PROGRESS REPORT ON CURRENT DISSERTATIONS

THE EMERGENCE OF THE TRUST COMPANY IN NEW YORK CITY: 1870-1900

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Background

Between 1875 and 1900 the assets of trust companies in New York City grew at a compound annual rate of 9.6%, approximately twice the rate of growth experienced by the National or State banks located in the city.

Table 1

COMPOUND ANNUAL GROWTH RATES
OF NEW YORK CITY ASSETS: 1875-1900

Intermediary	Annual Rate 1875-1900
Trust Companies	9.6%
National Banks	4.1
State Banks	5.4

Source: Date for national banks from Annual Reports of the Comptroller of the Currency. Data for other intermediaries from Annual Reports of The New York State Superintendent of Banking.

In the years immediately following the Civil War, trust companies in New York City were small in size, few in number and barely distinct as a financial intermediary. By 1900, however, trust companies were robust competitors, capturing a significant portion of the commercial banking market, attracting some of the finest (and some of the least) financial entrepreneurs in the City and reaching that tidal mark of self awareness - a trade journal.

The object of my dissertation is to explore the economic, political and legislative forces prompting and molding the spectacular growth of the New York City trust company; and to determine the reasons why, at the end of the century, the trust company movement assimilated into the commercial

banking system, rather than pursuing the course of a separate and independent financial intermediary. Some of these forces and reasons I will cover today.

Functions of a Trust Company

Since about 1900, the term "trust company" has implied to most people a bank with personal and corporate trust powers. In the 1870s, however, this definition was altogether too narrow.

Table 2

CORPORATE POWERS OF TRUST COMPANIES
SEEKING CHARTERS: 1870-1873

	Number of Companies
Companies Seeking Charters	47
Powers:	
Lending on Collateral	47
Receiving Deposits	39
Agency	27
Debt Guaranty	27
Mortgage	18
Corporate Trust	15
Personal Trust	11
Branching	9

Source: Laws of New York, 1870-3 or Bills Introduced - New York State Legislature, 1870-3.

A cross-section analysis of trust company charter applications to the New York State Legislature in the years from 1870-1873, reveals that of the 47 companies seeking charters, less than one-fourth sought personal trust powers and less than a third sought corporate trust powers.

As Table 2 indicates, the trust companies were basically interested in the banking business - in making loans and receiving deposits. Note too that about a fifth of the companies requested power to branch. These branches were mainly mortgage origination offices.

Trust Company Formations

Approximately half-a-dozen trust companies were formed in New York City in the forty years prior to the Civil War. It was not until the 1870s, however, that trust company formations began to reach the proportion of a significant movement.

Table 3

TRUST COMPANY FORMATIONS
LOCATED IN NEW YORK CITY

Date of Chartering	Number of Charters	Date of Chartering	Number of Charters
1870	2	1886	0
1871	3	1887	1
1872	1	1888	1
1873	2	1889	4
1874	1	1890	2
1875	0	1891	0
1876	0	1892	0
1877	0	1893	0
1878	0	1894	0
1879	0	1895	0
1880	0	1896	0
1881	1	1897	0
1882	1	1898	4
1883	0	1899	6
1884	0	1900	1
1885	1		

Source: New York State Superintendent of Banking, Annual Reports, 1874-1900.

As Table 3 illustrates, there were three main periods of trust company formations in New York City: from 1870 to 1874, from 1887 to 1890, and from 1898 to 1900. These periods were influenced, among other things, by legislative and economic factors.

Trust companies were chartered by the state and regulated by state legislation. In the 1870-1900 period there were, in New York State, two major pieces of legislation bearing on the trust companies. The first, The Act of 1874, brought the trust companies under the supervision of the State Superintendent of Banking. Prior to this time the regulation of the industry was fragmented, passive and scattered among several state agencies.

That the Act of 1874 gave the Superintendent of Banking jurisdiction over trust companies, was, in retrospect, a fairly significant development. At the time the jurisdiction could have gone to the Superintendent of Insurance, the Secretary of State or even a new agency head. If any of these alternatives had prevailed, it would have been considerably harder for the trust company movement to eventually assimilate into the commercial banking system and the structure of the American financial community would likely be much different than it is today.

