BRANCH BANKING IN CANADA

Material prepared for the information of the
Federal Reserve System by the
Federal Reserve Committee on
Branch, Group, and Chain Banking

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The Committee was appointed February 26, 1930, by the Federal Reserve Board

> ". . . to assemble and digest information on branch banking as practiced in the United States, group and chain banking systems as developed in the United States and elsewhere, the unit banking system of the country, and the effect of ownership of bank stocks by investment trusts and holding corporations."

LETTER OF TRANSMITTAL

To the Federal Reserve Board:

The Committee on Branch, Group, and Chain Banking transmits herewith a study of branch banking in Canada, its organization, safety record, and services to the public.

Respectfully,

E. A. Goldenweiser
Chairman

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CHAPTER I

THE CANADIAN BANKING SYSTEM

A study of the banking system of Canada is particularly pertinent at this time, since the commercial banking requirements of Canada and the United States are essentially similar in nature. The differences are those of volume or magnitude rather than of kind. Moreover, the Western or Prairie Provinces of Canada and our Western Grain States have been struggling with the same agricultural problems. In banking structure, however, a striking contrast exists between the two countries. The Canadian system is composed of a few great banks, which are made up of an aggregate of a large number of branches, while in the United States there are thousands of independent banks, the great majority of which are small institutions, operating single banking offices in small communities. Moreover, the banks of Canada operate under a single banking code, while those of the United States transact their business under forty-nine separate jurisdictions.

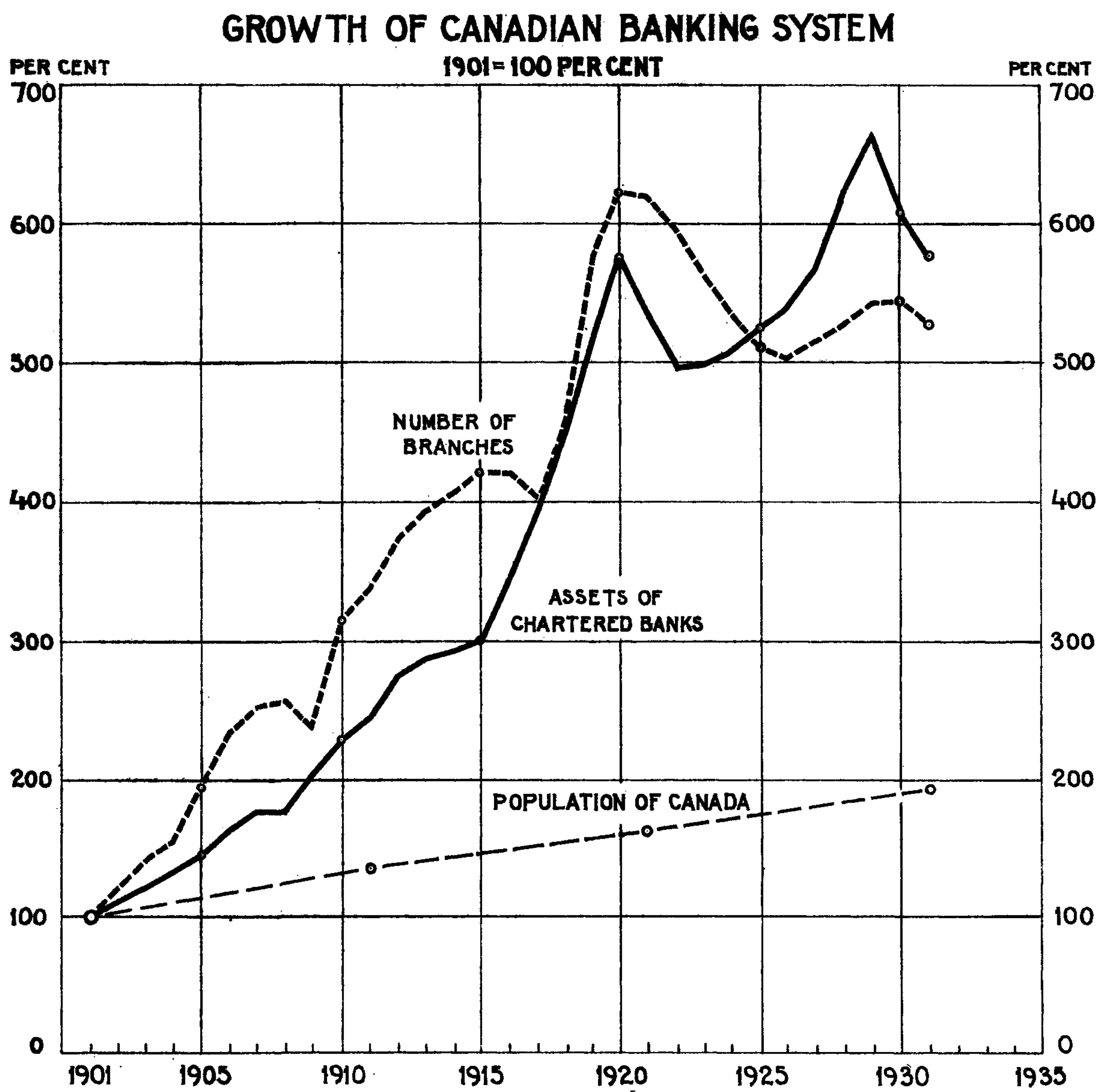
In this preliminary chapter an attempt is made to sketch in broad lines the essential elements of the financial institutions of Canada, with special reference to the commercial banking structure. The analysis will then be confined to the two vitally important and interrelated questions which arise in the consideration of any banking system:--namely, its safety and stability and its capacity to supply to the economic community adequate service at reasonable cost.

Origin of Canada's Banking System

A distinctive feature of the Canadian banking system has been its steady, orderly growth. Whereas banking in the United States has been subjected to several revolutionary changes in the course of its history (establishment and abolition of the First and the Second Banks of the United States, the passage of the National Bank Act, establishment of the Federal reserve system, etc.), Canada has had more than a century of unbroken continuity in her financial structure. The early banks, of which the Bank of Montreal, founded in 1817 and still in existence, was the first and the most important, were chartered by the various Provinces of Canada while still separate colonies of Great Britian, under laws generally similar in content and simple in operation. When the two Provinces of Upper and Lower Canada (now Ontario and Quebec) were united in 1841 to form the colony of Canada, the banks in existence continued their operations with little change. Thirty years later, after confederation, which established the present Dominion of Canada, a general law known as the Bank Act was passed, which for the most part merely confirmed and codified the banking statutes already in force in the various Provinces. Since that time revisions of the Bank Act have been made at ten year intervals, but the alterations have not resulted in any essential change in the organization of the banking system.

Canadian banks from the beginning have been comparatively large institutions, and they have been allowed to establish branches as a matter of course. In the Bank Act of 1871 a requirement was incorporated to the effect that no charter could be issued to a bank with less than $500,000 of subscribed capital, and this provision has remained in force ever since. On two occasions, in connection with the passage of the Bank Act in 1871

CHART 1



Assets and number of branches of Canadian chartered banks and the population of Canada each year from 1901 to 1931, in percentages of the 1901 figures and again during the discussions preceding the revision of 1923, serious attempts were made to change the law so as to permit and even compel the adoption of the type of small scale unit banking common in the United States. The controversy over this question has in fact persisted in desultory fashion almost from the beginning of Canadian banking; but all specific proposals to change the fundamentals of the existing system have been overwhelmingly defeated.

Commercial Banks

Growth. - A comprehensive view of the growth of the commercial banking system in relation to the population, since confederation, may be obtained from Chart 1 and Table 1.

Table 1 - Growth of the Canadian Banking System

Year	Population(1)	Branches in Canada of chartered banks(2) (December 31)	Total assets of chartered banks(3) (average of monthly returns) (000 omitted)
1867			$ 78,295
1868		123	79,861
1869			86,284
1870			103,197
1871	3,689,257		125,274
1872			148,862
1873			166,057
1874			187,921
1875			186,255
1876			183,500
1877			181,019
1878			175,450
1879			173,548
1880			184,276
1881	4,324,810		200,614
1882			227,427
1883			228,085
1884			219,999

Table 1 - Growth of the Canadian Banking System (Continued)

Year	Population(1)	Branches in Canada of chartered banks(2) (December 31)	Total assets of chartered banks(3) (average of monthly returns) (000 omitted)
1885			$ 219,147
1886			228,062
1887			230,393
1888			243,504
1889		402	253,790
1890		426	254,546
1891	4,833,239	468	269,307
1892		479	291,635
1893		502	302,697
1894		513	307,520
1895		530	316,537
1896		533	320,938
1897		555	341,164
1898		622	370,584
1899		663	412,505
1900		708	459,715
1901	5,371,315	750	531,829
1902		904	585,761
1903		1,049	641,543
1904		1,145	695,418
1905		1,454	767,490
1906		1,745	878,512
1907		1,886	945,686
1908		1,927	941,291
1909		2,164	1,067,008
1910		2,367	1,211,452
1911	7,206,643	2,554	1,303,131
1912		2,813	1,470,065
1913		2,962	1,530,094
1914		3,049	1,555,676
1915		3,159	1,596,425
1916		3,160	1,839,287
1917		3,015	2,111,560
1918		3,439	2,432,331
1919		4,337	2,754,568
1920		4,676	3,064,134
1921	8,787,949	4,659	2,841,782
1922		4,451	2,638,776
1923		4,227	2,643,774
1924		4,040	2,701,427
1925		3,840	2,789,619

Table 1 - Growth of the Canadian Banking System (Continued)

Year	Population[1]	Branches in Canada of chartered banks[2] (December 31)	Total assets of chartered banks[3] (average of monthly returns) (000 omitted)
1926		3,770	$2,864,019
1927		3,870	3,029,681
1928		3,966	3,323,163
1929		4,069	3,528,468
1930		4,083	3,237,074
1931	10,374,196	3,970	3,066,018

(1) The Canada Year Book, 1932, p. 91.

(2) Includes subagencies. Figures for 1868-1915 from compilation of B. H. Beckhart, in Willis and Beckhart, Foreign Banking Systems, p. 362, based in part on History of Banking in Canada (National Monetary Commission), p. 310, by Breckenridge, and on data supplied by Canadian Bankers' Association; figures for 1916-1926 from The Canada Year Book, various years, and from Canadian Bankers' Association; figures for 1927-1931 from The Canada Year Book, 1932, p. 776.

(3) Figures from The Canada Year Book, 1932, p. 769.

Legal Basis. - The legal basis of the present commercial banking system is the Bank Act of 1871 and the subsequent revisions and amendments.[4] The full text of the act as amended is published in the appendix. It is a comprehensive code of Dominion laws covering all important phases of the organization and operation of banking institutions. While no attempt is made here to summarize all the provisions of the act, a few are commented upon briefly and others are referred to at appropriate points in later chapters.

Under the Bank Act, no institution can use the word "bank" or any other word or words of similar import in its corporate name except it

(4) Canada Laws, Statutes, etc., Chapter 12; An Act Respecting Banks and Banking, R. S., 1927 - Short Title: The Bank Act, 1923.

be chartered by a special act of the Canadian Parliament (Sections 4 and 166). Preparatory to starting such an institution a private bill is introduced in the House of Commons and usually the Minister of Finance is called upon to make recommendations as to the granting of a charter. If he approves, the bill is likely to be passed and the charter granted. Before a new bank can open its doors for business $250,000 of the subscribed capital must be paid up in cash (legal tender of gold or Dominion notes) and temporarily deposited with or to the credit of the Minister of Finance (Sections 13 and 14). This must be done within one year of the granting of the charter, unless a longer delay is later authorized by parliamentary action. As in the case of national banks in the United States, the shareholders are subject to double liability up to the par value of their holdings.

Each director of a bank must be the <u>bona fide</u> owner of stock on which at least three thousand dollars has been paid up if the paid-up capital of the bank is $1,000,000 or less. Four thousand dollars of each director's stock must be paid up when the capital of the bank is over $1,000,000 but does not exceed $3,000,000, and five thousand when the capital exceeds $3,000,000.

The Canadian banks do not issue transferable share certificates but this does not prevent bank stocks from being freely bought and sold. A Canadian bank is prohibited from purchasing, dealing in, or lending money upon the security not only of its own shares but of the shares of any other bank (Section 75). Moreover, since transferable certificates are not issued, Canadian bank shares are not desirable collateral for loans. Banks are given a lien on their own stock for indebtedness of shareholders (Section 76). Another restriction of potential importance in preventing manipulation of bank stock is that no bank can sell any of its own original or new shares for more than their book value--that is, at a premium greater than "the percentage which the rest or reserve fund of the bank then bears to the paid-up capital stock thereof."(1)

Each bank is authorized to issue notes up to the aggregate value of its unimpaired paid-up capital and the amount of gold and Dominion notes it has on deposit in the central gold reserves (which may be augmented by borrowing from the Dominion Treasury as explained below); and in addition, during the six months of September to February inclusive--the usual crop moving season--up to 15 per cent of its combined unimpaired paid-up capital and rest or reserve fund (Section 61).

Any bank may open as many branches as it likes, anywhere in Canada; and there is no restriction in the Canadian law as to foreign branches (Section 75).

Canadian banks are not authorized to conduct a fiduciary business.

