioner issues his Certificate of Authority. To obtain this, it must appear by affidavit that the entire capital has been paid in in cash. Thereupon the Commissioner must satisfy himself of that fact and that the bank is duly and legally organized. The certificate is then issued. It certifies that the bank is duly and legally organized and authorized to transact business as such.

We find that certificates of authority have been issued in cases where:

1. The capital instead of being fully paid in was short upwards of $200,000, which sum was borrowed from another bank;

2. The certification of payment was by unsworn letter instead of under oath;

3. The bank had transacted business other than formation and organization before the certificate of authority was issued;

4. Additional directors had been elected by directors instead of by stockholders as required by law;

5. The capital stock had not been properly issued;

6. Rights to subscribe to shares as evidenced by the charter had not been waived;

7. Stockholders had had no voice in the election of directors and the adoption of by-laws.

In the last three instances, the certificates were issued to the accompaniment of the Department's comment that these "technical matters" should but could be cleared up afterwards. Conscious violation of legal requirements cannot be excused by dubbing them technicalities. The certificate authorizing the bank to do business with the public should not be granted until the completeness and correctness of organization is independently verified.

Not only have certificates of authority been issued without compliance with the statutory requirements; but the rules and regulations of the Department on the same subject have been violated in these respects:

1. The Department requires the paid in capital stock to be on deposit in a bank in New Jersey, and also affidavit by the depositary that such deposit is free and clear of any claims or offsets and in no sense the proceeds of loans granted by the depositary to the bank. This practice is commendable and should be codified into law. This rule was violated by the Commissioner himself in approving a deposit of $750,000 in a New York City bank, and this without any affidavit whatsoever.

2. Another ruling forbids the use by any bank in its business of any unpaid installments of its capital stock until the entire amount has been paid and certified. This rule, also worthy of translation into law, was evaded by a bank which increased its authorized capital by charter amendment before its certificate of authority was issued. In order to utilize in its business the original paid in capital without awaiting full payment of the installments of the increased capital, it was made to appear on the Department records that the affidavit of payment of original capital had been filed a few hours before the certificate of amendment, although we find the facts to be that they were filed simultaneously; that erasures and alterations of the Department filing marks were made, and fractions of a day observed by notations in pen and ink instead of the usual filing stamp employed in every other instance. We further find that the bank, emboldened by the co-operation and the ease by which the certificate of authority had been thus improperly obtained, used, in its business, not only the original capital but also the installments of its increased capital to the extent of more than $2,000,000 in the call loan market in New York City before such installments were fully paid; that the subsequent report of the bank disclosed such use of installments thereby charging the Department with knowledge of the fact, but no action has ever been taken in the premises by the Department.

BANK CHARTERS—CHANGE OF LOCATION WITHOUT COMMISSIONER'S CONSENT

Originally, both the Act Concerning Banks and the Act Concerning Trust Companies prescribed that the certificate of incorporation shall set forth the place where the business is to be carried on. It would thus appear that location was an essential of the banking franchise, and since amendments required the Commissioner's approval, no change of location could be effected without his consent. The present Commissioner ruled, however, that his approval was not necessary to a change of location of an existing bank. Thereafter, both acts were amended in 1926 by requiring that the certificate of incorporation shall specifically designate the place where the business is to be carried on by street and number in the municipality, and removal therefrom shall not be permitted without the written approval of the Commissioner first obtained. By the Laws of 1927, Chapter 13, the Trust Company Act was amended in other respects, but inadvertently the restriction concerning change of location was omitted. It should be forthwith restored. There is no value in deliberating upon the proposed location of a bank as one of the essential factors in determining whether it will be of public service when, without the approval of the Commissioner, it can be changed at will. If there is any question about the absolute right, it should be set at rest by expressly forbidding it.

BANK CHARTERS—DUMMY INCORPORATORS

The usual practice of the Department, when a charter application is presented, is to have an examiner investigate the incorporators as to character, reputation in the community for honesty and fair dealing, financial standing, banking experience and business knowledge.

In some cases, after the charter was granted, the curtain was drawn aside and for the first time the real parties in interest appeared. Thus, in one case, the names of ten of the fourteen directors, who were elected at the organization meeting held immediately after the charter was granted, did not appear at all

in the certificate of incorporation. In others, examiners reported that certain incorporators did not intend to retain the stock subscribed for.

It is not desirable to attempt any restriction on transfer of stock, but examinations of incorporators, who are the potential and putative directors, are quite meaningless if the incorporators are, in fact, but dummies. We see no permanent, practical cure for this situation, which depends largely on the good faith of the organizers, but it can be ameliorated considerably by requiring an affidavit that the incorporators are the true and the only parties in interest, and by prescribing that the certificate of incorporation shall set forth the names of the directors who are to serve as such until the next annual election following issuance of the certificate of authority.

BANK CHARTERS—AMENDMENTS

The present statutory procedure in this respect is satisfactory and requires in general nothing but enforcement. The directors first enact a resolution declaring the proposed amendment to be advisable and calling a meeting of the stockholders to take action thereon; if two-thirds of the stockholders vote in favor of the amendment, a certificate thereof, signed by the officers and requisite stockholders, is filed with the Department; upon such filing and the approval of the Commissioner the charter is deemed amended accordingly.

We find that the Commissioner has approved Certificates of Amendment in cases where:

1. The certificate fails to identify the resolution enacted by the stockholders as being the same resolution, or even substantially the same as that enacted by the directors;

2. The stockholders' resolutions certified to the Department, although purporting to be quoted and therefore a true copy, are nevertheless different from the resolutions as the same appear in the minute book of the bank;

3. The stockholders' resolutions are certified to have been enacted as of a date on which no meeting was held according to the minute book of the bank;

4. The capital stock was ordered increased, but no certificate filed with the Department until after another increase had been authorized:

5. Stock, increased pursuant to an amendment, was later issued without any authority of the stockholders;

6. The amended certificate was criticized by a Deputy Commissioner and returned for correction in that the text of the amendatory resolutions certified would operate to restrict rather than amplify, as was intended, the powers of the bank. The certificate was returned to the bank, which thereupon prepared and filed, with the approval of the Commissioner, an amended certificate. But neither directors' nor stockholders' meetings were ever held to validate the changes and made the amendments legally effective;

7. The certificate purports to show on its face that the stockholders' meeting was held in Newark at the same hour and minute that the certificate, with the Commissioner's approval attached, was marked "filed" in Trenton. Inspection of the minute book disclosed that the stockholders' meeting was not held until four hours after the certificate avowing that fact had been approved and filed. The secretary of the bank who prepared and filed the certificate and also signed the purported minutes of the respective meetings of directors and of stockholders, as secretary, admitted that he could not tell when or where the meetings were held, whether the recitals in the minutes as to attendance were true or not, whether the certificate of amendment was filed before or after the stockholders' meeting, and finally whether any such meeting was ever held or not, but opined there was no such meeting, the signatures being obtained *seriatim*. Such procedure, showing contemptuous defiance of legal requisites, could not, except by connivance, be perpetrated if the Commissioner had adopted the simple expedient of causing an examination and verification to be made of the minute book, proxies, signatures, and all the statutory proceedings to ensure that the law had been complied with before affixing his approval. Otherwise approval is idle and meaningless except as to mere form.