The Act of 1887, provided "free banking" legislation for trust

companies. Prior to this Act, each trust company was chartered by a special act of the State Legislature. Powers granted to trust companies could and did vary widely from charter to charter.

The Act of 1887, however, eliminated the special legislation procedure, providing instead that all a trust company had to do to gain a charter was to make application to the Superintendent of Banking and satisfy certain standard, and rather minimal, requirements. Hereafter, charter powers were uniform for new companies; but the old trust companies retained their original powers.

Immediately after the passage of the Act of 1887 there was a flurry of trust company formations, as though there were a pent-up demand. This appears to have been the case. Starting in 1872, both the Governors and the Legislators of New York State became increasingly apprehensive about the broad powers demanded by trust companies and increasingly reluctant to pass charters by special legislation.

Seen in this light, the Act of 1887, reduced barriers to the formation of new trust companies. The dissertation also deals with other political factors which influenced trust company formations. Very few trust companies were formed in periods of economic recession, as defined by the National Bureau of Economic Research. In the 1870-1873 period, for example, the Governor and Legislature passed 21 charters for new trust companies. Only five of these charters, however, were activated by June, 1874. The principal reason for this was the deterioration of financial conditions, manifested in higher interest rates, which made it progressively more difficult to tap the capital market between 1872 and 1874.

Comparative Profitability

We can readily imagine that the superior growth rate of the trust companies was accompanied by a superior record of profitability. We would be surprised if this was not the case.

Table 4

RATE OF RETURN ON CAPITAL:
NEW YORK CITY

	National Banks	Trust Companies
1875	6.5%	10.8%
1880	10.3	9.5
1885	6.5	9.2
1890	8.1	12.6
1895	4.3	10.8
1900	11.7	11.0
Average	7.9	10.7

Source: See Table 1

As Table 4 illustrates, the rate of return on capital and surplus was considerably higher for the trust companies than for the national banks. Over this entire period, the trust companies averaged a 10.7% rate of return, compared with 7.9% for national banks. Moreover, the earnings of the national banks were considerably more sensitive to economic cycles.

Table 5

DIVIDENDS PAID
NEW YORK CITY
(in millions)

	National Banks	Trust Companies
1875	$6.4	$0.9
1880	4.8	1.0
1885	4.1	1.4
1890	4.6	2.1
1895	4.7	3.3
1900	5.3	4.8

Source: See Table 1

The trust companies were also able to translate earnings growth into a superior dividend stream. In terms of corporate finance, especially the ability to attract new capital, this was an important consideration. The investment market over most of the 1870-1900 period was strongly oriented towards bonds, or an income bias. The customary measure at the time of a common stock's outlook was its dividend expressed as a percentage of par value of the stock, and not a price/earnings ratio as we are accustomed to today.

To carry the discussion of comparative profitability a step further, the trust companies not only showed a superior growth rate in the dividend stream, but they did so at a significantly lower payout ratio.

Table 6

DIVIDEND PAYOUT RATIO:
NEW YORK CITY

	National Banks	Trust Companies
1875	95.5%	47.3%
1880	58.5	59.2
1885	80.8	35.5
1890	55.6	34.6
1895	97.3	49.7
1900	37.7	37.5
Average	70.1	47.3

Source: See Table 1

The average trust company payout ratio was 47.3% over this period, compared to 70.1% for the national banks. Note too, that the national banks did not modulate dividends with earnings. In years of adverse economic conditions, earnings declined, dividends remained virtually unchanged and payout ratios jumped. This policy had a noticeable impact on the growth rate of capital. The retained earnings of the trust companies were nearly twice as great during this period as those of the national banks.

The investor in trust company stocks enjoyed another advantage - the performance of his stock.

Table 7

STOCK MARKET INDICIES FOR TRUST COMPANIES AND COMMERCIAL BANKS NEW YORK CITY (1880 = 100)

Year-end	National Banks	Trust Companies
1880	100	100
1885	106	148
1890	133	302
1895	156	326
1900	199	580

Source: Based on quotations in the Commercial and Financial Chronicle

Over the 1880-1900 period, the Trust Company Stock Index increased at a compound annual growth rate of 9.2%, compared with 3.5% for the Commercial Bank Stock Index.