No bank may lend money upon real estate as security (Section 75), although mortgages may be taken as additional security for debts previously contracted (Section 79). If real estate acquired by the bank, other than that required for its own use, is not disposed of within the statutory period allowed, it may be forfeited to the Government (Section 82).

There is no limit to the amount a bank can lend to a single borrower, except that (1) no loan of over $1,000 can be made to any officer or employe of the bank without the approval of the directors, and none of over $10,000 in any case; and (2) no loan in excess of 10 per cent of the

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(1) The Bank Act, 1923, Section 33. The term "rest or reserve fund" in bank accounting in Canada corresponds to "surplus" in the United States.

bank's paid-up capital can be made to a director or to a company or corporation of which the president, general manager, or a director of the bank is a partner or a shareholder, except with the approval of two-thirds of the directors present at a regular meeting of the board, or a meeting specially called for the purpose (Section 75).

Under the somewhat celebrated provisions of Sections 88 and 89 of the Bank Act, Canadian banks making loans to certain classes of borrowers may take liens on certain products, goods, wares, and merchandise which give them the same rights as holders of warehouse receipts even though such products, goods, wares, and merchandise remain in the possession of the borrowers and are subjected to manufacturing processes, except that certain priorities are preserved for wages of the borrowers' employes. Loans for which such security may be taken include, among others, loans to wholesale purchasers and shippers of, or dealers in, products of agriculture, the forest, quarry, mine, sea, lake, or river; loans to dealers in live stock or dead stock or the products thereof; loans to farmers on the security of their threshed grain grown upon their farms; loans to persons engaged in stock raising upon the security of their live stock; and loans to wholesale manufacturers on the security of the goods, wares, and merchandise manufacturered by them or procured for such manufacture. Since 1923, notice of intention to borrow under Section 88 must be registered in the office of the Assistant Receiver General of the Ministry of Finance in the Province in which the principal place of business of the borrower is located, so that prospective creditors may have the protection of being able to learn of prior commitments and possible liens.

Canadian banks can buy and hold for their own account any kind of securities (except bank stocks). As a matter of practice, however, by well established tradition they confine their activities more strictly to commercial banking than do the banks of many other countries. Some of the large institutions occasionally engage in the underwriting of high-grade bond issues, and most of them have bond departments to supply their customers with a selected list of securities; but no bank has an affiliated securities company in Canada, nor do the banks there perform the wide variety of financial services which are commonly rendered by banks and trust companies in the United States.

There is no provision in the law as to reserves against deposits, except that at least 40 per cent of the cash reserves held in Canada shall be in Dominion notes (Section 60).

The act requires monthly and annual statements of condition to be submitted to the Minister of Finance and prescribes in detail the items to be included in these statements. The minister may also require special returns at any time (Sections 112, 113, 114). There is a specific prohibition against the classification of certain types of loans as "current loans" in any statement or balance sheet prepared and issued by the bank (Section 113, subsection 5). Separate monthly returns must be made showing the assets and liabilities of each controlled corporation and the value of the bank's interest in the corporation. The act also requires the directors to submit to each annual shareholders' meeting a statement of the affairs of the bank and prescribes in detail the items to be included. In this statement non-current loans must be shown separately, and investments must be shown at not exceeding their market value (Section 53).

Structure and Organization. - There are at present only ten chartered banks in Canada, including a subsidiary of Barclay's Bank, Ltd., of England, which also is incorporated under Canadian banking law. The names of these institutions, together with their capital funds, total assets, and number of branches in Canada as of December 31, 1931, are as follows:

Table 2 - Canadian Chartered Banks, December 31, 1931(1)

Name of bank	Capital paid up	Rest or reserve fund(2)	Total assets	Number of branches in Canada(3)
	(000 omitted)			
Bank of Montreal	$ 36,000	$ 38,000	$ 761,157	624
Bank of Nova Scotia	12,000	24,000	262,732	307
Bank of Toronto	6,000	9,000	120,792	191
Banque Provinciale du Canada	4,000	1,500	52,796	331
Canadian Bank of Commerce	30,000	30,000	592,513	758
Royal Bank of Canada	35,000	35,000	782,584	805
Dominion Bank	7,000	9,000	132,875	137
Banque Canadienne Nationale	7,000	7,000	150,206	591
Imperil Bank of Canada	7,000	8,000	136,917	226
Barclays Bank (Canada)	500	500	5,101	2
Total	$144,500	$162,000	$2,997,673	3,972

(1) Returns of the Chartered Banks. Figures include assets of foreign branches. Number of branches from Houston's Bank Directory of Canada, January, 1932. The total number of branches shown is 2 more than the figure in The Canada Year Book, given in Table 1 above.

(2) The term "rest or reserve fund" in bank accounting in Canada corresponds to "surplus" in the United States. "Undivided profits" are not reported in Returns of the Chartered Banks.

(3) Including over 600 subagencies, which are usually open for business no more than two or three days a week. Most of these are operated in the Province of Quebec by the Banque Provinciale du Canada and the Banque Canadienne Nationale.

These institutions are organized into the Canadian Bankers' Association, which since the Bank Act revision in 1901 has been given a definite legal status and authority to perform certain functions in the general administration of the banking system. In case a bank suspends payments the association is authorized to appoint a curator to supervise its affairs until it resumes business or until a liquidator is appointed to wind up its business. The functions of the association are set forth in Section 124 of the Bank Act as follows:

"124. The Association may, at any meeting thereof, with the approval of two-thirds in number of the banks represented at such meeting, if the banks so approving have at least two-thirds in par value of the paid-up capital of the banks so represented, make by-laws, rules and regulations respecting

(a) all matters relating to the appointment or removal of the curator, and his powers and duties;
(b) the supervision of the making of the notes of the banks which are intended for circulation, and the delivery thereof to the banks;
(c) the inspection of the disposition made by the banks of such notes;
(d) the destruction of notes of the banks;
(e) the custody and management of the central gold reserves and the carrying out of the provisions of this Act relating to such reserves; and
(f) the imposition of penalties for the breach or non-observance of any by-law, rule or regulation made by virtue of this section.

2. No such by-law, rule or regulation, and no amendment or repeal thereof, shall be of any force or effect until approved by the Treasury Board.

3. The Association shall have all powers necessary to carry out, or to enforce the carrying out, of any by-law, rule or regulation, or any amendment thereof, so approved by the Treasury Board. 1923, c. 32, s. 124."

Both through the association, and directly, the banks are intimately related to and supervised by the Ministry of Finance. There is no central bank; the growing requirements for central banking service have been met to some extent in recent years by the Ministry of Finance, through the making of advances to the banks against certain classes of securities. As compared with the facilities existing in New York or London, there is no highly developed money market in Canada, and loans designated there as "call" are in reality short-term advances not strictly payable on demand.

The Canadian banking system is composed of banks of branches rather than banks with branches. Each aggregation of branches is a closely coordinated unit managed by the head office, which is an administrative office and does not deal directly with the public. All business with the public is done by the branches, each of which is conducted largely as a separate institution and keeps its own complete set of accounts. Each branch, however, has an account with the head office, by means of which transfers of funds from one branch to another can be accomplished, usually with little more than a bookkeeping operation. The larger institutions have branches throughout the inhabited portions of Canada; in fact, even the smallest (exclusive of Barclays) spreads its operations over a considerable part of the territory of the Dominion. In addition, some of them have branches abroad, the Royal Bank leading in numbers with over 100 foreign offices and agencies.

As in other countries, the ownership of a Canadian bank, together with the ultimate power of its administration, rests with the shareholders, who for all ordinary transactions delegate their authority to the board of directors. Usually the president of the institution acts as chairman of the board of directors. The principal executive officer of the bank is the general manager, with functions and powers corresponding approximately to those of the president of a bank in the United States. In the larger institutions his duties and responsibilities are shared by one or more assistant general managers. The usual main departments of the head office are those of the superintendent of branches, the chief inspector, and the chief accountant. In general terms it may be said that the higher officers subordinate to the general manager rank about equally with the vice presidents of a bank in the United States.

Often there are two or more superintendents of branches, each with the title of assistant general manager, who are in charge of regional groups of branches. Sometimes the assistant general managers are not stationed in the same city as the head office, the Bank of Montreal, for example, having one in London (England), one in Toronto, and another in Winnipeg. In addition to these, the larger banks have district superintendents in each of the Provinces of Canada and in some cases in foreign countries, with authority delegated either from the head office directly or through resident assistant general managers. Their offices are in effect extensions of the head office.

The chief inspector and his corps of assistants are charged with the audit and examination of all the branches of the bank. Each branch is inspected at irregular intervals at least once a year, the inspection consisting first of a routine audit and then of a thorough examination of the assets and of all other activities of the local office. The latter part of the inspection is often carried out by a different and senior inspector, who may time his visit to take place a few days after the routine audit. The inspection department works in the closest possible collaboration with the superintendent or superintendents of branches and with the chief accountant. All the various executive and supervisory departments, whether located in the same city or not, are parts of the head office organization, their work being coordinated and directed by the general manager.

Branch Operation and Supervision. - Branch managers throughout the system function much as do the presidents (or cashiers in the case of some of the smaller institutions) of independent banks in the United States, except that they are under the supervision of the head office organization, either directly or through the intermediary of a district superintendent, for their more important lending operations. In all matters pertaining to loans, the district superintendent's office, in the case of the larger banks, is in effect the local manager's head office. Each local manager is allowed a certain discretionary limit as to the size of loan he can make without special instructions from higher authority. This varies among the banks and with different managers, according to the size or importance of the branch and the proven ability and experience of the manager. The maximum in the smallest branches is usually about $500, whereas in the large city offices the manager is often permitted to lend up to ten or fifteen or even twenty-five thousand dollars on his own responsibility.

Generally the district superintendent is empowered to authorize loans by the branches under his supervision up to twenty or twenty-five thousand dollars. For larger operations authorization must be obtained from the general manager. The assistant general managers have about the same discretionary limits as the district superintendents. The general manager himself sometimes authorizes loans up to $100,000, although such transactions may require the consent of the board of directors, who generally meet once a week. All along the line there is of necessity a considerable degree of elasticity in the application of lending limits, particularly under active business conditions.

At each step of the process of making or authorizing a loan there is, in addition to the discretionary limit, what is known as a reporting limit. Thus a local manager with authority to lend up to $1,000 may be required to report immediately to the district superintendent the full particulars of all loans between $500 and $1,000. The district superintendent, in turn, with lending powers perhaps up to $25,000, must report to head office on all loans between, say, ten and twenty-five thousand dollars. To complete the chain of responsibility, the assistant general managers and the general manager must report to the board of directors full particulars on all loans above, say, $25,000.

For each local branch, or in each district, an effort is made by the general management to set the lending limit high enough to cover nearly all applications for loans. For the exceptional cases, when possible, borrowers requiring advances above the discretionary limit make application for a line of credit in advance of their needs to extend over a period of one year. When this is granted the local manager, or the district superintendent as the case may be, can make or authorize loans from time to time without consultation with higher authority.

For every loan, from the smallest advances made by local managers to the largest authorized by head office, a complete financial statement of the borrower is drawn up and carefully analyzed. This statement is designed primarily to disclose the current position of the borrower and his prospects of being able to repay the loan when due, although, of course, consideration is also given to fixed assets, and the "net worth" of the borrower. In finally granting the credit special importance is attached to the debt record of the borrower.

Besides the careful consideration given the loan at the time it is made, and the various reports made to the district superintendent and the head office, every advance recorded in the liability ledger, no matter how small, is rigorously scrutinized by the bank's examiners at least once a year at the time of the annual inspection.

Liabilities of the branches consist almost entirely of deposits. Something like two-thirds of the aggregate amount of individual deposits for the whole of the Canadian banking system is in savings accounts, upon which a uniform rate of 3 per cent of interest is paid. Such accounts are handled by means of passbooks as in the United States, and although legally the banks have the right to require notice before they are withdrawn, actually they are paid on demand. There is no legal requirement for the segregation of savings deposits, which in practice are merely kept in separate ledgers.

An elaborate system of daily, weekly, and monthly returns and reports, from the branch managers to the head office, or to the district superintendents and from the latter to the head office, makes it possible to keep track of and coordinate all the transactions of the bank. The subject matter of the reports includes not only the activities of the various branches themselves but also as much information as possible of a general economic nature, so as to provide the head office with accurate information regarding business conditions throughout the territory served by the institution.

Every banking service available in the largest cities is also at the disposal of the customers of the smallest branch. Moreover, branches draw upon the entire resources of the institution for making loans, in so far as these are considered safe and in accordance with sound banking practice.

Personnel. - Most of the employes are taken into the Canadian banks at ages varying from sixteen to nineteen, the average being perhaps seventeen or eighteen. The young clerks, or "juniors,"[1] as they are called, are usually high school graduates; only occasionally is there a college or university man among them, the Canadian banks following in this respect the ancient traditions of apprenticeship brought over from England and Scotland. Upon entering the service of the bank the "junior" is pledged to secrecy, and to all intents and purposes is sworn in as an officer of the institution. Usually he enters the organization with the expectation of making banking his life work. Promotions to the higher executive positions are almost invariably made from the ranks, and each employe is expected to understand that his advancement will depend upon his own ability and energy.