BANKS—EXAMINATIONS AND EXAMINERS

The Department appears to have a competent corps of bank examiners. Their examinations are thorough and searching except that they do not run the individual ledgers, or verify the accounts or passbooks of depositors. Their reports are rendered without fear or favor.

In one case the bank examiners were called off, after the examination had begun, by the Deputy Commissioner at the request of the bank then under examination. The Commissioner ratified the withdrawal. This unprecedented action struck a vital and wholly deplorable blow at the morale of the force.

There should be permanently on the examining staff at least one competent lawyer to examine the original documents, minute books and records so as to verify compliance with the legal requisites of all documents filed with the Department such as charter amendments, surrender of franchises, dissolutions, mergers and consolidations, and every other transaction whatsoever which requires the approval of the Commissioner and/or upon which he is bound to or may act.

This talent should and could be equally available to the insurance, and building and loan divisions.

The employment of such legal talent is imperative in order to verify the intricate legal matters which arise in the conduct of trusts administered by our banking institutions which constantly beget difficult problems. The trust business of banks is constantly growing. No examiner, unless skilled in the law, can hope to make anything more than a superficial examination of such matters. To say that they can be passed on by the Attorney-General is beside the point. They must be first picked up in the field from the original sources in order that the Department may know that there is a problem to decide.

BANKS—ALLEGED WITHDRAWALS FOR POLITICAL REASONS

Charges that State deposits in certain banks had been totally or heavily withdrawn by the State Treasurer for political reasons, were investigated and found wholly without foundation.

BANKS—ALLEGED CONSPIRACY BY CLEARING HOUSE ASSOCIATION

Charges that a Clearing House Association had entered into a scheme or conspiracy to force an investment trust which owned the controlling interest in several banks to sell out its interest in one of those banks, were investigated and found groundless.

BANKS—WRITE-UP OF BANKING HOUSES

Several banks have caused heavy write-ups on their books of the value of their respective banking houses. The motive has been to create by bookkeeping entries a surplus out of which dividends might be paid or to absorb alleged good-will. This has occurred in cases where:

1. There have been widely variant appraisals;

2. There have been no appraisals;

3. There is nothing in the minutes authorizing the write-up;

4. There has been no determination of value by the directors but the write-up was ordered by self interested officers;

5. The write-up was measured exactly by the amount of 100 per cent stock dividend concurrently declared and issued, the surplus and undivided profits being insufficient therefor.

No write-ups should be permissible except after approval of the Commissioner first had and obtained.

BANKS—DIVIDENDS

The power to declare dividends is limited to the profits of the company. The term clearly contemplates profits actually realized from operations and earnings. Dividends based on alleged appreciation of real estate assets not coupled with actual realization via sale, are an inherently insidious source of danger. Conservative banks would not do so. Others should not be allowed to do so. Our recommendation as to write-ups covers this point.

We find that dividends have been declared and paid and/or issued where:

1. The board of directors never made any declaration of the dividend;

2. The dividend was not paid out of or charged to surplus or undivided profits, the only proper source of any dividend, but was debited against real estate account.

BANKS—STOCK DIVIDENDS

Stock dividends have been declared and issued by several banks without any question raised by the Department. There is grave room for doubt whether shares of bank stock issued by way of stock dividend are legally issued. The question was raised during the investigation and thereafter submitted to the Attorney-General for opinion now pending. We believe the Legislature should itself clarify this situation by unequivocally declaring its intention either one way or the other, and in any event validate the stock dividends previously issued. The present statute requires that the capital should be paid in in cash. Nothing but cash will suffice however valuable the commodities offered in lieu of cash may be. In this respect it is entirely different from the General Corporation Law. The legislative motive undoubtedly was that the capital stock of banks constitutes a standing affirmation that cash has actually been paid in. On the other hand, there is nothing which prevents a bank, immediately after receiving certificate of authority, from converting its capital into whatever form it lawfully chooses. Again, stock dividends fortify financial standing by impounding and converting profits into capital. There is nothing inherently wrong with stock dividends but we believe them inhibited as the banking law now stands. The matter should be set at rest by legislative fiat one way or the other.

BANKS—MERGERS AND CONSOLIDATIONS

Our statutes authorize mergers of State banks, trust companies, banks with trust companies, and title guaranty insurance

companies with trust companies. The requisites are substantially: A merger agreement, stipulating the terms, conditions, and mode of carrying it into effect, is authorized by the directors and approved by both the stockholders and the Commissioner.

Several mergers have taken place in which the requirements have been scrupulously observed, but other consolidations have been effected with utter disregard of the statutory requirements and in cases where:

1. The agreement was never submitted to or approved by the stockholders or by the Commissioner;

2. The officers of two institutions, both of them controlled by one group, executed and delivered an agreement different in several material respects from the agreement actually authorized;

3. Assets of one trust company were transferred in bulk to another in consideration of assuming the liabilities thereby amounting to a gift of the entire capital stock, surplus and undivided profits; to provide for the claims of dissenting stockholders, the transferee set up a reserve on its books;

4. Consolidation effected in fact by merely coalescing assets and the exorbitant prices paid for good-will assimilated by carrying false values in stocks and bonds to avoid reducing the surplus account—followed by a write-up of the banking houses;

5. The interlocking majority ownership of stock in the two institutions coalesced was abused by saddling liabilities upon one for utterly inadequate consideration which amounted to a division of the assets more or less among the majority to the exclusion of the minority.

These illegal consolidations were brought to the specific attention of the Department by the official reports of the examiners, who characterized the same as high finance. Notwithstanding this direct notice, the Department has done nothing. Recommendation is useless in the face of complete collapse of authority.

No question arises where the result is accomplished by strict compliance with the merger requisites. Besides the instances noted under that caption, we find that the controlling stock of one institution has been purchased by another in cases where:

1. The controlling stock so purchased was owned by the president of the buyer; and there was no authorization by the directors of the buyer; and the stockholders were kept in ignorance of the purchase and had no opportunity to either assent or dissent;

2. Losses incurred on the purchase were concealed by the simple and expeditious formula of writing up the banking house;

3. One bank controlled by the buyer was forced to furnish the funds for the acquisition of another bank in an amount equal to twice its own combined capital and surplus, which transaction was first set up on its books as an investment, but the shares were never transferred or intended to be, and seventeen days later, upon the deposit of additional collateral, entry was changed on the books of the bank to make it appear as a loan, but interest was paid from the inception of the transaction;

4. A resolution, certified to the Department respecting the acquisition of all the stock of a bank to be thereafter liquidated and operated as a branch of the purchasing bank, does not appear in the minute books of the latter. The Department had ordered the latter, a year before, to dispose of 200 shares of that stock it then owned, but received the announcement of the acquisition of the whole 1,000 shares with calm indifference and granted the branch application.

As our laws now stand, stockholders of banks have neither vote nor voice in the acquisition of stock of another bank. The acquisition by banks of control of other banks is not governed or affected by the remedial legislation of 1928, Chapter 273, because banks are expressly excepted therefrom.