To take a specific example, on April 20, 1875, Central Trust shareholders paid in $100 capital per share. By 1900 Central Trust stock sold at 21 times the original input, shareholders had received a dividend payback of 6.2 times, and book value was 11.9 times the original contribution.

Trust companies were profitable in their own right, and very profitable compared with national and state banks.

What then were the sources of this comparatively superior profitability?

Actually the trust companies enjoyed a competitive advantage over the commercial banks at almost every point of the operation. We will only comment on three of these areas: cash, taxes and deposits.

Cash

The national banks carried a substantially higher percentage of their assets in cash than did the trust companies.

Table 8

CASH-TO-ASSET RATIO:
NEW YORK CITY

	National Banks	Trust Companies
1875	23.7%	0.8%
1880	39.1	3.2
1885	39.6	11.9
1890	35.6	10.0
1895	23.9	13.7
1900	31.5	12.7

Source: See Table 1

The reasons for this were: first, the trust companies were not required by law or regulation to maintain reserves on deposits, while the national banks were; secondly, the deposit structure of the trust companies was believed to be less volatile because deposits were purchased, and hence deposit levels could be stabilized by adjusting interest rates.

National banks in New York City, under the National Bank Act of 1864 and the Redistribution Act of 1874 were required to maintain a minimum cash reserve equal to 25% of deposits. New York state banks were not required to maintain reserves against deposits until 1892, when a 15% minimum level was imposed by law. But those state banks which were members of the New York Clearing House Association were required to maintain a 25% minimum, the same as national banks.

The trust companies, none of whom were members of the Clearing House, had no statutory minimum reserve requirement. The absence of minimum reserve requirements allowed the trust companies to invest a substantially larger portion of their assets than the commercial banks; and certainly this would be an important competitive advantage.

Table 8 also indicates, however, that trust company cash ratios were higher towards the end of the century than in the 1875-80 period. This increase appears to be the result of pressure from the commercial banking sector. The trust companies, of course, dealt mainly in checks and these checks were cleared through New York Clearing House member banks - with whom the trust companies maintained a correspondent relationship. The trust companies consequently had most of the advantages of Clearing House membership, but none of the responsibilities. That these correspondent relationships were quite sizeable, is suggested by the fact that in 1900, 9.2% of the Clearing House's member deposits were from New York City trust companies.

As the volume of trust company business grew, the member banks of the New York Clearing House became apprehensive that in times of financial crises the reserveless trust companies would experience difficulties and that the member banks would have to carry the burden. Therefore the Clearing House became instrumental in the 1890's in pressuring the trust companies to voluntarily raise their reserve ratios.

This did not work altogether to the trust companies' dis advantage, however, because the higher cash balances were simply higher deposits with their correspondent bank (the Clearing House member across the street) and the correspondent bank normally paid interest to the trust companies for these deposits.

Taxation:

In the area of taxation, trust companies also enjoyed a comparative advantage over the commercial banks, during most of the 1875-1900 period.

Then, as now, taxation was complex and heavily litigated. National banks, state banks and trust companies were each subject to taxation by three jurisdictions: the federal, the state and the municipal governments. Any one jurisdiction could and did have different laws of taxation for different classes of financial institutions. And these laws or their interpretation often changed. In the main, however, the federal government levied taxes at one time or other, on deposits, capital and circulation; the state government on deposits, capital and dividends; and the municipal government on real estate.

There were three general groupings, or combinations of tax laws in the period of our study: from 1870-1882, from 1882-1898 and from 1898-1900.

By constructing a hypothetical financial institution, assuming variously a national, state or trust company charter, we can see how each class of institution made out with its tax bill in 1875, 1885 and 1900.

Table 9

HYPOTHETICAL BANK
1875, 1885, 1900

Assumptions for All Banks in All Years

Deposits	$8,000,000
Capital	1,000,000
Surplus	700,000
U.S. Bonds	500,000
Circulation	none
Real Estate	none
Dividends	80,000

Our hypothetical bank has deposits of $8 million, capital of $1 million, surplus of $700,000, U. S. bonds of $500,000, no circulation (which eliminates an added burden for the national banks), no real estate (which eliminates municipal taxation on all three charters) and dividends of $80,000.