The juniors usually begin work as all around handy men in the smaller branches, although they are often assigned for varying periods to more specific tasks in the larger offices. During the first few years they are shifted about from one kind of work to another, and from one branch to another, in order that their latent capacities may be discovered and developed. Frequently, also, they are given a turn in the head office. After having shown sufficient ability and judgment as second in command of a branch, the employe may be promoted to a branch managership--unless he should happen to show special capacity and a liking for some sort of administrative work in the head office. If he is ambitious and gives evidence of greater ability than is required for his duties in a given position, he is likely to continue to he shifted every few years from one branch or department to another. On the other hand, if it is believed by his superiors that managing a branch of a given size, or performing the tasks of a given position in the head office,

(1) This discription does not apply to stenographers and machine operators, or to messengers, doormen, etc.

is about the upper limit of his capacity, he is likely to settle down and remain in the same place for many years, perhaps until retirement. Considerable effort is made to see that each employe has an opportunity to develop his fullest capacities. Each inspection of a branch includes a report on the personnel, a part of which is the inspector's opinion regarding the potential abilities of each employe. Since each branch is usually examined from year to year by different inspectors, there will be in the head office the impressions and recommendations of several different observers, which serves to eliminate the possible effect of recommendations based on personal bias.

As far as natural ability makes it possible, each member of the personnel is expected to become familiar with and competent to perform the various duties connected with the operation of the bank. Those who demonstrate exceptional ability, therefore, become well equipped by experience to assume larger responsibilities as branch managers or in other executive capacities. The remainder of the personnel are trained in such tasks as they are called upon to perform.

Other Types of Financial Institutions

Brief mention should be made of the other types of institutions which make up the financial organization of the Dominion. Apart from the insurance companies, the principal ones are the loan companies, trust companies, savings banks, investment banking houses, investment trusts, and Dominion and provincial institutions for agricultural credit.

Canadian loan companies are incorporated under either Dominion or provincial laws and procure their funds partly from deposits but mainly from the issue of debentures. The principal function of the loan companies is the making of loans on real estate, but they also invest in securities and make loans collateraled by securities. They are not, however, permitted to discount commercial paper or engage in ordinary commercial banking. The book value of the assets of all loan companies in Canada in 1930 was reported as \$205,962,000, and their liabilities to the public as \$137,056,000.(1)

Canadian trust companies, which also operate under either Dominion or provincial laws, are in some instances closely related to the commercial banks and to loan companies through interlocking directorates. They are essentially trust companies and confine their activities mainly to trust and agency business, although they accept deposits to a limited extent. Canada has no counterpart of the trust companies in the United States which carry on a combined fiduciary and commercial banking business. Since the trust companies have practically the same privileges as the loan companies, and in addition have trust powers which the loan companies do not possess, there has been a noticeable tendency for loan companies to convert to trust companies.

Many of the trust companies accept money in trust for investment and some of them act virtually as savings depositories, even accepting deposits subject to check. Others restrict themselves to the issue of guaranteed investment certificates as evidence of the deposit of money for investment. All these deposits, of whatever nature, are guaranteed by the company and are listed in the balance sheet as "guaranteed funds."

The largest trust companies accepting deposits are incorporated by the Provinces. In 1930 the guaranteed funds of all provincially incor-

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(1) The Canada Year Book, 1932, p. 787.

porated trust companies in Canada amounted to $137,573,000, as compared with $26,409,000 for those incorporated under Dominion law.(1) Total assets were reported as $2,080,913,000 for the provincial companies and $246,644,000 for the Dominion companies, thus making a total for Canada of $2,327,557,000.(2) These were made up of: company funds, $86,129,000; guaranteed funds, $163,982,000; estates, trusts, and agency funds, $2,077,-446,000.(3)

Savings banks are operated by the Dominion Post Office Department and by certain provincial governments. In addition there are two important privately owned institutions, the Montreal City and District Savings Bank and la Caisse d'Economie de Notre Dame De Quebec, both operating under Dominion charters authorized by the Quebec Savings Bank Act. The former had on December 31, 1931, paid-up capital of $2,000,000 and total assets of over $60,000,000; the latter had paid-up capital of $1,000,000 and total assets of over $16,000,000. Inasmuch as the commercial banks accept savings deposits, the strictly savings institutions play a comparatively minor role in Canada. The combined deposits of all such institutions at the end of 1931 amounted to about $150,000,000 as compared with aggregate savings deposits of over $1,300,000,000 in the commercial banks.

A large number of investment banking houses and brokerage firms are in operation, although the bulk of the underwriting is done by a few of the larger concerns, which sometimes act in combination with the banks

(1) Ibid.
(2) Ibid.
(3) Ibid.

or other financial houses in Canada or the United States. Their business is not essentially different from that of similar firms in the United States. The same observation applies, moreover, to the investment trusts, which have come into existence only in recent years.

There are certain publicly owned institutions for supplying agricultural credit, one of which is the Canadian Farm Loan Board. This was created by legislation passed in 1927 and had outstanding at the end of 1931 long-term farm loans of about $7,500,000. Other similar organizations are conducted by some provincial governments, and in Quebec there are a number of cooperative credit societies. The main sources of long-term agricultural credit, however, are the trust companies, loan companies, life insurance companies, and private individuals, as was the case in the United States before the passage of the Federal Farm Loan Act.

Currency System

Canada's monetary unit is the dollar, having the same gold content as the United States dollar. Currency consists of gold and subsidiary coin and Dominion notes, which are legal tender, and the notes of the chartered banks. The latter are not legal tender, although accepted without question in all parts of Canada. Under the Dominion Notes Act of 1914 the Government is authorized to issue $50,000,000 of Dominion notes against a gold reserve of not less than 25 per cent. The act of 1915 authorizes a further issue of $26,000,000 without any gold reserve requirement, of which $16,000,000 must be secured by certain specified Canadian railway securities guaranteed by the Dominion Government. Dominion notes in excess of $76,000,000 may be issued only against dollar for dollar gold reserves or, under the Finance Act as amended in 1923,[1] against approved securities pledged by the banks.

Dominion notes are used for general circulation only in denominations of $5 and under, the larger denominations being employed mainly for interbank transactions and reserves. The bulk of the money in circulation consists of the notes of the chartered banks in denominations of $5 and multiples thereof. The total circulating media of all kinds in the hands of the public since 1916 has varied from an average of $21.86 per capita in that year to $34.33 in 1920. In 1931 the average per capita was $20.36.[2]

From earliest days the chartered banks have had the privilege of issuing notes up to the full value of their paid-up capital stock. The notes are a first charge against assets. As an added measure of security, in effect since 1891, each bank is required to keep on deposit with the Minister of Finance an amount of cash equal to 5 per cent of its average circulation, subject to annual adjustment, to constitute a guarantee fund for the payment of all notes of any suspended bank with interest until the date set for their redemption by the liquidator. If depleted for this purpose, the fund must be replenished by the remaining banks in proportion to their circulation, each bank contributing not more than one per cent per year of its average circulation. There has been no delay or loss to the noteholders of a suspended bank since 1881.

So long as the banks' own notes made up a large proportion of their funds available for loans, the note issue privilege represented one of their chief sources of income. Although now relatively less important, it is still

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(1) See discussion below.

(2) The Canada Year Book, 1932, p. 764.

considered valuable, owing to the fact that a bank's notes are not a liability until actually paid out over the counter. Because of this feature, small branches, amply supplied with currency, may be opened with very little cash (gold or Dominion notes).

Prior to 1900 the total of notes in circulation was usually well below the paid-up capital of the banks, and consequently a sufficient degree of elasticity of the currency was assured. Thereafter the rapid economic expansion of the country caused circulation to approach the total of paid-up capital, with the result that difficulty was sometimes encountered in meeting seasonal requirements, particularly in connection with crop movements. To remedy this situation, the Bank Act was amended in 1908 to permit, for a period covering the crop moving season of each year, the issue of additional notes up to 15 per cent of the combined paid-up capital and rest or reserve fund of each of the banks. Then in the 1913 revision of the act, provision was made for the establishment of central gold reserves, to be administered by trustees appointed by the Canadian Bankers' Association and the Minister of Finance, and the banks were authorized to issue additional notes up to the amount of gold or Dominion notes deposited therein.

To add still further elasticity, a law was passed in 1914, known as the Finance Act, providing that the banks could borrow Dominion notes from the Minister of Finance against Government bonds and certain other approved securities, including commercial paper of not more than six months' maturity. Originally this law was to be in force only during emergencies. In 1923, however, it was amended to permit the Minister of Finance to issue

Dominion notes and lend them to the banks against approved securities and commercial paper at any time, and without any prescribed limit as to the amount,[1] so that by depositing them in the central gold reserves the banks could in effect issue their own notes to take care of any requirement for additional currency.

(1) Finance Act, R. S., 1927, pp. 1717-1720.

CHAPTER II

SAFETY RECORD OF CANADIAN BANKS

In the period 1901 to 1931 inclusive there were seven suspensions of chartered banks in Canada, with total reported resources of $23,442,361.[1] During the same period of thirty-one years in the United States there were 10,190 State and national bank suspensions, with total reported resources of over $6,500,000,000.

This comparison, however, should be related to the size of the banking systems. Two sets of figures will perhaps serve as the best standard obtainable for this purpose:--(1) the ratio of total reported assets of suspended banks to the average yearly total banking assets of each country, and (2) the ratio of the total number of banking offices closed as a result of suspensions to the average number in existence. These comparisons have been made in Table 3 below for three periods: 1901 to 1920, 1921 to 1931, and 1901 to 1931.

For the period 1901 to 1920 the assets of suspended banks in Canada amounted to about one-half of one per cent of the average yearly banking assets of the country. The corresponding figure for State and national banks in the United States for the same period was about seven times as large, or 3.6 per cent. For the eleven year period 1921-1931 the assets of suspended banks in Canada were again equal to about one-half of one per cent of the average yearly banking assets of the country, while the corresponding figure in the United States was about twenty times as high, or 10.7 per cent.

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(1) From data furnished by the Inspector General of Banks in Canada.

Table 3 - Bank Suspensions in Canada and the United States

	Canada(1) (chartered banks)	United States(2) (national and State banks)
	1901-1920	
Average yearly total banking assets	$1,396,163,000	$21,581,950,000
Total reported assets of suspended banks	7,593,961	767,577,000
Percentage suspended	0.5%	3.6%
Average yearly total banking offices	2,428	21,228
Total closed as result of suspensions	50	1,274
Percentage suspended	2.1%	6.0%
	1921-1931	
Average yearly total banking assets	$2,969,437,000	$54,183,455,000
Total reported assets of suspended banks	15,848,400	5,773,299,000
Percentage suspended	0.5%	10.7%
Average yearly total banking offices	4,086	28,975
Total closed as result of suspensions	68	9,390
Percentage suspended	1.7%	32.4%
	1901-1931	
Average yearly total banking assets	$1,954,421,000	$33,150,226,000
Total reported assets of suspended banks	23,442,361	6,540,876,000
Percentage suspended	1.2%	19.7%
Average yearly total banking offices	3,016	23,976
Total closed as result of suspensions	118	10,664
Percentage suspended	3.9%	44.5%

(1) Average yearly total banking assets in Canada are computed from data in The Canada Year Book, 1932, p. 769. Total reported assets of suspended banks and the number of banking offices closed as result of suspensions in Canada are from data furnished by the Inspector General of Banks in Canada. For sources of data on the average yearly total banking offices in Canada see Table 1, pp. 4-6.

(2) Data for the United States have been compiled by the Federal Reserve Committee on Branch, Group, and Chain Banking from reports of the Comptroller of the Currency and State banking departments. The number of branches closed in the United States during 1901-1920 is not available, but the omission does not seriously affect the percentages. Assets of State banks suspending from 1901 to 1920 are estimated from data contained in the annual reports of the Comptroller of the Currency.

The above data relate to banks which have suspended payments to depositors because of financial difficulties. They do not take into account banking difficulties which are met in other ways, such as emergency consolidations or assessments and contributions from stockholders to prevent closing. There have been some amalgamations in Canada and many in the United States in order to prevent the failure of institutions in difficulties, but it is not possible to enumerate these with sufficient accuracy to make a reliable comparison between the two countries. Some banks, especially in the United States, have been saved by different measures, such as reorganization with new capital, the cooperation of public officials and sound banks, or by injecting new funds into them by their directors and stockholders. Millions of dollars have been poured into weak banks by this process during the past eleven years, but reliable figures as to the total amount involved are not available.

It is not possible to compute the total loss or damage to a community as a result of a bank suspension. Even in those cases where the bank reopens or where the depositors are ultimately paid in full the shaking of confidence and the general demoralizing effects are serious. It is possible, however, to make a rough comparison of losses to depositors in the two countries. This comparison must be based largely on estimates, since the liquidation of many suspended banks in the United States is incomplete. On the basis of the best estimates available, the results for the eleven years 1921-1931 are as shown in Table 4.