BANKS—DISSOLUTION

With the concurrence of management and membership, a bank may discontinue business, settle its affairs and surrender its franchise; thereupon the bank is dissolved and the directors act as trustees in dissolution.

This statute was violated without dissent or criticism by the Department in cases where the stockholders appointed of their number a committee on liquidation, instead of having the directors act as trustees in dissolution.

BANKS—IMPROPER RELATIONS

We find collisions of the duty of the Commissioner as such with his individual self interest resolved by him in favor of the latter in cases where:

1. As receiver of an hotel heavily mortgaged to a bank under his jurisdiction, he interfered with and delayed foreclosure and sale contrary to the expressed desire and over the protest of the bank to an extent rendering necessary the intervention of the Chancellor himself and the latter's exercise of reserved and extraordinary jurisdiction.

2. Having as receiver of a chemical company conveyed its assets to a new company and agreed to take his fees via the common stock of the latter, he requested banks under his jurisdiction to finance the new company by loaning large sums of money thereto, which loans were declined when sought previously by others as not being a bankable proposition, but granted when asked by the receiver in order to cement friendly relations with the Commissioner. The loans were secured by unsold preferred stock of the new company. Following the granting of the loans, applications of the bank for permission to establish branch banks were approved by the Commissioner.

The act establishing the Department provides that no person shall be appointed Commissioner who is in any way connected with the management or control of any corporation affected by the act and his term of office shall immediately cease if at any time he shall become so interested.

Banks and other institutions under the jurisdiction of the Department cannot forget that the Commissioner, in whatever capacity he may deal with them, is in fact the Commissioner.

The spirit of the act may be enforced by adding to its letter that neither the Commissioner nor any of his deputies or examiners shall have any dealings or transactions in any capacity whatsoever with any bank or trust company under the jurisdiction of the Department of Banking and Insurance save in the strict performance of his or their duties, except such institutions with which he or they were dealing prior to his or their respective appointments.

BANKING LAWS—ENFORCEMENT OF COMMISSIONER'S ORDERS

In one instance, the bank examiners reported that the president of a certain bank had kited checks, manipulated its funds for his own benefit, and had violated certain sections of the banking law, one of which constituted a misdemeanor and another a high misdemeanor. The Department demanded that the president resign and cease to have any voice in the company's management, declaring that his manipulations had placed the company in a position where its good name and solvency were jeopardized. But two days later, the directors of that bank, in defiance of the order, re-elected the president. Nothing further was ever done by the Department as concerns the resignation, or notifying the prosecutor, or the Attorney-General, of the crimes committed.

The law provides that if it appears that any bank has violated its charter or any law of the State, or is conducting business in an unsafe or unauthorized manner, the Commissioner shall order discontinuance of such illegal or unsafe practices and conformity with the requirements of its charter and safety and security in its transactions. If such order is disobeyed, he may take possession of the bank and liquidate it, or permit it to resume business upon such conditions as may be approved by him.

Question arises as to duty and power of the Commissioner in cases where the transaction has been consummated before he

knows of it. To then merely order discontinuance of such practices is futile—a vain gesture.

His duty is clear: The law must be enforced. As against the State, performance of ultra vires or wrongful acts is not a cure for lack of authority but rather the cause why the law should be invoked.

His power to undo the transaction and restore the situation exists in the provision that he may approve conditions for the resumption of business, which means that he may formulate them as justice may require. But to exercise that power, he must first take possession of the bank. That remedy is so drastic as often to deter its use even in justifiable cases.

The power of the Commissioner should therefore be amplified to include not only an order to discontinue illegal practices but also to make such other orders whatsoever as the facts and justice may require and this without necessity of taking over the bank, leaving that power in reserve to compel obedience if such other orders are not executed. With the fear that that power will be courageously and unflinchingly exercised if contemned, obedience will be yielded to the Commissioner's orders in like manner as the decrees of Chancery are obeyed because, in the last analysis, of the fear of imprisonment for contempt. Appropriate penalties for violations should also be provided.

BANKING LAWS—GENERAL

Both the Act Concerning Banks and Banking, and the Act Concerning Trust Companies have not been revised since 1899. There have been many amendments and supplements. These acts are distributed in pamphlet form by the Department, and are used, practically as a manual, by examiners, bank officers, directors and clerks. Both acts should be wholly revised and brought down to date.

Companies organized under these acts and the stockholders and directors thereof, should have all the powers granted and be subject to all the restrictions, limitations, duties and obligations imposed by the General Act Concerning Corporations and the acts supplementary thereto and amendatory thereof, except so far as

they may be inconsistent with the express provisions of the Banking Laws.

Each director is required to take an oath that he is the owner of not less than $500 par value unpledged shares of the capital stock of the company. There is no penalty attached if the oath be false. Such an oath was taken by a director but non-ownership of any stock was later discovered by the examiner. Stock was thereupon transferred into his name and he continued as a director. Penalties should attach if the oath be false.

The Crimes Act declares it unlawful for any corporation to engage in this State in the practice of law. Banks are not mentioned by name, but are included because they are corporations. We find, in this respect, that certain trust companies have violated the spirit, if not the letter, of the declared policy of the State. The practice of law by banks is inimical to good banking. There is no need, however, for any new legislation. The Commissioner has the power to command and enforce discontinuance of illegal practices. The power should not be allowed to atrophy, but rather be impartially and rigorously enforced. The statute prohibiting corporations from practicing law might well be included in the pamphlet reprint of the banking laws issued by the Department from time to time.

INVESTMENT TRUSTS

The term is not susceptible of exact definition. "Investment Company" more accurately characterizes the average modern organization recently popularized by the name "Investment Trust." In general, it is a company which issues its own stock or obligations against the securities which it purchases. "Trust" is usually a misnomer. Of the thirty or more companies examined by us only one placed the securities purchased in an actual trust.

These companies take form as determined by the provisions of their respective charters. Some purpose diversified investment simply as such and without eye to the management of the companies in which the stock investment is made. Others are primarily concerned in acquiring and maintaining control of subsidiaries or other constituent companies and financing and fur-

thering the development thereof. In some, the type of allowable investments is fixed and rigid. In others, the determination of what shall be bought and carried in the portfolio, the modern sonorous name for the company's treasury, or sold or speculated in from time to time is absolutely vested in the management. The latter amounts to no more than a blind pool. Between these extremes the whole gamut of discretion is run, from entire absence of any to wholly unlimited managerial power.

Much has been said and written as to the forms and merits of investment trusts and the principles to be applied in order to make them a success. Our investigation has not been concerned with the question of how they should act, but rather to observe and ascertain how they do act. The form is of small moment for our purposes. What counts is the action of the men who sit around the directors' table. The action in some cases has been exemplary; in others we found grave abuses of power. The action varies inversely as to formal restrictions, but directly as to the men behind the management. Properly managed, they may well earn the respect and confidence of the public. Those that are not are a menace to the others and a source of grave danger to the public.