Given these parameters, how did each type of charter come out under the tax laws prevailing in 1875?

Table 10

1875 Taxation

	National Bank	State Bank	Trust Company
Federal Taxation:			
Deposits	$40,000	$40,000	$40,000
Capital	6,000	6,000	6,000
Subtotal	$46,000	$46,000	$46,000
State Taxation:			
Deposits	$ 4,100	$ 4,100	$ 4,100
Capital	820	820	820
Dividends	--	--	--
Subtotal	$ 4,920	$ 4,920	$ 4,920
Total Taxation:	$50,920	$50,920	$50,920

As you can see from the bottom line of Table 10, the tax bill of the trust company was on a parity with national and state banks at this time.

Table 11

1885 Taxation

	National Bank	State Bank	Trust Company
Federal Taxation:			
Deposits	$ --	$ --	$ --
Capital	--	--	--
Subtotal	--	--	--
State Taxation:			
Deposits	$40,000	$40,000	$ --
Capital	8,500	8,500	--
Dividends	--	--	2,000
Subtotal	$48,500	$48,500	$2,000
Total Taxation:	$48,500	$48,500	$2,000

be interest bearing, and these mainly represented balances from political entities or correspondent banks.

The trust companies were not interested in the little man's deposit - that went to the savings bank. The trust companies were interested in the big deposit, a quarter-of-a-million, a half-of-a-million or even a million dollars. The trust companies were virtually alone over most of the 1875-1900 period in offering a safe, liquid, remunerative haven for corporate funds.

Any one traversing and retraversing the financial literature of the time must be struck by the scarcity of quality, short term money market instruments. Corporate treasurers needed facilities to adjust their money positions. As large corporations grew rapidly, this need grew correspondingly. The trust company could absorb the corporation's excess cash for a negotiated period, and pay the corporation a return. On the other side, the trust company could meet the cash demands of a corporation very quickly by buying funds on the market.

By contrast, the deposit structure of the commercial banks was addressed mainly to transactional needs and was highly seasonal.

The question legitimately arises - if paying interest on deposits was the key to success, why not the commercial banks? The answer is that the greater portion of the commercial banking community considered the payment of interest on deposits an unsound practice and a contributor to financial panics.

In 1853, 1873 and 1884 the New York Clearing House Association passed resolutions prohibiting the payment of interest on deposits by member banks. The Comptrollers of the Currency repeatedly warned of the evils of paying interest.

It was not until about 1895 that the commercial banks really began to actively bid for deposits on the open market. Just how important this could be is shown in Table 13.

Table 13

HANOVER NATIONAL BANK

	Deposits (millions)	Interest Paid (Thousands)
1880	$ 7.5	$130.0
1885	11.5	90.0
1890	13.5	160.0
1895	17.5	175.0
1900	49.0	500.0

Source: Hanover National Bank, General Ledgers.

Hanover National was an important bank in New York City, not the largest but very prestigious. Notice how the growth in net deposits closely paralleled the willingness to pay interest on deposits. More than coincidently, the earnings of the commercial banks were better in the 1895-1900 period than in any other time of our study.

The deposit structure of the trust companies led to a few other advantages.

Table 14

AVERAGE DEPOSITS-TO-SALARIES
1885

	Average Deposits/ Salaries
Union Trust Company	$543
Central Trust Company	322
Catham National Bank	97
Phenix National Bank	96

Source: General Ledgers of respective companies

For one, because the trust companies dealt with large accounts, the average deposit per salary dollar was considerably higher than was the case with the transaction oriented commercial bank.

Table 15

LOAN AND DEPOSIT TURNOVER: 1885

	Total Loans	Total Deposits
Union Trust Company	7.0x	6.6x
Central Trust Company	3.7	3.7
Catham National Bank	4.0	43.5
Phenix National Bank	12.4	77.0

Source: See Table 14

And for another, because the trust companies purchased deposits, they could adjust the maturity structure of the loan and deposit portfolios to match, something which the transaction-oriented commercial banks could not do. In effect the trust companies managed both the asset and the liability side of their balance sheet. The loan-to-deposit ratio for each of these four banks was one-to-one, yet notice how much better balanced were the turnover ratios of two trust companies.

Such in brief are selected conclusions of my dissertation.