Table 4 - Estimated Losses to Depositors of Suspended Banks in Canada and the United States, 1921-1931 Inclusive

	Canada (chartered banks)	United States (national and State banks)
Average yearly total deposits(1)	$1,897,519,000	$39,450,500,000
Total estimated losses to depositors(2)	6,400,000	1,386,000,000
Percentage loss	0.34%	3.51%

(1) Includes for Canada only individual demand and time deposits; for the United States, demand deposits, time deposits (including Postal Savings), certified and cashiers' checks, cash letters of credit, and travelers checks outstanding. Canadian figures are from The Canada Year Book, 1932, p. 768. United States figures are computed from the annual reports of the Comptroller of the Currency, 1921-1931.

(2) Total estimated losses to depositors in Canada are from data furnished by the Inspector General of Banks in Canada. Losses to depositors in the United States are estimates by the Federal Reserve Committee on Branch, Group, and Chain Banking based on data supplied by the Comptroller of the Currency and State banking departments. The estimates were made on the basis of the experience of those suspended banks that had been reopened, taken over, or completely liquidated at the time the data were compiled. The ratio of losses to total deposits as shown by these banks was applied to the deposits of all banks suspending during the eleven year period.

Bank Failures in Canada[3]

Of the 7 Canadian banks which have suspended payment since the beginning of the present century, 6 were relatively small, while the seventh and last was a comparatively large institution, its suspension causing considerable losses and widespread indignation.

The Bank of Yarmouth, a local institution without branches, founded in 1859, suspended payment on March 6, 1905. Its reported assets were $723,660, and liabilities to the public were $388,660. All depositors were eventually paid in full.

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(1) See appendix, p. 133, for list of Canadian bank insolvencies since 1867.

The Banque de St. Jean, founded in 1873 and having five branches at the time of suspension, closed its doors on April 28, 1908. Assets were reported as $326,118, and liabilities to the public amounted to $560,781. Losses to depositors have been estimated at $237,000.

The Banque de St. Hyacinthe, founded in 1873, went into liquidation on January 24, 1908. It had 6 branches, reported assets of $1,576,443, and liabilities to the public of $1,172,630. All depositors were paid in full.

St. Stephen's Bank, founded about 1836, closed its doors on March 10, 1910. It was a local bank with no branches, having at the time of suspension reported assets of $818,271 and liabilities to the public of $549,830. Shortly after its suspension some of the directors advanced sufficient funds to pay off all creditors, and the bank's assets were sold to the Bank of British North America. Thus there were no losses except to the shareholders.

The Farmers' Bank, comprising 27 branches at the time of suspension, closed its doors on December 19, 1910, after only four years of operation. At the time of suspension its paid-up capital amounted to $567,579 and there was no surplus. Liabilities to the public were $1,997,041 and assets were reported to be $2,616,683, although these turned out to be composed largely of bad debts.

From the very beginning, the operations of the Farmers' Bank appear to have been fraudulent.(1) The organizers, as provisional directors, took personal notes for the bank's shares, then pledged them as collateral against loans from a trust company and an insurance company, and used the proceeds to make the temporary deposit with the Minister of Finance which

(1) See Proceedings of Royal Commission on Farmers' Bank, pp. 456-490.

was required before the institution could obtain a certificate authorizing it to commence business. After the certificate was issued, this temporary deposit was returned to the bank and the loan from the trust company, as had been arranged when the loan was made, was repaid. Shortly after opening, it began to incur heavy losses from poorly secured loans. The general manager was accused of having looted the institution, and some smaller defalcations were said to have occurred in the branches. According to press reports the general manager was convicted of forgery, theft, and perjury in connection with the bank's returns to the Minister of Finance and was sentenced to six years in prison.(1) The main cause of the failure was clearly shown to be mismanagement and dishonesty in the head office.(2) Losses to depositors have been estimated at $1,314,000.(3)

On December 14, 1914, the Bank of Vancouver, which had been chartered less than seven years previously, was obliged to close its doors. Operating locally in southern British Columbia, it had 10 branches. Its paid-up capital amounted to only $445,188 and there was no surplus. Assets were reported as $1,532,786, and liabilities to the public amounted to $912,137. Losses to depositors have been estimated at about $550,000.(4) Failure seems to have occurred chiefly because there had been no economic justification for the bank's opening in the first place, and because of the poor loans it made in its desperate attempts to retain its customers and obtain new business.(5)

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(1) Monetary Times, January 21, 1911, p. 315 and April 8, 1911, pp. 1441-1442.

(2) See Proceedings of Royal Commission on Farmers' Bank, pp. 456-490.

(3) From a tabulation furnished by the Inspector General of Banks in Canada.

(4) Liquidation incomplete at the end of 1931. Figures for estimated losses furnished by the Inspector General of Banks.

(5) For a discussion of this bank's affairs, see Monetary Times, Dec. 18, 1914.

The last failure which has occurred in Canada was the Home Bank of Canada on August 17, 1923. This institution closed its doors under circumstances even more disturbing to public confidence than those of the Farmers' Bank in 1910. At the time of suspension it had 68 branches and reported paid-in capital of $1,960,591, surplus of $550,000, and liabilities to the public of $18,356,373. Assets were reported as $15,848,400.(1)

The history of the Home Bank of Canada goes back to 1854, when the original institution was founded as the Toronto Savings Bank. After the passage of the Bank Act in 1871, forbidding the use of the word "bank" in the title of institutions not chartered by the Dominion Parliament, it became the Home Savings and Loan Company. Although finally obtaining a charter under the Bank Act in 1903, it did not commence business as the Home Bank of Canada until 1905.

When the institution started as a chartered bank, its condition was apparently sound, but beginning with 1909 it included unpaid interest on certain loans, real estate write-ups, and other questionable items in reported earnings, and continued to pay dividends while the bank was actually operating at a loss.(2) In addition, it made very large loans to certain of its customers. Its heaviest losses occurred between 1916 and 1923, amounting for this period to at least $7,500,000. Practically all the doubtful loans were made through the head office or with the approval of the head office. Many of them were made without the knowledge of the

(1) Figures furnished by Inspector General of Banks in Canada, and are as of date of suspension, August 17, 1923; whereas figures in <u>The Canada Year Book</u> are as of June 30, 1923.

(2) Statements in this paragraph are based on "The Story of the Home Bank," <u>Monetary Times</u>, December 14, 1923, and the <u>Report of the Royal Commission on Home Bank</u>, 1924, pp. 258-288 and 507-515.

directors. In later years the bank resorted to trading in securities to bolster its profits. Testimony at the hearings of a Royal Commission in 1924 indicated that it had actually been insolvent for from eight to ten years before its suspension.

Losses to depositors have been estimated at $6,400,000, after a donation of about $3,425,000 by the Dominion Government for the benefit of creditors with claims of less than $500, as well as those with claims of over $500 if found to be in special need.(1) Primary responsibility for failure was shown to be that of the general management at the head office.(2)

Forced Amalgamations(3)

Besides the suspensions noted above, two Canadian banks, the Ontario Bank and the Sovereign Bank of Canada, have disappeared since 1900 through liquidation with open doors, and 30 through mergers, several of which were forced amalagamations to prevent suspension. Among the latter in recent years were the Merchants' Bank and the Banque Nationale. The Merchants' Bank made application to the Minister of Finance in 1921 for permission to sell its assets to the Bank of Montreal. Authorization was given and the institution was taken over in 1922, but without loss or delay to depositors. The Banque Nationale was a French Canadian institution, operating mainly in the Province of Quebec. By 1924 it was insolvent, but the provincial government of Quebec intervened and induced the Banque d'Hochelaga to take it over.(4) The Province assigned its own forty year 5 per cent bonds in the amount of $15,000,000 to the Banque d'Hochelaga in

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(1) Information furnished by the Inspector General of Banks in Canada. Liquidation incomplete at the end of 1931.

(2) See Report of Royal Commission on Home Bank, 1924, pp. 491-522 and 539-551, testimony of Mr. George Edwards, special auditor appointed by Minister of Finance.

(3) For a complete list of bank absorptions since 1867 see appendix, p. 134.

(4) Information furnished by Mr. C. S. Tompkins, Inspector General of Banks.

full ownership, the latter agreeing in return to pay to the Province of Quebec $125,000 a year for forty years to liquidate the principal amount of the bonds, but only out of net profits and after 10 per cent dividends to shareholders. The Banque d'Hochelaga then changed its name to Banque Canadienne Nationale.

Other forced amalgamations have occurred, although very little information is available as to the exact conditions and circumstances. In view of the above cases, however, it is evident that mergers to prevent suspension constitute a recognized procedure.

Notwithstanding the suspensions and forced amalgamations which have occurred, it is evident from the tabulations at the beginning of this chapter that, in comparison with the unit banking system of the United States, the Canadian branch system has in recent years provided a higher degree of safety to its depositors.

Factors Relating to Safety

Banking Structure. - Made up of branches spread over an expanse of territory in which the economic activities are varied, the Canadian banks have obtained considerable diversification in their assets. This, coupled with the fact that they are institutions of large resources, has enabled them to provide a degree of safety usually not obtainable for a small independent unit bank operating in a single community. When unforeseen difficulties have arisen in the collection of loans made in one community, or to one division of economic activity, the other loans and investments of the bank have usually been of such a character as to preserve the institution as a whole from danger of insolvency. These two factors, large resources and wide diversification of loans, may be described as the elementary structural features making for safety in the Canadian banking system.

Certain administrative advantages are claimed by Canadian bankers, moreover, in connection with the branch system. They say that a large branch organization possesses superior facilities for investigating not only the soundness of current investments but also the broader trends of economic development calculated to affect general policies. Owing to the close supervision and control exercised over the branches, the degree of safety of the organization as a whole is measured largely by the integrity, the ability, and the judgment of the general management of the institution.

Management. - The degree of safety to depositors of any banking system depends very largely upon the quality of its management. Consequently the actual safety record of the Canadian banks reflects in some measure the quality of their management. A banking system which has developed gradually over a long period of years without revolutionary changes, as in Canada, has been able to build up time-tested and well established traditions of sound banking practice. By the very nature of their structure and their methods of personnel administration, the Canadian banks have for generations played an important role as training schools for bankers.

Under the laws of the Dominion, Canadian banks must be at least ten times as large in terms of paid-up capital stock as the minimum for national banks in the United States, and modern economic tendencies have resulted in institutions a great deal larger than the legal minimum.

<u>Function</u>. - The kind of business in which the Canadian banks engage is determined partly by law, as in the case of the prohibition of loans secured by real estate, but in greater measure by the judgment exercised by the management. It is a noteworthy fact that the commercial banks do not operate security affiliates in Canada and do not engage in general investment banking activities. It is commonly asserted in authoritative circles in Canada, moreover, that the banks are conducted as strictly commercial institutions, avoiding not only real estate loans but all loans the proceeds of which are intended for capital investment. As pointed out in the preceding chapter, a large proportion of their total deposit liabilities are time or "savings" deposits; but in practice these are paid on demand and loaned out or invested exactly as if they were demand deposits. Practically all loans are made, originally at least, as short-term advances, and most investments are eligible as collateral for advances by the Dominion Treasury under the Finance Act.

Some indication may be had of the distribution of their resources from the accompanying condensed statement (Table 5) of assets and liabilities in 1931 and at five year intervals since 1915.

Table 5 - Assets and Liabilities of All Canadian Chartered Banks[1]

(yearly averages of monthly returns; in thousands of dollars)

	1915	1920	1925	1930	1931
ASSETS					
Quick assets					
1. Cash items: Specie, Dominion notes, notes of and checks on other banks, foreign currencies	255,687	435,380	366,739	353,485	312,836
2. Balances due from other banks in Canada and elsewhere	72,763	85,465	73,606	106,772	106,528
3. Deposits in central gold reserves and with Dominion Government for security of note circulation	15,082	113,826	63,496	46,722	32,869
Total quick assets	343,532	634,671	503,841	506,979	452,233
Other liquid assets					
4. Call and short (not exceeding thirty days) loans on securities in Canada and elsewhere	191,592	319,054	345,548	414,431	278,760
5. Dominion, provincial, and Canadian municipal securities; other public securities; railway and other securities	118,389	379,215	565,506	471,638	674,357
Total other liquid assets	309,981	698,269	911,054	886,069	953,117
Other assets					
6. Current loans and discounts in Canada and elsewhere	867,950	1,611,440	1,205,589	1,642,516	1,476,026
7. Non-current loans	6,747	4,952	10,879	7,651	9,303
8. Bank premises	47,704	58,112	73,086	77,465	79,112
9. Other real estate and mortgages on real estate sold	5,645	7,460	13,085	12,496	12,734
10. Liabilities of customers under letters of credit	9,835	46,055	62,541	90,356	67,897
11. Other assets not itemized	5,031	3,175	9,544	13,542	15,597
Total other assets	942,912	1,731,194	1,374,724	1,844,026	1,660,669
Total assets	1,596,425	3,064,134	2,789,619	3,237,074	3,066,019

Table 5 - Assets and Liabilities of All Canadian Chartered Banks(1) (Continued)

(yearly averages of monthly returns; in thousands of dollars)

	1915	1920	1925	1930	1931
LIABILITIES					
Liabilities to the public					
1. Notes in circulation	105,137	228,800	165,235	159,341	141,969
Deposits and due to banks:					
2. By the public, payable on demand in Canada	358,444	653,863	531,181	622,895	578,604
3. By the public, payable after notice in Canada	690,904	1,239,308	1,269,543	1,427,570	1,437,977
4. Elsewhere than in Canada	110,672	335,164	362,104	390,403	332,903
5. Made by and balances due to other banks in Canada and elsewhere	30,780	59,269	52,820	90,447	79,954
6. Balances due to Dominion and provincial Governments	38,320	209,744	58,334	75,743	73,351
Total deposits and due to banks	1,229,120	2,497,348	2,273,982	2,607,058	2,502,789
7. Bills payable and advances under the Finance Act(2)	6,710	8,156	27,707	46,496	23,975
8. Letters of credit outstanding	9,826	46,055	62,541	90,356	67,897
9. Other liabilities	2,836	3,710	3,367	6,279	4,924
Total liabilities to the public	1,353,629	2,784,069	2,532,832	2,909,530	2,741,554
Liabilities to shareholders					
10. Capital paid up	113,983	123,617	118,831	144,561	144,675
11. Rest or reserve fund	113,020	128,757	123,109	160,639	162,075
Total liabilities to shareholders	227,003	252,374	241,940	305,200	306,750
Total liabilities(3)	1,580,632	3,036,443	2,774,772	3,214,730	3,048,304

(1) Data from The Canada Year Book, 1918, pp. 524,525; 1924, pp. 797,798; 1927-1928, pp. 868,869; 1932, pp. 770,771.