They may be created under the liberal provisions of our General Corporation Law as freely as and subject to no more restraint than any industrial company. Their charters may, but rarely do, contain self-imposed restraints and limitations. The pronounced tendency is rather the other way, i. e., toward uncontrolled and uncontrollable management. Hence such charters draw down the widest corporate powers, abridge and even abrogate the rights of the individual stockholder, increase the powers of the management and exemptions from responsibility or accountability to the stockholders. Thus we found that charters of financial or investment companies, advertised to or regarded by the public as investment trusts, contained provisions:

1. Conferring the widest latitude of powers so that the company can enter into almost any conceivable kind of business;

2. Abrogating stockholder's right of inspection of the corporate books:

3. Denying stockholder's pre-emptive rights to subscribe for additional stock;

4. Authorizing directors pecuniarily self interested in contracts or transactions with their own corporations to make same without being subject to attack on the ground of self interest and without the necessity of any disclosure to the stockholders. Such clauses constitute a standing invitation to a director to resolve the almost inevitable collisions of duty and self interest in his own favor. Corporations might well remove the temptation by voluntarily purging themselves of such charter provisions;

5. Prescribing that one class of stock offered only to the directors and favored insiders shall have the sole voting power with right to diminish the interest of the non-voting stock in the surplus and profits of the corporation;

6. Empowering the creation of optional rights to purchase and subscribe to stock from the enjoyment of which the non-voting stock may be excluded;

7. Purporting to vest the right in the corporation to use not only its surplus, but also its capital for the purchase of shares of its own capital stock.

Since the stipulations in the certificate of incorporation in theory of law merely embody the agreements made by the incorporators among themselves and every one buying the stock is deemed to consent thereto whether he actually knows of the charter provisions or not, there is no intrinsic harm in glorifying the management at the expense of the stockholders. If the public will credulously and blindly buy stock without examination or inquiry, practical paternalism should go no farther than to make sure

(a) That the advertising sets forth clearly and unequivocally every salient fact;

(b) That the corporation does everything it agreed to do and nothing it ought not to do.

Both these objectives may best be attained through summary powers of investigation and prosecution vigorously exercised on the initiative of the Attorney-General.

On the other hand, item 7 *supra* is illegal. It is contrary to the

statute. The law was vindicated by the institution of quo warranto proceedings by the Attorney-General at the instance of this Commission which action has been settled by striking out the obnoxious clause from the charter.

Since our investigation was made with a view to ascertaining the necessity or expediency of regulatory legislation, we report only the general nature of the unfavorable features discovered in respect to certain companies, to wit:

1. Securities bought at grossly excessive over valuations from directors whose fellow directors knew of the enormous profits thereby realized;
2. Securities purchased by manipulation of corporate funds so that the seller-director was enabled to reap personal profit by using the company's money and credit without investing his own;
3. Securities bought and valued by dummy directors;
4. Heavy and secret commissions paid for acquiring the control of bank stocks;
5. Stock advertised by false and misleading statements;
6. Stock sold by high powered intensive salesmanship at prices several dollars above the open market;
7. Prices of stock advanced arbitrarily and irrespective of values;
8. Subscribers to stock unable by terms of subscription to anticipate installment payments;
9. False and misleading financial statements of condition issued to the stockholders and prospective purchasers;
10. Statements exhibiting surplus failed to distinguish trifling actual earnings from enormous written up surplus;
11. Recasts of financial statements made to conceal true conditions revealed by auditor's report;
12. Heavy organization expenses improperly carried as assets;
13. Additional directors elected by directors instead of by stockholders as required;
14. Directors elected but not qualified by ownership of stock at the time of election;

15. Directors acted admittedly as if but rubber stamps;

16. Loans made to directors in guise of purchase coupled with agreement to resell;

17. Release without consideration of director's obligation to sell securities;

18. Directors afforded easier terms of installment payments on stock subscriptions;

19. Salaries incommensurate with services rendered or to be rendered paid officers as figureheads;

20. Men in high places of public office prevailed upon to lend their names and that of the positions occupied to stock promotion schemes;

21. Securities diverted from treasury to another concern in order to reap a profit in which the stockholders would not share and thereafter repurchased ex-profit;

22. Options to buy the company stock at favorable prices granted without consideration to directors by fellow directors;

23. Stock issued to promoters after market established at less than half the market price;

24. Stock in parent company in process of installment payment pledged to wholly owned and financed subsidiary as collateral security;

25. Dividends declared but not earned;

26. Dividends paid out of capital;

27. Exorbitant promotion charges;

28. Bank under control compelled to guarantee contrary to law mortgages sold by a title company under the same control;

29. Funds of the company used to support the market for the stock;

30. Markets created and maintained at company expense to afford insiders the opportunity to dispose of stock;

31. Trading accounts opened with brokers;

32. Corporate funds used for trading in the company's stock resulting in one case in a loss to the stockholders of nearly three million dollars;

33. Corporate funds advanced to the president for personal account without authorization of the directors;

34. Officer's accounts credited with personal obligation against other parties;

35. Checks kited and held in suspense account;

36. Contract made for management of the portfolio for price equivalent to 6 per cent of the whole capital invested;

37. Contracts made with underwriting agencies to handle all future issues of stock without binding commitment and irrespective of past performances;

38. Contracts for purchase of stock whereby special privileges of subscription were granted to favored parties to the exclusion of other stockholders;

39. Contracts for purchase of control of banks conditioned upon personal employment agreements;

40. Depositors of controlled banks circularized to buy stock of holding company, recommended by officers of those banks;

41. Loans made by subsidiary banks on collateral of holding company stock;

42. Hypothecation of the assets of one bank to accommodate the exigencies of another bank in the same chain.

Inspection of the foregoing shows that new laws are not so much needed as the diligent enforcement of existing law.

The efficient operation of the division of securities of the Attorney-General's office can cover the several phases of fraudulent stock selling. It will be necessary, however, that this office take the initiative. Dilatory and perfunctory questionnaires will not suffice. The broad investigatory powers delegated must be actively utilized not only at inception of the company but from time to time to ascertain and enforce compliance with the law.

The existing law as administered according to the high ethical concepts of our Court of Chancery is adequate to cover all the other matters, except ethics, if invoked by the stockholders prejudiced thereby. Law cannot make men honest in the handling of investment funds for others but, it can prevent them from enjoying personal profit acquired through unfair manipulation of those

funds. And ethics thrive best when purely voluntary. Good taste and public opinion are more potent in such matters than law.

We see, therefore, no reason for special regulatory legislation or for placing the supervision of investment trusts or financial companies in the Department of Banking and Insurance. Their business is not any part of deposit or trust banking. The very attempt to create a standard or form applicable to all such companies which often have but little in common would, if fair, necessarily be so general as to induce unreliable managements to comply therewith with resultant unmerited public confidence. Fraud is too cunning and insidious to be boxed. Each case must stand or fall on its own facts.

We do believe that the word "trust" should not be allowed to be used by any company as a part of its corporate name, or its business in anywise advertised as such except by a banking institution thereunto duly authorized. Neither should the words "bank", "bankers", or "banking" be used as part of the corporate name, or so advertised.

BUILDING AND LOAN ASSOCIATIONS—SIZE OF LOANS

Complaints, regarding the amount of loans made in certain specific instances by building and loan associations, have been investigated with the efficient aid of the deputy in charge but the loans so investigated were found to come within both limitations of the Building and Loan Act.