(2) "Advances under the Finance Act" were not reported separately in 1915 and 1920, and in those years are included among "other liabilities."

(3) The Returns of the Chartered Banks are not in the form of balanced statements. The excess of assets over liabilities as shown in the returns is usually reported as undivided profits in the balance sheets presented in the annual reports of the banks.

The composition of items 5 and 6 of the assets listed in this statement is the most important factor in determining the character of the banks' business. The investments described in item 5 are reported in the monthly returns in three classifications: (1) "Dominion government and provincial government securities"; (2) "Canadian municipal securities, and British, foreign and colonial public securities other than Canadian"; and (3) "Railway and other bonds, debentures and stocks." Securities of the first classification are eligible as collateral for loans from the Dominion Treasury. These averaged about 32 per cent of total investments in 1920, 63 per cent in 1925, 67 per cent in 1930, and were reported as about 69 per cent on December 31, 1931. Some of the securities in the second classification, namely, the Canadian municipals, securities of the British and colonial Governments, and United States Government bonds, are also eligible as collateral for loans from the Treasury, but the amounts held by the banks are not reported separately. Although none of the securities in the third classification are eligible, it is evident that in recent years a very large proportion of the total of the banks' investments have been in effect quickly convertible into cash.

The largest single classification of the banks' assets, of course, is current loans and discounts, as shown in item 6. Only a few facts concerning these may be stated with certainty. In the first place, all those which meet approximately the requirements for eligibility for rediscount in the United States by the Federal reserve banks are also eligible as collateral for advances from the Dominion Treasury under the Finance Act. In the second place, current loans and discounts contain no loans made in the first instance against the security of real estate, although some real estate mortgages have been acquired as additional security on loans already made. The actual amounts of these are not made public.

Current loans and discounts in other respects may perhaps be assumed to have encountered from time to time the vicissitudes common among commercial banks everywhere. It is known with certainty, and the fact will be dealt with at some length in a later chapter, that following the agricultural deflation of 1920-1921 many of the loans of the western branches of the Canadian banks were in a condition described as "frozen"; but in general they were made in the first instance as current loans, and not as capital investments.

Reserves. - Canada, in contrast with the United States, has no legal requirements for reserves against deposits other than that 40 per cent of whatever cash reserve is held in Canada shall be in the form of Dominion notes. Primary or cash reserves consist of gold and subsidiary coin, Dominion notes, and United States and other foreign currencies. Additional reserves are of two types, those maintained abroad and those in Canada. Those maintained abroad are made up of call and short loans (not exceeding 30 days) elsewhere than in Canada--principally in New York--and balances due from banks elsewhere than in Canada. The domestic secondary reserve consists of call and short loans (not exceeding 30 days) on securities in Canada and securities held, a large proportion of which are eligible as collateral for advances from the Government.

The following table shows the reserves of each class in percentages of demand liabilities and time deposits at the end of selected years since 1910.

Table 6 - Reserves of the Chartered Banks in Percentages of Demand Liabilities and Time Deposits(1)

December 31	Primary reserve	Secondary reserve			Total reserves
		Abroad	In Canada		
	Cash--gold, subsidiary coin, Dominion notes, and United States and other foreign currencies	Call and short loans elsewhere than in Canada and balances due from banks elsewhere than in Canada	Call and short loans in Canada and Government and other marketable securities	Total	
1910	11.3%	13.3%	16.6%	29.9%	41.2%
1915	15.6	17.6	15.1	32.7	48.3
1920	10.9	13.3	19.8	33.1	44.0
1925	11.1	14.4	29.7	44.1	55.2
1930	9.2	9.3	32.0	41.3	50.5
1931	8.7	8.0	34.3	42.3	51.0

(1) Compiled from Returns of the Chartered Banks. Figures for years prior to 1923 are not strictly comparable with later figures because the item of "United States and other foreign currencies" was not segregated from "notes of other banks." Demand liabilities are taken to include: notes in circulation (less notes held by other banks and deposits in the central gold reserves), demand deposits, time deposits, balances due to the Dominion and provincial Governments, deposits in branches elsewhere than in Canada, and balances due to banks elsewhere than in Canada (less checks on other banks). Time deposits, accounting for about half the demand liabilities upon which the above percentages are based, while not legally payable on demand, are included because in practice they are paid on demand.

Another feature of the organization of the Canadian banks, which should be noted in connection with their general reserve policy, is the ratio of their reported capital funds (paid-up capital plus rest or reserve fund) to total liabilities. During the past twenty or thirty years this ratio has been greatly reduced. By 1928 the average for all banks was less than 8 per cent and in the three largest banks it was less than 7 per cent, as compared with an average in 1900 of well over 20 per cent for all banks. Since 1928, however, capital and surplus have been increased, so that the average ratio at the end of 1930 was slightly over 9 per cent and slightly over 10 per cent at the end of 1931, although the increase in 1931 resulted solely from a decline in liabilities. As of December 31, 1931, the highest ratio of capital funds to total liabilities among the different banks (exclusive of Barclays, which was about 20 per cent) was nearly 14 per cent and the lowest 9 per cent. It is a matter of common knowledge, however, that most of the banks have in addition to their reported rest or reserve fund, varying amounts of hidden reserves. These hidden reserves are included in an account or accounts set up in the head office general ledger and may be said to be represented by the excess of general assets over their statement value. No data are available as to the amounts of hidden reserves possessed by any individual bank or by the banking system as a whole, but those of certain institutions are generally believed to be substantial.

External Supervision. - All the chartered banks of Canada are required to send monthly returns to the Ministry of Finance. These are made out in considerable detail and their accuracy is attested by the signatures of the general manager, the president, or a director acting as president, and the chief accountant. At the various revisions of the Bank Act since 1871, requirements for additional data have been incorporated in the law, in an effort to have the returns reveal more fully the true condition of the banks. Thus, among other things, they are required to report: (1) not only cash (gold and subsidiary coin and Dominion notes) on hand at the end of the month, but the average holdings during the month; (2) the greatest amount of their own notes in circulation during the month; (3) the aggregate amount of loans to directors and to firms of which directors are partners, as well as loans for which they are guarantors, and (4) the amount of "non-current loans." Under the latter classification, according to subsections 5 and 6 of Section 113 of the Bank Act, the monthly returns must include separately a report of "any loan in respect of which:

"(a) the borrower has not for a period of two years preceding the date of such return, statement or balance sheet paid the interest thereon at the rate agreed, in cash, unassisted by the bank;

"(b) the bank has taken possession of the property or any part of the property covered by any security given by the borrower with the intention of realizing thereon, or has realized or taken any step or proceeding for the purpose of realizing upon any security given by the borrower;

"(c) the bank has commenced an action at law to recover from the borrower the amount of the loan or any part thereof;

"(d) the borrower has made an abandonment of his estate for the benefit of his creditors or any of them; or

"(e) there is other cause, sufficient in the opinion of the manager of the branch of the bank where such loan is domiciled, or in the opinion of any director or officer of the bank who prepares, signs, approves or concurs in such return, statement or balance sheet, for deeming such loan not to be a current loan.

"6. Any loan falling within the last preceding subsection may be included amongst current loans if the directors declare that after due inquiry they have approved such loan as a current loan."

The Canadian law since 1923 provides that any officer, director, or trustee of a bank who knowingly prepares, signs, or approves any bank report containing any false or deceptive statement shall be guilty of an indictable offense punishable by imprisonment for a term not exceeding five years. Furthermore, any officer, director, or trustee who negligently signs or approves any such report may be punished by imprisonment for a term not exceeding three years.[1]

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(1) Section 163 of the Bank Act, 1923.

In addition to the monthly returns, the Minister of Finance is empowered under the law to require from any bank a special report and audit whenever he sees fit. This provision, however, has been considered of doubtful efficacy, since the action authorized by it, being unusual and exceptional, would be likely to become publicly known and might cause injury to a financially sound institution.

For over forty years after the passage of the Bank Act of 1871 there was no external supervision of the chartered banks other than that which the Minister of Finance could legally exercise on the basis of the information contained in the regular monthly returns and such special reports or audits as he might require. If the reports indicated that the law was being violated he could proceed against the bank, or if it was insolvent he could order it closed and liquidated. But he had no means of determining whether the returns were accurate, nor could he enforce any restraining measures in case an institution was engaging in unsound banking practices, so long as it appeared to be solvent and innocent of violating the letter of the law.

At the revision of the Bank Act in 1913 a provision was incorporated to require at least once a year an independent audit of each bank in behalf of the shareholders. This was the first measure of active supervision of the chartered banks from outside their own management ever passed in Canada. From time to time something of the kind had been advocated in the Canadian Parliament, but with only one exception the banks had consistently opposed all such measures. The exception was the Bank of Nova Scotia, whose general manager (retired 1910), the late Mr. H. C. McLeod, had for many years urged the necessity, both in the public interest and in that of the banking system itself, of external supervision. After the failure of the Farmers' Bank in 1910, when the circumstances of its administration became known, some of the opposition to external supervision disappeared, and the shareholders' audit was provided for. This, however, did not turn out to be very effective in practice. It was carried out simply as a technical audit, and the law was not sufficiently specific to ensure that even this would be done by well qualified accountants. The difficulties of the Merchants' Bank, which necessitated its being taken over in 1922 by the Bank of Montreal, crystallized public opinion, and in the Bank Act revision of 1923 a provision was inserted requiring a more complete examination of every bank by two chartered accountants, chosen by the shareholders from a list approved by the Ministry of Finance.

Before a real test could be made of the adequacy of the revised shareholders' audit, the Home Bank failed in August, 1923, by reason of alleged maladministration and fraud at the head office. This precipitated a demand on the part of public opinion for external supervision by the Government, and in 1924 the Bank Act was amended to provide for the appointment (by the Governor in Council on the recommendation of the Minister of Finance) of an inspector general of banks. This official is required to make an examination of each institution at least once a year, "for the purpose of satisfying himself that the provisions of this Act having reference to the safety of the creditors and shareholders of each such bank are being duly observed and that the bank is in a sound financial condition."[1]

Existing Safeguards Against Failure. - As pointed out above, there have been no bank suspensions in Canada since 1923. Moreover, it is claimed

(1) Ibid., Section 56.

by Canadian bankers and others that in all probability no suspensions will ever again be allowed to occur. The validity of such assertions will depend, first upon the integrity and ability of bank management, second upon the adequacy of the existing measures for external supervision to disclose promptly to the public authorities any condition which might impair the solvency of a particular bank, and finally upon the readiness and ability of the Government and the other banks to take preventive action.

As to the integrity and ability of the management, it is clear that the critical point is the administration of the head office. The essential purpose of external supervision is therefore to make certain that such qualities as incompetence and dishonesty on the part of the general management are detected in time to permit the taking of remedial measures.

The annual shareholders' audit which has been carried out since 1923 consists of an examination of the head office and several of the principal branches.(1) The two auditors, who must not be members of the same firm and one of whom must be replaced by another auditor after every two years of service, are required to sign jointly a certificate to the effect that they have examined the bank and are convinced that the annual report of the directors to the shareholders shows its true condition. In addition they must report to the general manager and to the directors upon each loan in excess of 1 per cent of the capital(2) of the institution which appears to be inadequately secured, and in general upon any transaction or condition deemed by them unsatisfactory. A copy of all reports made by the auditors to the general manager or the directors of a bank must be transmitted at the same time to the Minister of Finance. Moreover, the minister may in his

(1) *Ibid.*, Section 55.

(2) In the course of their examination the shareholders' auditors actually satisfy themselves as to the quality of all loans in excess of a much more moderate amount.

discretion order the scope of the audit to be enlarged or extended. No attempt is made to examine all the branches of one bank simultaneously, but the auditors have access to the reports of the banks' own internal inspections and of all their transactions as reported by the branches. The branches do not carry accounts with each other, all interbranch transactions being carried out through the head office. This is calculated to make it difficult to conceal irregularities by shifting assets among the branches and altering the records in the head offices, especially because of the considerable number of people who would have to be involved in the conspiracy.

The Inspector General of Banks makes an examination at least once a year of the head office of each bank, where he has access to the returns and reports from all the branches, as well as the reports of the bank's internal inspections. He has full authority under the law, however, to examine any or all of the branches of any bank, if such procedure is considered necessary or desirable. Particular attention is directed by the inspector general to the quality of all loans in excess of 1 per cent of the bank's paid-up capital, although the position of accounts under this limit is often ascertained. The examination also extends to investments in securities and to real estate, mortgages, and other assets of importance. The inspector general is authorized to call upon the directors, officers, and auditors of a bank for such information and explanations as he may require. Thus far he has made all examinations personally, having no staff of assistant examiners. Because of the elaborate system of internal inspections carried out by the banks themselves and because of the shareholders' audit described above, it has not been considered necessary to provide for the type of detailed examinations commonly made of banks in the United States. The inspector general is expected to keep closely enough in touch with the more important transactions of the banks to enable him to detect the sort of mismanagement or fraud in the head office which has been responsible for the insolvencies and suspensions of the past. According to the testimony of well qualified bank auditors and accountants, notably that of Mr. George Edwards,[1] any such practices as those causing the failure of the Home Bank would have been disclosed to a competent banker by a brief examination of the head office. Further opinion to the same effect is contained in the testimony of Mr. C. E. Neill, general manager of the Royal Bank of Canada, before the Select Standing Committee on Banking and Commerce, in 1924, as follows:[2] ". . . I believe this, that any competent and experienced man can go into the head office of any bank in Canada, and within a very short time, if he has access to the figures, to the returns, and to the correspondence and auditors of the bank, and also if qualified and is able to question the different officers of the bank, I believe that within a very short time that officer can determine absolutely whether that bank is solvent or not."

It is thus the theory of external supervision of banking in Canada that the Minister of Finance will be forewarned of any condition of insecurity in a bank's affairs in time to enable him to deal with the situation. There is nothing in the Canadian banking law authorizing the Minister of Finance to compel other banks to take over a weak institution, but in practice he seems to have considerable moral authority. In the course of investigations of the failure of the Home Bank, Sir Thomas White, Minister of Finance from 1911 until 1919, declared that if he had known the true condition of the

(1) Proceedings of the Select Standing Committee on Banking and Commerce, 1924, pp. 19, 24, 26, 31, and 49.
(2) Ibid., p. 286.

institution he would have forced the other banks to take it over. Replying to a question as to his authority he stated, ". . . the fact is, when the Minister tells banks to do things they do them, they can't afford not to."(1)

(1) Hearings of Royal Commissions on Home Bank, p. 365.

CHAPTER III

THE TEST OF THE POST-WAR AGRICULTURAL CRISES

It has been frequently asserted that an important cause of the large number of bank suspensions occurring in the United States since 1920 was the sudden and drastic post-war decline in the value of farm land and farm products, and the subsequent depression in agricultural values. This question will be the subject of consideration in another section of the Committee's report. It will be of interest here, however, to examine somewhat more fully than in the preceding chapter the contrast presented in the matter of safety to depositors by the branch banking system of Canada, where the course of inflation and subsequent deflation in agriculture has been much the same as in the United States.

Both countries made strenuous efforts during the World War to increase their output of basic commodities, particularly of agricultural products. There was a period of exceptional prosperity. This was especially true in the great grain growing areas of the Northwest in the United States and the Prairie Provinces of Canada. In both countries a large part of the increased agricultural activity was made possible by the expansion of bank credit. The result was that with the advent of readjustment and deflation in 1920, the banking systems of both countries began to be subjected to tests of extreme severity, which have continued in varying degree to the present time.

Agricultural Expansion and Bank Credit

Available data regarding developments in the western agricultural regions of Canada lack comprehensiveness in some respects, but sufficient information of a general nature has been obtained to show that developments there during and after the war were of much the same character as in the Northwestern States of this country. According to available information, including the verbal statements of well known Canadians, the essential facts of the rise of the farming industry in Western Canada may be summarized as follows:

During a period of some ten or twelve years preceding the outbreak of the war there was a great influx into Canada of farmers from various parts of the world to take up the free land available in Manitoba, Saskatchewan, and Alberta under the so-called "homestead" provisions of the law. As farms were brought under cultivation and titles acquired by the homesteaders, improvements, such as new buildings, machinery, and equipment, were added, by means of long-term credit obtained from insurance companies, trust companies, loan companies, private individuals, and other agencies, through mortgaging the land. The result was that a large percentage of the farms were encumbered with mortgage indebtedness. After the war commenced, and the increased demand for foodstuffs resulted in higher prices, many farmers began to pay off their mortgages. But with the continued rise in prices, and the continued demand for agricultural products, they soon began to buy more land, sometimes from their neighbors, sometimes from the Government, greatly increasing their mortgage indebtedness to pay for their purchases. In spite of the remaining free, though less desirable, acreage available to homesteaders, land prices rose considerably. The result was that by the time deflation set in most of the farms operating in the Prairie Provinces, which had increased considerably in acreage per unit, were more heavily mortgaged than in 1914. A large part of the added indebtedness consisted of purchase money mortgages held by former owners of the land. Owing to several crop failures and to world-wide agricultural conditions, there had been little if any reduction in farm mortgage indebtedness by the beginning of 1930.

During the period of high prices for agricultural products current loans were readily obtained from the chartered banks and easily paid off, despite the considerable carrying charges for invested capital. When deflation set in the farmers found themselves faced with exceedingly difficult conditions and the banks with large amounts of slow or "frozen" paper in their Prairie Province branches--a state of affairs which had not been completely remedied when the world-wide economic depression began in 1929.

Preliminary to an examination of the available statistical and other evidence showing the similarity of agricultural developments in the Prairie Provinces and the Northwestern States, one aspect of the above account of conditions in Canada calls for special comment. This is the matter of mortgage indebtedness. Data are not available for accurate comparisons of such indebtedness in the two regions under consideration, but it should be noted that the mortgages encumbering the farms in the Prairie Provinces, particularly the purchase money mortgages, have not generally been held by the banks. Canadian banks, as pointed out in preceding chapters, are forbidden by law to make loans secured by real estate, and mortgages can be taken only as additional security for loans already made.

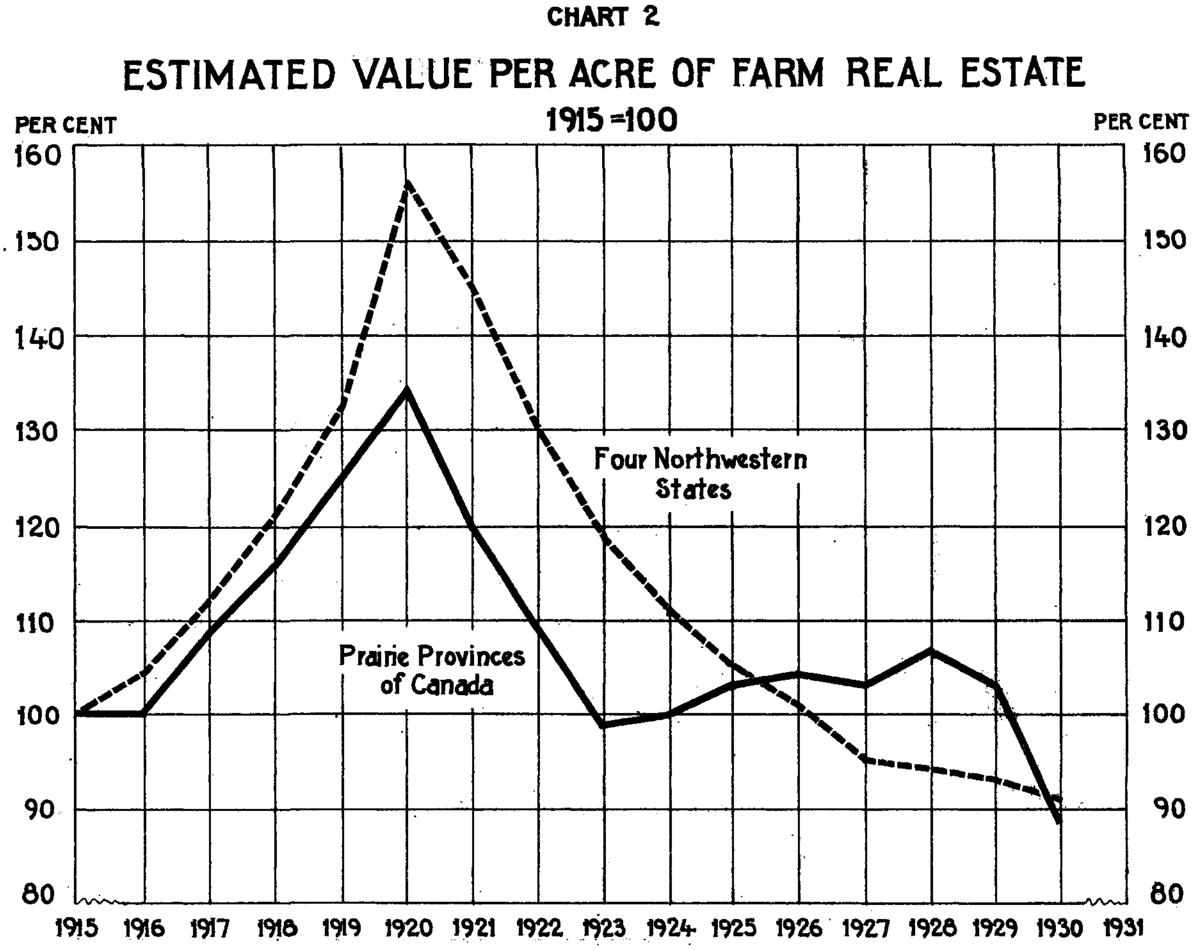
Tables 7 and 8 and Charts 2 and 3 show the fluctuations from year to year in the values of land and field crops in the Prairie Provinces of Canada and in four Northwestern States.

Table 7 - Indexes of Estimated Value of Farm Real Estate per Acre in Prairie Provinces and Four Northwestern States(1)
1915 = 100

Year	Prairie Provinces of Canada	4 Northwestern States of the United States
1915	100	100
1916	100	104
1917	109	112
1918	116	121
1919	125	132
1920	134	156
1921	120	145
1922	109	130
1923	99	119
1924	100	111
1925	103	105
1926	104	101
1927	103	95
1928	107	94
1929	103	93
1930	89	91

(1) The Northwestern States include Minnesota, North and South Dakota, and Montana.

Sources: Prairie Provinces, The Canada Year Book, 1931, p. 260; Northwestern States, U. S. Dept. of Agriculture, Circular No. 209, December, 1931: The Farm Real Estate Situation, 1930-31, pp. 8, 9. The published figures give indexes for each State and each Province. In combining these indexes in the above table they were weighted according to the land area of the States and Provinces included.



Estimated value per acre of farm real estate in the three Canadian Prairie Provinces of Manitoba, Saskatchewan and Alberta and in the four States of Minnesota, North Dakota, South Dakota and Montana each year from 1915 to 1930, in percentages of the 1915 figures

Table 8 - Indexes of Estimated Value of Principal Field Crops in Prairie Provinces and Four Northwestern States(1)
1912-1914 = 100