BUILDING AND LOAN ASSOCIATIONS—CHARTERS

We have privately examined all building and loan charters granted within the last six years ending December 31, 1928. In open session we have examined but two charters. We find evidence of the same kind of political and friendly influence exercised in these matters as in bank charters; also similar alterations over signatures and acknowledgments.

Because of the exigencies of time, and in view of the broad scope of the investigation, we deemed it our duty, after making an intensive investigation of bank charters, to devote our principal

energies to other imperative matters of an entirely different nature from that disclosed by our investigation of bank and building and loan charters.

INSURANCE COMPANIES—CERTIFICATE OF AUTHORITY

Insurance companies, like banks, may not transact business with the public until receiving a Certificate of Authority. Among other requisites, the capital stock must have been actually paid in in cash. The practice of the Department is to require an affidavit of payment to the effect that there are no charges or claims against the capital so paid in.

In one case, the printed affidavit of payment submitted to the Department failed to disclose, as an exception, that obligations had been previously incurred in lieu of promotion fees. Examination of the minute book of the company would have disclosed this.

Such certificates should not be issued until all the facts have been independently verified by the Department examiner.

INSURANCE COMPANIES—EXAMINATIONS

The Commissioner has the power, whenever he deems it expedient, to make an examination of the assets and liabilities, method of conducting business, and all other affairs of insurance companies. The cost is borne by the company.

To protect New Jersey companies seeking admission to and/or doing business in other States from the cost of examinations both by our State and every other State in which business is transacted, our laws provide that if other States refuse to accept our certificate of examination as conclusive, that then New Jersey will refuse to accept the examinations of such other States in respect to companies organized under their laws when doing or seeking to do business in New Jersey, and further that every insurance company of that other State shall be refused license to do business in New Jersey, and every license previously granted to an insurance company of that State shall be revoked and annulled.

The statute is drastic. The provision for revocation is mandatory and is visited on all companies of the foreign State irrespective of the worthiness of the particular company. The emphasis

which our Legislature has placed upon the conclusiveness of our own examination implies the highest obligation of good faith on the part of our Department that our examination reports which we certify and transmit to other States, and which they are bound to accept as conclusive, shall contain not merely a part of the truth but the whole truth as to every material matter which might affect the decision of that other State as to whether to admit or continue to permit the New Jersey corporation to do business therein.

The spirit of that statute has been violated by the practice of the Department, which has grown up recently and been employed on several occasions with the knowledge and acquiescence of the Commissioner, in making two reports of a given examination, one the so-called "official" report, the other "confidential"; that the motive has been to enable insurance companies of this State to present to other States the official report which on its face purports to be the entire report, i. e., the official report declares that it is the report of the examination made of the given company as of a certain date "of the assets and liabilities, method of conducting business and all other affairs" of said company—whereas, in fact, material, relevant, pertinent matters have been suppressed from the official report and are contained only in the confidential report.

This is a fraud upon the insurance departments of other States and absolutely indefensible.

The reason assigned in one such confidential report for the making thereof separate from the official report was the prominence of the men in the company. The Deputy admitted that the separation into two reports was made to enable the company to enter New York State. He had been deputized by the company to assist it in effecting such entrance. But when the reports were prepared by the Department and presented to the company, its officials deemed the separation and suppression wrongful and refused to present the official report to New York State, although it was a required condition precedent to entrance.

The Deputy claimed that the offensive practice was followed in other States, notably New York, but was unable to prove any instances thereof or any precautions taken by him to discount the reports emanating from such other States when certified to

New Jersey. And it was unequivocally denied by the New York State Superintendent of Insurance. We do not believe it. Even if true it is no excuse. It undermines the confidence and comity that should exist between our States. The practice must never be resurrected.

The only colorable justification offered was that matters of mere opinion of the examiner might be unfairly or maliciously incorporated in such report. This is readily cured by affording a hearing to each company before the report, in final form, is filed.

INSURANCE COMPANIES—EXCESS RETENTIONS

The limit of a single risk by any insurance company is ten per centum of its net assets. The statute, however, provides that so much of any risk as shall be reinsured shall not be considered part of the risk.

The business practice is to take the risk and then endeavor to reinsure everything above the statutory maxims. In case of failure to effect such reinsurance, the excess retention violates the statute.

This has occurred on frequent occasions. The Department has taken no action. The nature of the business is such that reinsurance cannot be contracted for in advance, for risks depend on variant facts. The statutory prohibition, however, ought not to be flaunted and treated by both company and Department, as no more than a mere recommendation. The Legislature means what it says. Practicable effect, consonant with the nature of the business, may be given the statute by adding that excess retentions after ten days shall be reported forthwith to the Department and no further business, so long as such excess retention subsists, shall be thereafter written unless the Commissioner's approval shall be first obtained. Dispensations to be granted in reasonable cases, but to be withheld where it appears that the company is making a practice of accepting risks that it cannot reinsure in other companies, will uphold the law and, at the same time, not unreasonably injure any company doing a sound and proper business.

INSURANCE COMPANIES—DEPOSITS FOR PROTECTION OF POLICY HOLDERS

Before an insurance company may transact business it must deposit with the Commissioner $50,000, in stocks, bonds or mortgages. The Commissioner may, from time to time, after the company shall have commenced business, require it to make further deposit up to the sum of $100,000. The deposit is held for the benefit and security of all policyholders. When the company voluntarily dissolves, or a receiver is appointed, the Commissioner must deliver to the receiver or directors or trustees in dissolution, such deposit.

The minimum deposit should be continued, but the maximum should be graduated according to the volume of business transacted.

The rights of policyholders would undoubtedly be duly protected by delivery of the deposit to a receiver appointed by the Court of Chancery. But delivery of the deposit to trustees in voluntary dissolution, while it may inflict a personal liability upon them as individuals, does not continue the real and secured protection intended to be afforded the policyholder.

Since insurance companies are affected with a public interest, and the protection of policyholders to the full extent of the corporate assets is a trust duty surviving dissolution, the deposit should not be surrendered and no disbursement whatever made to stockholders until all proceedings in voluntary dissolution shall have first been approved by the Commissioner.

INSURANCE COMPANIES—DISSOLUTION

Dissolution required the concurrence of the management and a two-thirds vote of the stockholders, whereupon the Commissioner, if satisfied "by due proof that the requirements aforesaid have been complied with," issues a certificate that such consent has been filed. The certificate is then published and, upon the filing of an affidavit of publication, the company is deemed dissolved. The directors in office act as trustees in dissolution.

In one case, the proof furnished by affidavit was on its face regular in all respects and provocative of no inquiry. Upon the

faith of that affidavit, the certificate of dissolution was granted. We found, however, that 75 per cent of the stock had been placed in the name of a bookkeeper as trustee; that these shares were treasury stock which could not lawfully be voted directly or indirectly; that the shares were transferred into the bookkeeper's name to enable him to vote the shares for the express purpose of dissolution; that thereafter the sum of $50,000 deposited with the Department as a protection to the policyholders was released to the trustees in dissolution and paid out to stockholders although the policies are still subsisting and their guarantees unperformed.

This could not have occurred if the facts and procedure set forth in the affidavit had been verified by the Department examiner. The Commissioner was entitled, because of the existing statute, to rely upon the "due proof" submitted. The statute should be strengthened, in analogy with our recommendation for verification in bank matters.

Moreover all the proceedings in voluntary dissolution of insurance companies should require the approval of the Commissioner as recommended under the caption—Deposits for Protection of Policyholders.

INSURANCE COMPANIES—STATE BUSINESS

We find that one company organized to transact a surety and fidelity bond business had as its president a prominent State official who had, however, no official connection with the State Highway Commission or with any other Commission, department, bureau, office or division of the State for the protection of which such bonds were issued. Included in its list of officers, directors and stockholders, are several other men of political prominence to whom the same comment as to official connection also applies as far as we know and believe.

Of the bonds in connection with State road work awarded by the State Highway Commission, this company wrote about 6 per cent of the amount of all the bonds in 1926, the first year of its organization; 36 per cent in 1927, and a little over 53 per cent in 1928, or more than all other companies, domestic and foreign, combined.

We find no tangible connection between the company and its officers, directors and stockholders on the one side, and the fact that it has succeeded in obtaining the greatest volume of such State business. We find no violation of law. We do find, however, a natural tendency for contractors and bidders on State work to surmise and believe that by placing their bonds in such a company, favor will be shown them. The thought is the practical and motivating equivalent of the fact. Some agents, realizing this, have attempted to capitalize the idea of official prominence in the endeavor to sell stock of the company to contractors and in solicitation of surety contracts. When this was discovered by the company officials, the services of the agents were promptly and properly terminated. Irrespective, however, of fair intention by the company of which we have no doubt, there is no way to gauge or ascertain the bidder's mental processes. The inevitable tendency to go with the political crowd constitutes a species of unfair competition to other companies and creates an atmosphere of distrust and temptation not conducive to the best interests of the State. The company itself recognized this situation to a degree by voluntarily enacting a resolution not to solicit State business. But if it is wrong to solicit, why is it right to accept? The solicitation may come from the bidder.

One agent of the company, in soliciting fiduciary bonds from banks, represented that by taking the bond in that company the bank would be favored by receipt of a deposit of State treasury funds, or by a substantial increase thereof if such account were already established. In several instances where bonds were placed in the company, State deposits did follow or were increased. In one case the comptroller of the company, on learning of such representation, refused to renew the bond at maturity. Otherwise, knowledge of such representations were unequivocally denied by the responsible officers of the company and the coincidence of State deposits likewise unequivocally affirmed by both the present and former State Treasurer as being only apparent and in nowise connected with the placing of the bonds. But the popular belief

will always exist that the chances of obtaining the naturally desirable deposit are not weakened by taking a bond in such a company, even if not furthered.

INSURANCE COMPANIES—ASSOCIATIONS NOT FOR PECUNIARY PROFIT.

The act to incorporate associations not for pecuniary profit makes it lawful, where certificate so specifies, for such associations to provide for the relief of disabled or destitute members or their families and to maintain a fund for that purpose, or to contract with members to pay death benefits according to the rules or by-laws adopted by such associations.

This, in substance, is a power to insure, but the exercise of the power is in no way subject to the supervision of the Department. Therefore it was not within the jurisdiction of this Commission, and hence we did not investigate the many complaints of grave abuse of the act which reached us.

We believe that all corporations and associations engaged in any type of insurance business should be under the jurisdiction of the Department.

INSURANCE LAW—GENERAL

This act has not been revised since 1902. Like the Banking Laws, it is printed in pamphlet form by the Department from time to time and used as a manual. The supplements and amendments have been many and sometimes confusing.

Thus Section 16, relating to investment of capital and surplus, has been amended so many times and generally so inaptly and unscientifically that grave doubts have arisen as to its proper construction and whether restrictions probably intended to apply to all insurance companies do not in fact apply only to life insurance companies. A bare inspection of the section will suffice to confirm the doubt. It has been the cause of disputes between the Department and certain companies on frequent and repeated occasions which disputes are still unsettled.

The act should be wholly revised, clarified and brought down to date.

SMALL LOAN COMPANIES—THE LAW AND THE RATE OF INTEREST

The pioneer legislation of 1914 in this State has proved sound in principle. It authorized those who obtained license to make loans not exceeding $300. at interest rate not greater than 3 per cent per month computed on unpaid balances. No other charge, bonus, fees, expenses or demands whatsoever may be exacted. The law provided punishment for violation of the strict regulations it stipulated for the conduct of the lender's business. Upon the Department was conferred the power to license, and to revoke or refuse to renew for cause. Upon it was imposed the duty to see that the law was enforced.

The experimental rate of 3 per cent per month allowed in what was then considered a risky business was adopted to attract legitimate capital to satisfy the small loan requirements of the people of our State and thereby drive out the "loan sharks" whose extortions were subject to no regulation. The privilege of charging that rate—six times the maximum of the usury act—was not designed as a franchise for the exclusive benefit of the lender but rather an inducement to supply needed funds under State regulations. The undoubted object and the only justification for such a law is the designed benefit to the borrower. The rate and every other provision of the law must be subservient to that end consistent, of course, without so overdoing it as to intimidate the desired and necessary capital and thereby revert to the deplorable conditions which previously obtained. The rate of interest can be determined fairly to both sides only by experience—just as insurance rates are based.

We have analyzed the actual figures representing the operations of several hundred of these small loan companies or lenders. The profits of those who have exploited this fertile field are astounding in many cases and certainly not contemplated by the framers of the Act. Inordinate profit to the lender means an exorbitant charge to the borrower. The apparent rate of profit made by the big chain companies, who for stock promotion and other reasons are interested in maintaining the present rate, has been obscured by loading expenses with arbitrary charges for supervision and auditing. Even then, the return on their invested

capital is more than twice that on investments in ordinary industrial enterprises. At the same time, it has been proved clearly that it is not a risky business. Losses are but one-fourth of one per cent, in many cases as low as one-tenth of one per cent.

Our investigation has demonstrated by the experience of those lenders who have entered this field that the small loan business can be and has been profitably conducted at rates less than half the maximum now allowable.

We therefore recommend that the maximum rate be reduced by half, i. e. from three per cent. per month to one and one-half per cent. per month.

Other changes regulating the business are suggested under Recommendations.

SMALL LOAN COMPANIES—ADMINISTRATION OF THE LAW BY THE DEPARTMENT

The enforcement of the Small Loan Act by the Department has been singularly inept and inert. Numberless and repeated violations of the Act have been reported by the examiners despite which nothing has been done aside from gentle remonstrance. Licenses of flagrant and continuous violators have nevertheless been renewed from year to year. In only one case prior to this investigation was any license ever revoked.

The Department, with knowledge and without protest, has allowed itself to be held out to the public in connection with the selling of stock of these companies as supervising them, whence is derived the plain and played up advertised inference that the investment in such stock must be safe for the investor. In truth, the Department has and exercises no supervision whatsoever except to see that the restrictive provisions in the law relating to the conduct of its business are enforced. Questions of prudent, prospective investors addressed to the Department seeking verification of the alluring advertising were side-stepped, answered evasively and without denial or challenge of the misleading but glittering phrases of the promoters which capitalized the Department for their benefit. Nor did the Department quarrel with the false representations made that these small loan companies were

banks or industrial banks doing a banking or an industrial banking business, with innuendo, often expressed and always unmistakable, that the investor was buying bank stock.