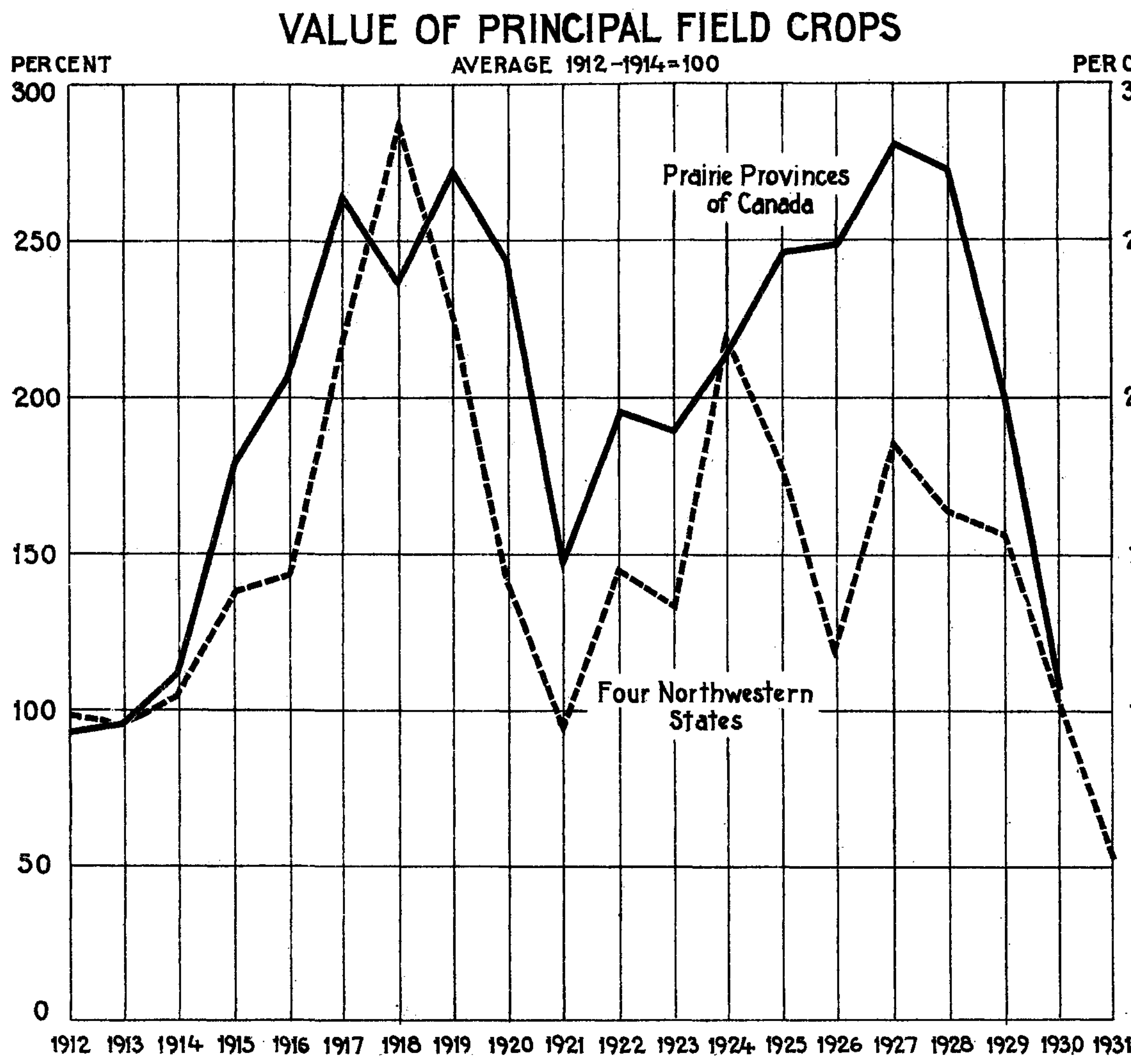
Year	Prairie Provinces of Canada	4 Northwestern States of the United States
1912	93	99
1913	96	96
1914	111	105
1915	180	138
1916	207	142
1917	265	219
1918	237	288
1919	272	225
1920	244	141
1921	148	95
1922	196	145
1923	190	134
1924	213	220
1925	247	179
1926	249	119
1927	281	186
1928	273	165
1929	201	157
1930	107	103
1931		53

(1) The Northwestern States include Minnesota, North and South Dakota, and Montana.

Sources: Prairie Provinces, The Canada Year Book, 1916-1917, p. 196; 1920, p. 214; 1926, p. 206; 1930, p. 210; 1931, p. 220. Northwestern States, figures compiled on comparable basis by the U. S. Department of Agriculture, Bureau of Agricultural Economics.

Commercial bank credit was widely extended to agriculture in the Prairie Provinces in the period from 1915 to 1920, but exact figures to measure the expansion are not available, since the Canadian banks do not report their loans by geographic subdivisions. It is possible, however, to arrive at a general idea of the extent of credit operations by the use of the reports of particular institutions. During the war and until the end

CHART 3



Value of the principal field crops in the three Canadian Prairie Provinces of Manitoba, Saskatchewan and Alberta and in the four States of Minnesota, North Dakota, South Dakota and Montana each year from 1912 to 1931, in percentages of the average for 1912-1914 of August, 1925, two banks were operated mainly or exclusively in the three Prairie Provinces. These were the Union Bank of Canada,(1) with its head office in Winnipeg, and the Weyburn Security Bank,(2) with head office in Weyburn and operating only in southern Saskatchewan. The combined current loans and discounts to the public(3) of these two institutions and the number and location of their branches, together with the total current loans and discounts to the public in Canada of all the banks, as of the end of June of each year, are shown in Table 9 and Chart 4.

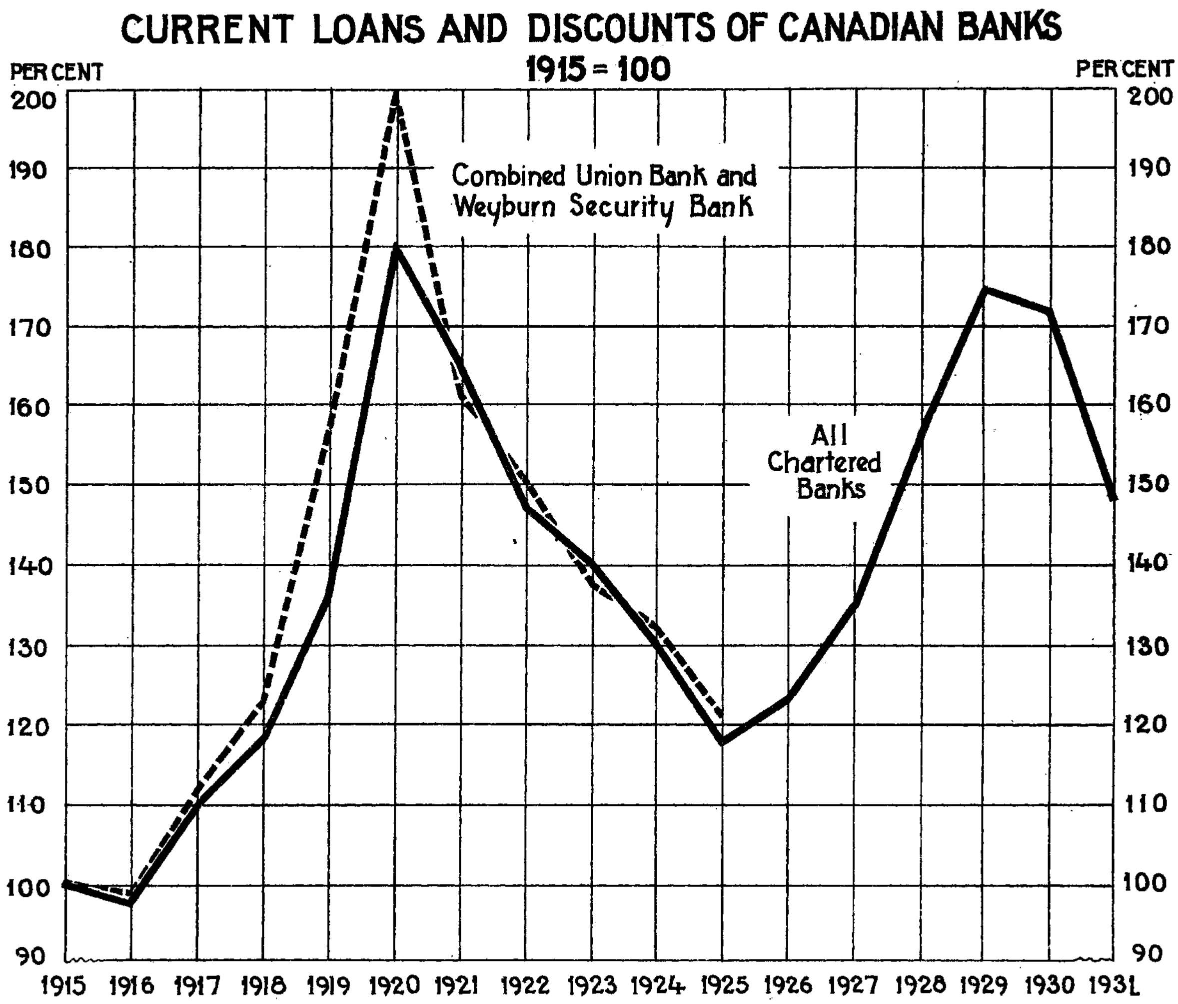
Table 9 - Branches and Current Loans of Canadian Chartered Banks

June 30	Union Bank and Weyburn Security Bank						All chartered banks in Canada	
	Combined branches(4)				Combined current loans		Total current loans	
	In Prairie Provinces		Elsewhere	Total	Amount	Per cent of 1915	Amount	Per cent of 1915
	Number	Per cent of 1915						
1915	206	100	125	331	$44,211,000	100	$ 759,934,000	100
1916	208	101	113	321	43,750,000	99	747,471,000	98
1917	212	103	110	322	48,736,000	110	839,356,000	110
1918	224	109	121	345	54,468,000	123	897,226,000	118
1919	277	134	128	405	69,202,000	157	1,043,713,000	137
1920	272	132	141	413	88,456,000	200	1,365,151,000	180
1921	263	128	133	396	71,362,000	161	1,256,643,000	165
1922	254	123	132	386	66,139,000	150	1,117,845,000	147
1923	238	116	125	363	60,372,000	137	1,065,855,000	140
1924	233	113	121	354	58,577,000	132	986,366,000	130
1925	220	107	115	335	53,400,000	121	895,592,000	118
1926							931,549,000	123
1927							1,027,187,000	135
1928							1,184,924,000	156
1929							1,319,840,000	174
1930							1,306,665,000	172
1931							1,127,038,000	148

(4) Branches of Union Bank of Canada as of December 31; branches of Weyburn Security Bank as of June 30.

(1) Merged with Royal Bank of Canada on August 31, 1925.
(2) Merged with Imperial Bank of Canada on May 1, 1931. Loans of Weyburn Security Bank amounted to only 2 to 3 per cent of combined total.
(3) Reported in Returns of the Chartered Banks as "Other current loans and discounts in Canada." Does not include loans to Dominion and provincial Governments.

CHART 4



Current loans and discounts of two Canadian chartered banks operating mainly in the Prairie Provinces and of all chartered banks in Canada each year from 1915 to 1931, in percentages of the 1915 figures

The current loans and discounts to the public of the two institutions operating mainly in the Prairie Provinces increased up to 1920 somewhat more rapidly than those of all banks in Canada. At the same time the loans and discounts of the two institutions increased faster than the number of their Prairie Province branches. The other banks were represented by numerous branches in the Prairie Provinces[1] and they were all in keen competition for business.

The expansion in the number of branches prior to 1920 in the Prairie Provinces as compared with the rest of Canada is shown in Table 10 and Chart 5.

Table 10 - Number of Branches of the Chartered Banks of Canada

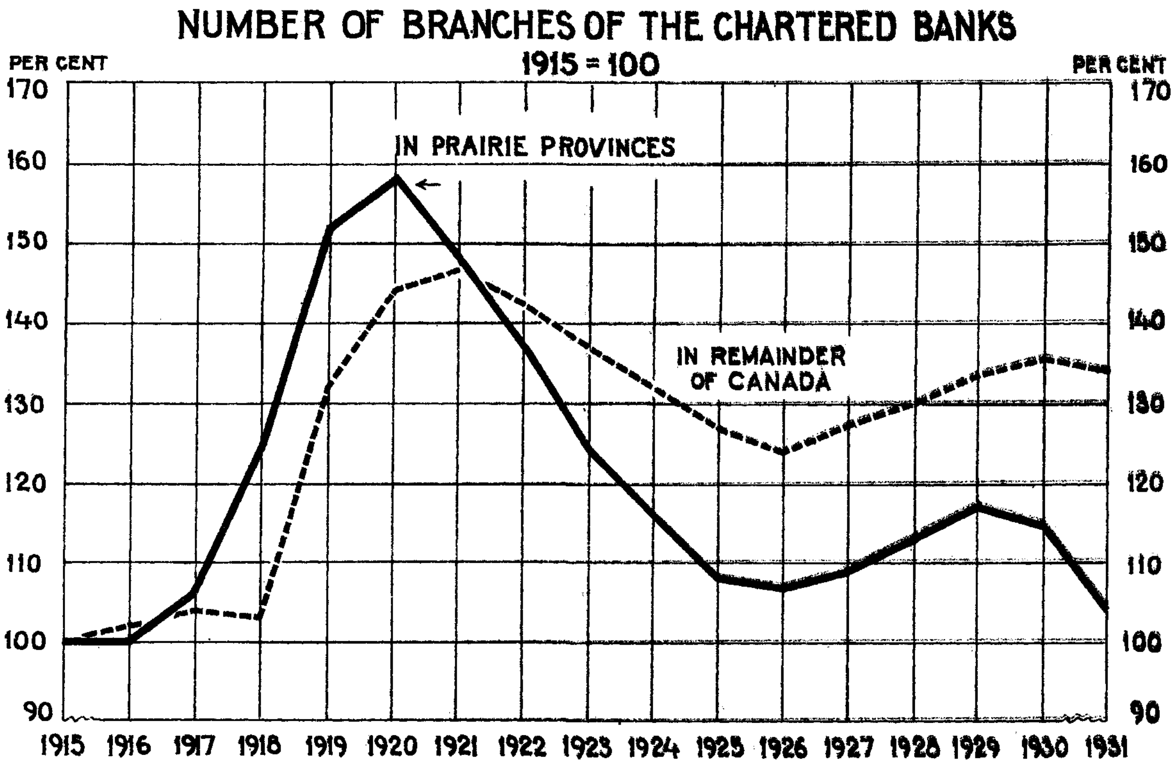
December 31	In Prairie Provinces(2)		In remainder of Canada(2)	
	Number	Per cent of 1915	Number	Per cent of 1915
1915	863	100	2,296	100
1916	860	100	2,338	102
1917	911	106	2,395	104
1918	1,067	124	2,373	103
1919	1,311	152	3,026	132
1920	1,364	158	3,312	144
1921	1,274	148	3,385	147
1922	1,184	137	3,267	142
1923	1,072	124	3,155	137
1924	1,000	116	3,040	132
1925	933	108	2,907	127
1926	920	107	2,850	124
1927	943	109	2,927	127
1928	979	113	2,987	130
1929	1,009	117	3,060	133
1930	990	115	3,093	135
1931	894	104	3,076	134

(2) From The Canada Year Book of various years. Subagencies are included.