The Commission determined the emergency was so great, that, without waiting for the presentation of this report, its immediate duty was to request the Commissioner to promulgate a rule forbidding all such representations; with which request, we are glad to report, the Commissioner promptly complied.

SMALL LOAN COMPANIES—STOCK EXPLOITATION

The financial possibilities of small loan companies operating under the presently allowable high rate of interest have been exploited by a series of fraudulent stock promotion schemes. As a result of this phase of our investigation, several such companies are now in the hands of receivers and several persons have been indicted. We have above referred to advertised capitalization of the Department and the false representations that these companies were doing a banking business. Such representations have been disseminated not only by printed advertising but also widely broadcast from different radio stations. False and fraudulent statements pertaining to earnings and dividends of newly formed companies have been uttered. Thousands of small investors in this and in other States have been grossly and injuriously deceived.

Investors have assumed that the representations must be true, else in view of the general publicity incident to broadcasting they would not be permitted by the Banking Department, the Attorney-General's Office, and the radio stations themselves. The stations in turn have been lulled into security by the inertia of the Department and of the Office. In one case, certifications on the letterhead of the Attorney-General's Office, Division of Securities, signed by the Examiner of Securities, purporting to certify the approval of that Department to the broadcasting in question, were presented to a radio station and by its reliance and recommendation thereon, other stations were also deceived. That examiner was also the treasurer of the company whose stock was sold and at times he himself broadcasted selling talks over the radio under a fictitious name.

The Attorney-General did not take action until the matter was brought to light by this investigation, but we find that his Office had actual knowledge several months before, that the identity of the treasurer of the loan company as being the Examiner of Securities in the Attorney-General's Office was being advertised; that complaints had been lodged by civic organizations respecting misleading advertising by that company; that it was representing itself as being under the supervision of the Department and doing a banking business; that by bill in Chancery the company had been compelled to desist from fraudulent practices therein set forth; that broadcasting was being done but no inquiry was made as to representations except to accept the word of the known self interested examiner that everything was all right from the point of view of the Department.

Some of the radio stations in question were located without the State, and therefore transcript of the testimony concerning such broadcasting has been transmitted to the Federal Radio Commission with request to consider preventive, rather than punitive measures, in reference to the use of radio transcending State lines in connection with fraudulent stock selling schemes.

ATTORNEY-GENERAL'S OFFICE—DIVISION OF SECURITIES

We have heretofore adverted to this division in connection with Investment Trusts and also Small Loan Companies. The situation requires vigorous initiative and constant, diligent and intelligent attention.

THE DEPARTMENT AS AN ENTIRETY—THE LAW

The Act to Establish the Department was enacted in 1891. Section 5 of the Act vests powers and charges duties then vested and imposed upon certain other State officers, without anything more definite than such incorporation by reference. No one may know the powers and duties now vested and imposed upon the Department except by tedious ascertainment of the law as it existed in 1891 as respects each of the several officers named. The Act should with precision state the powers and duties of this very important office.

Section 8 still provides that the offices of the Department shall be located in the State House, whereas it is common knowledge that they are located in a private building.

Revision should be made. General provisions relating to all Bureaus of the Department might well be inserted in such revision instead of the increasingly involved legislative work of amending each and every particular act. Each of the latter should be made expressly subject to the Act Establishing the Department.

THE DEPARTMENT AS AN ENTIRETY—ORGANIZATION AND OPERATION

We have carefully considered the mooted question of splitting up the Department as now constituted into three different bureaus or departments with a separate Commissioner at the head of each, but we are firmly of the opinion that the investigation has demonstrated that the best interests of the State will be served by coordination of all the divisions or bureaus as now constituted under one common head because of the growing inter-relation of different financial institutions with each other.

The use of rubber stamps bearing the signature of the Commissioner, heretofore condemned by an earlier commission, still continues. The deputies have power to act in their own names. The dangerous practice should be forthwith discontinued.

Correspondence carbons should show accurately by whom the original letter was actually signed. The Commissioner denied signing a letter which by the official carbon purported to have been signed by him. It recited the affixing of his signature and the seal of his office and was the only letter of that important kind issued in the six years of his incumbency of office. If not signed by him, the office carbons fail to fix responsibility.

SECOND MORTGAGE FINANCING

This subject is not within our jurisdiction, but was encountered collaterally in examining a small loan concern. We were thereafter favored by the voluntary appearance of officers of two of the larger companies doing exclusively a second mortgage

business. For the purposes of comparison with small loan companies, we have made a brief examination of rates and methods.

The rates range from a discount of 8 to 20 per cent. for one to three years, and in addition there are appraisal fees and title search charges. The required monthly amortization increases the rate still higher. It is a risky business as evidenced by the number of foreclosures and the tendency to acquire frozen assets because of the lack of marketability of second mortgages.

The companies buy not only existing mortgages, but also make original loans secured by second mortgages. In the latter cases the above rates are obtained by evading the usury laws. This is attempted in two ways: (1) by making loans to corporations then in existence or created for the purpose, since corporations are by law forbidden to plead usury; (2) by causing the borrower to make and deliver a mortgage to a dummy, who thereupon assigns the mortgage thus manufactured to the second mortgage company. The borrower receives the face of the mortgage less the above discount. In form it is the purchase of a mortgage; in substance it is the taking of usury.

There is apparently a great and growing demand without enough capital to supply it not only for second mortgages on realty, but also for the financing of automobiles, radio apparatus and articles of household equipment. The present usury laws cast doubt at least upon the legal efficacy of the present methods. That doubt intimidates the influx of capital into the field, increases the risk incidental to the business and is a potent factor in the high rates exacted. Since a public demand exists for such forms of financing which cannot be supplied at ordinary interest rates, it may be advisable that the method be legalized in analogy to the Small Loan Act at a reasonable rate of interest, thereby making it attractive to competitive capital to enter the field and make direct loans without any question of usury with the object in view of ultimately reducing the cost to the borrower. We make no specific recommendation except that the matter should be further studied by the Legislature.

RECOMMENDATIONS

We recommend that:

1. Applicants for bank charters and/or branch offices shall publish reasonable notice of such application and mail such notice to every State bank, national bank and trust company located within two miles of the place where the charter applicants purpose to locate, and also upon the Federal Comptroller of the Currency and upon the Federal Reserve Board of the District embracing said location.

2. No charter or branch office shall be approved without affording an opportunity for a hearing to those interested and requesting same.

3. The Commissioner shall decide either to grant or decline charter and/or branch office applications within three months of the date of presentation to the Department, and shall file a written memorandum stating the reasons for his decision.

4. Such decision shall be reviewable by the Supreme Court by writs of certiorari and/or mandamus, as the case may require, to the extent of determining whether the requirements of the law have been observed, and/or whether the discretion confided in the Commissioner has been abused.

5. To set at rest any question of jurisdiction, the refusal to issue Certificate of Authority shall be subject to writ of mandamus by the Supreme Court.

6. No charter shall be approved that contemplates or provides for any promotion fees. There shall be submitted with every application for a charter an affidavit made by each of the incorporators setting forth (1) that no fee or commission has been paid or has been contracted to be paid directly or indirectly by the bank or by any one in its behalf to any person, association or corporation for securing subscriptions for or selling stock in

said proposed bank; (2) a complete disclosure of all fees, if any, paid or agreed to be paid in the matter of chartering and organizing the bank, whether payable in money or requited by stock allotments, or any other form of compensation, and every agreement or understanding relating thereto; (3) that the incorporators are the true and only parties in interest.

7. There shall be set forth in the Certificate of Incorporation of every bank the names of the directors who are to serve as such until the next annual election following issuance of the Certificate of Authority.

8. Before the Certificate of Authority shall issue, the Department shall, by examination, verify the payment in cash of the entire capital stock and the surplus to be paid in, if any, as set forth in the Certificate of Incorporation, and that the same is on deposit in banks and/or trust companies of this State, and/or national banks located within this State, without offset, claim or demand of any nature or description and subject to withdrawal upon demand, and that no part of the deposit is in any sense the proceeds of loans granted by the depositary to the applicant for said certificate, and that the applicant is not in any way indebted to the depositary. Such examination shall also verify the completeness and the correctness of the entire organization proceedings and every matter properly incidental thereto.

9. No bank or trust company shall use in its business any portion or installment of its capital or surplus paid in pursuant to its original or amended charter until the whole amount therein set forth shall have been fully paid in in cash, and such payment shall have been verified by the Department.

10. Chapter 13, Laws of 1927, relating to Trust Companies should be amended by restoring the provision that the place where the business is to be carried on shall be specifically designated in the Certificate of Incorporation by street and number in the municipality in which the business is to be conducted, and no corporation shall be permitted to remove therefrom to any other location without the written approval of the Commissioner of Banking and Insurance first had and obtained.

11. Banks shall not write up assets except after approval of the Commissioner first had and obtained.

12. The Legislature should declare its intention one way or the other as to the validity of stock dividends by banks and, in any event, validate stock dividends previously issued providing the surplus and/or undivided profits were otherwise sufficient.

13. False oath of ownership of unpledged shares by director of a bank shall constitute a misdemeanor.

14. Forbid use of word "trust" by any company as a part of its corporate name, and/or its business being in anywise advertised as such except by a bank thereunto duly authorized. So also the words "bank," "bankers," or "banking."

15. Amend Securities Act of 1927 by conferring upon the receiver all the statutory powers conferred upon receivers appointed pursuant to the General Corporation Act.

16. The minimum deposit of $50,000. required of insurance companies for the protection of policyholders should be retained but the maximum should be removed and the required deposit graduated according to the volume of business transacted.

17 Such deposit shall not be surrendered to trustees in voluntary dissolution and no disbursement of the insurance company's funds whatsoever shall be made to the stockholders until all proceedings in such voluntary dissolution shall have been first approved by the Commissioner.

18. The requirements of dissolution of insurance companies shall be verified by the Department instead of accepting submitted proofs at face value.

19. Every excess retention of insurance risk after ten days shall be reported forthwith to the Department, and no further risks, so long as such excess retention subsists, shall be undertaken or assumed unless the Commissioner's approval shall be first had and obtained.

20. Confidential as distinguished from official reports of examinations of all persons, firms, associations and corporations

subject to the jurisdiction of the Department shall be unlawful. The official report shall contain all the pertinent facts disclosed by the examination. It shall not be officially filed until opportunity has been afforded for a hearing thereon. Thereupon the Commissioner shall order the report filed or make such other order as the facts and justice may require.

21. The Small Loan Act of 1914 should be amended in the following respects:

Reduce the maximum rate of interest from 3 per cent to 1½ per cent per month;

No borrower or endorser to be directly or contingently liable at any time for more than $300.;

Borrowers to be able at any time to anticipate installment payments in whole or in part;

Licensees not be permitted to engage in or solicit any other business in the same office or in association or connection with the lending of money under the Act, excepting in municipalities having a population of not more than 15,000 according to the last preceding Federal census;

Licensees required to have a minimum capital of $5,000. paid in in cash;

The name of every corporate licensee shall require the approval of the Commissioner of Banking and Insurance, which name shall not be so nearly like the name of any other corporation as to deceive the public, and the words "Small Loan Company" shall form a part thereof;

The required bond to be conditioned not only for the faithful observance of all laws relating to such business, but also of the rules and regulations made by the Commissioner, and to contain a liquidated damage clause in the sum of $1,000. payable to the Department for the use of the State in respect to each violation of the Act and/or rules and regulations.

22. All advertising oral or written by any person, firm, association or corporation subject to the jurisdiction of the Department which in anywise mentions or refers to the Department shall be unlawful.

23. The Attorney General should assign from his staff for the use of the Department of Banking and Insurance at least one lawyer competent to examine and pass on the trust business of banks and verify, in the field, compliance with the legal requirements of all documents filed in the Department office requiring the approval of the Commissioner and/or upon which he is bound to or may act.

24. The Commissioner shall not approve or act upon any document filed or to be filed with the Department until the facts and procedure therein set forth shall have been verified to his reasonable satisfaction by an examiner appointed by him for that purpose.

25. Amplify Commissioner's power not only to direct discontinuance of illegal or unsafe practices but also to make such other orders as the facts and justice may require, enforceable by appropriate penalties for violation.

26. Amend the act to incorporate associations not for pecuniary profit by making all associations engaged in any kind of insurance subject to the jurisdiction of the Department.

27. Corporations organized under the Acts Concerning Banks and Banking and Trust Companies, and the stockholders and directors thereof, shall have all the powers granted, and be subject to all the restrictions, limitations, duties and obligations imposed by the General Act Concerning Corporations and the acts supplementary thereto and amendatory thereof, except so far as they may be inconsistent with express provisions of the respective Acts.

28. Provide for a complete revision of the Acts Concerning Banks and Banking, Trust Companies, and Insurance Companies.

29. The act establishing the Department should be completely revised with a view to determining accurately the powers confer-

red and the duties imposed upon the Department. General provisions relating to all Bureaus of the Department should be written into the Act instead of amending the several statutes relating to specific objects of jurisdiction. Each of the latter should be made expressly subject to the general Act establishing the Department.

30. Under penalty of immediate termination of office, neither the Commissioner nor any of his deputies or examiners shall have any dealings or transactions in any capacity whatsoever with any bank or trust company under the jurisdiction of the Department of Banking and Insurance save in the strict performance of his or their duties, except such institutions with which he or they were dealing prior to his or their respective appointments.

31. The Department should continue its coordination under one head.

32. We suggest the creation of a Legislative Commission to investigate installment purchases of automobiles and household equipment and the financing thereof, and also the financing of first and second mortgages on realty.

Respectfully submitted,

FRANCIS B. DAVIS, *Chairman;*
GUY GEORGE GABRIELSON, *Secretary;*
JOSEPH WOLBER,
ALEXANDER SIMPSON,
S. RUSLING LEAP,
ANTHONY SIRACUSA,

Committee.

D. FREDERICK BURNETT,
Of Counsel.

Trenton, N. J., March 18, 1929.