It will be observed that up to 1920 the total number of branches increased faster in the Prairie Provinces than in the remainder of Canada. Comparing now the chart of the increase in banking offices with that of

(1) All the Canadian banks were represented by branches in the Prairie Provinces during the period under consideration, except two institutions known as French banks, Banque Nationale and Banque Provinciale du Canada, the branches of which are confined mainly to the Province of Quebec.

CHART 5



Number of branches of the chartered banks of Canada in the three Prairie Provinces and in the remainder of Canada each year from 1915 to 1931, in percentages of the 1915 figures the increase in loans and discounts, it appears that throughout Canada up to the middle of 1920 the volume of loans increased faster than the number of branches of the banks. If this was also true in the Prairie Provinces for all the banks, as it was for the two whose operations were centered there, it is another indication that the credit granted to agriculture in the years preceding the depression of 1920-1921 was somewhat greater in proportion to the total volume outstanding than the advances to other lines of economic activity

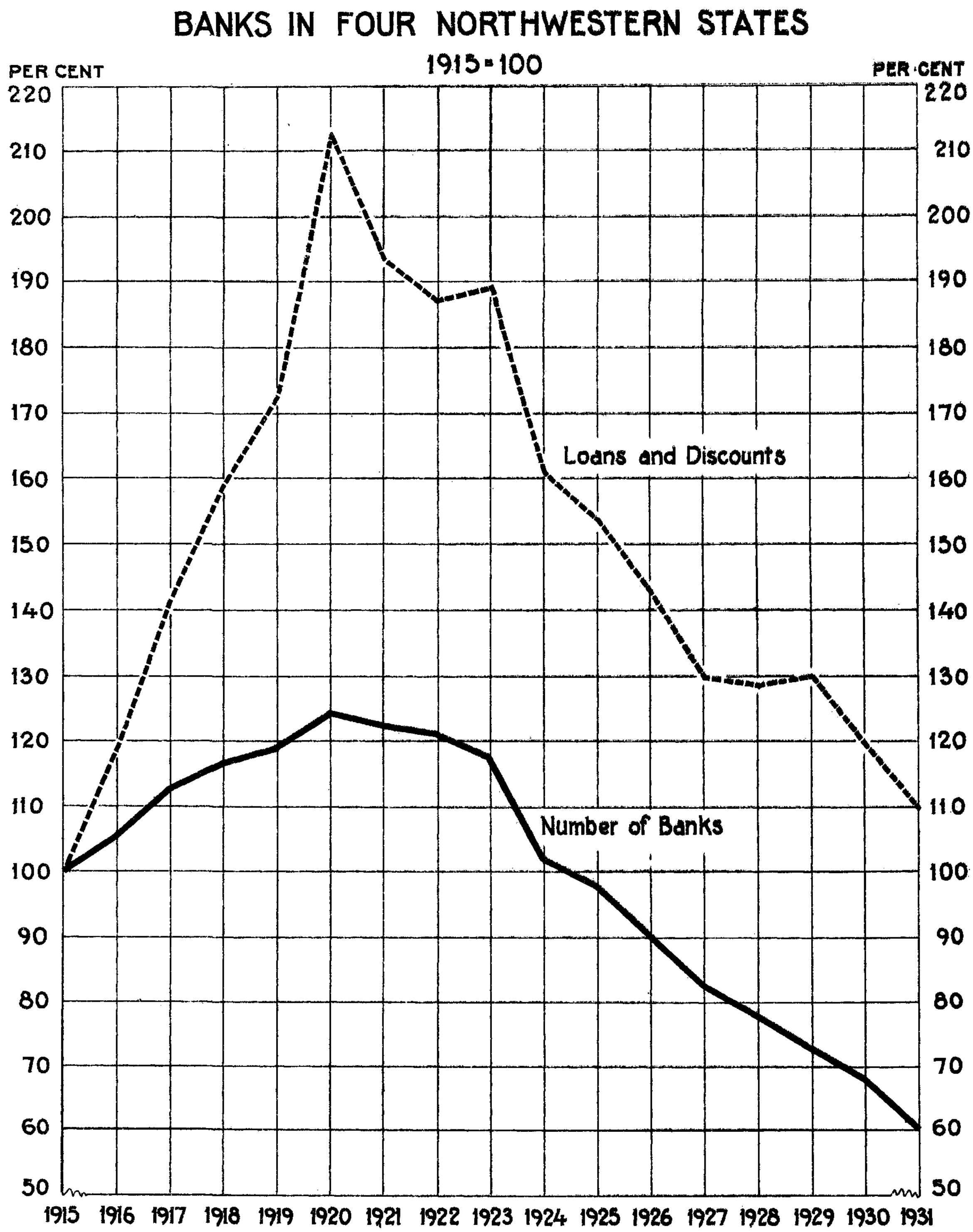
Accurate comparisons can not be made between the expansion of commercial bank credit to agriculture in the Northwestern States and in the Prairie Provinces of Canada. A general indication, however, may be obtained from Table 11 and Chart 6 which show for each year from 1915 to 1931 the number and the loans and discounts of State and national banks in four Northwestern States.

Table 11 - Number of Active State and National Banks in Four Northwestern States(1) and Their Loans and Discounts

June 30	Loans and discounts		Number of banks	Per cent of 1915
	Amount (000 omitted)	Per cent of 1915		
1915	$ 619,061	100	2,853	100
1916	735,541	119	3,001	105
1917	872,403	141	3,181	112
1918	982,736	159	3,322	116
1919	1,065,801	172	3,384	119
1920	1,313,984	212	3,521	124
1921	1,201,865	194	3,489	122
1922	1,156,953	187	3,437	121
1923	1,168,237	189	3,369	118
1924	993,925	161	2,897	102
1925	952,912	154	2,783	98
1926	885,092	143	2,576	90
1927	804,083	130	2,337	82
1928	801,171	129	2,224	78
1929	805,861	130	2,091	73
1930	742,300	120	1,932	68
1931	681,800	110	1,718	60

(1) The Northwestern States include Minnesota, North and South Dakota, and Montana.
Sources: Reports of the Comptroller of the Currency and reports of State banking departments.

CHART 6



Number of national and State banks and their loans and discounts in the four States, Minnesota, North Dakota, South Dakota, and Montana each year from 1915 to 1931, in percentages of the 1915 figures

Comparing this chart with the one showing loans and discounts of the two Canadian banks operating mainly in the Prairie Provinces, it will be observed that the increase up to 1920 in the four Northwestern States was only slightly greater. After 1920, on the other hand, the loans outstanding in the Prairie Provinces appear to have decreased much faster than in the Northwestern States. From 1920 to 1926 the reduction in the number of banking offices, although not as great as the contraction in loans, was more rapid in the Prairie Provinces than in the Northwestern States. After 1926 the number of offices in the Prairie Provinces increased slightly until the end of 1929, but declined again in 1930 and 1931. In the four States the decrease since 1920 has been continuous. The number of banking offices in operation at the end of 1931 represents a decline from the 1920 maximum of 34 per cent in the Prairie Provinces and 51 per cent in the Northwestern States.

These variations in the number of banking offices serving two regions so similar in economic conditions illustrate one of the fundamental differences between the banking systems concerned. Both areas were apparently equipped with more banking offices than were needed. In the Prairie Provinces a substantial reduction was accomplished without any suspension of payments to depositors (except for the 18 Prairie Province branches and 3 subagencies of the Home Bank, which suspended in 1923), the accounts of the closed offices being merely transferred to neighboring branches of the same or other banks. In the four States, on the other hand, the reduction was brought about largely by bank suspensions. Moreover, the suspensions have continued irrespective of the needs of the communities concerned for banking service.

Banking facilities in the Prairie Provinces were admittedly overexpanded in the three years from 1917 to 1920. Even as late as 1923, after a considerable reduction had taken place, the president of the Canadian Bankers' Association testified before a committee of the House of Commons that ". . . out of the 1,219 banks operating in Western Canada 419 are operating under an actual loss, an operating loss."(1)

Branches in Canada were closed or kept open on the basis of future prospects and the general policies of the banks; losses on loans, as distinguished from operating losses, were not the determining factor. Losses on loans in the Prairie Provinces are known to have been substantial, although no figures have been made public; no doubt, also, the amounts involved varied widely among the branches.

Deflation and "Frozen" Loans

After 1920 a large proportion of the loans to agriculture in the Northwestern States had to be renewed and extended for several years. That the same practice had to be resorted to on a large scale in the Prairie Provinces is evidenced by the testimony of witnesses heard in the course of various investigations of agricultural credit conditions subsequently made. At the instance of the provincial government of Alberta in 1922, Professor D. A. McGibbon made an extensive study and report on conditions in the Province. In the course of public hearings on July 17 of that year the branch manager of the Union Bank at Foremost, Alberta, testified in part as follows:(2)

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(1) *Proceedings of the Select Standing Committee on Banking and Commerce*, 1923, p. 311.

(2) D. A. McGibbon, *Report of the Commissioner on Banking and Credit with Respect to the Industry of Agriculture in the Province of Alberta*, 1922, p. 5.

"Q. What has been the average length of time that a note has actually run - could you say anything about that?

"A. At the present time I should judge the average of our notes that have run in our office, probably would be four years."

Referring to various allegations of curtailment of credit in Alberta, Professor McGibbon writes in part as follows:(1)

"With a view to forming an opinion in respect to the belief that the banks had not been sufficiently generous to western farmers since the fall in prices I have aggregated figures supplied to me by the individual banks covering current loans running for over one year, in 1916 and in 1921 for the branches of the chartered banks in the province of Alberta. In 1916, current loans running for over one year totaled in round numbers seventeen million dollars. In 1921, this total had increased to over fifty-two and a half million dollars. The significance of these figures lies in the fact that they represent fairly accurately the amount of carry-over from one year to another. The banks were carrying over at the close of 1921 over three times as large a sum as they were in 1916 . . . . . Speaking generally, I do not consider the farmers in this province have a legitimate grievance against the banks with respect to the degree they have been carried during the depression and drought of the last few years."

At the hearings in 1923 of the Select Standing Committee on Banking and Commerce of the House of Commons, a number of bankers gave evidence bearing on the extension of credit to western agriculture. Among these was Sir Frederick Williams-Taylor, general manager of the Bank of Montreal and at that time president of the Canadian Bankers' Association, whose testimony was in part as follows:(2)

"Q. And would you say that his (Professor McGibbon's) report indicated that every legitimate credit requirement of the province of Alberta had been met by the banks, or do you disagree with his report?

"A. Well it is quite possible that there may be a branch of a bank with a manager who has not extended to some farmer

(1) _Ibid._, pp. 25, 26.

(2) _Proceedings of the Select Standing Committee on Banking and Commerce_, 1923, pp. 310 and 340.

or other, the full facilities. That is quite possible, but I do say this--with some hesitation--that I could a tale unfold about the bank loans in Alberta which would show by the losses incurred by the banks, that they have not merely extended facilities, but they have over extended facilities.

"Q. Is the Bank of Montreal at the present moment carrying substantial amounts--I do not want the figures mentioned--of agricultural loans, and that their first maturity was more than six months ago?

"A. I am sorry to say we have loans, Mr. Chairman, that have been running for one, two, three, four and five years, in districts where the crops have been a failure, and where we are still carrying the farmer in the hope that he will eventually pull through with a good crop.

"Q. And those would run into quite substantial amounts?

"A. They would run I should say into millions, in our own case, and I am perfectly sure that I am correct in stating that every bank is in exactly the same position."

Before the same committee Sir Edmund Walker, president of the Canadian Bank of Commerce, declared:(1)

". . . You must remember that the overwhelming bulk of our business is loaned for one year and paid off in the year, so that you see the bottom. Almost the whole Western business has not that quality at the present time; it is almost all more or less frozen and dragging."

Diversification

The foregoing account of developments in the Prairie Provinces of Canada gives some indication of the extent to which the banks operating there expanded their loans to agriculture from 1915 to 1920. One of the principal reasons why they could do this with less dire consequences than the unit banks suffered in the United States, was the high degree of diversification for their loans and investments obtained through their large resources and their

(1) Ibid., p. 521.

branches in other parts of the Dominion. Difficult as was the situation in the West, the banking structure as a whole was able to withstand it.

The problems of small institutions under such conditions are well illustrated in the experience of the Weyburn Security Bank. This was a comparatively small institution (although operating as a branch system) doing business only in Saskatchewan, which was taken over in the spring of 1931 by the Imperial Bank of Canada. Because of the fact that the conditions under which this bank carried on its operations are similar to those prevailing for banks operating in the agricultural regions of our own Northwest, it will be of advantage to examine its history in some detail.

A Local Canadian Bank. - The origins of the Weyburn Security Bank go back to 1902, when certain real estate dealers from the United States started, as a partnership, a small private bank and trading concern in southern Saskatchewan, known as the Weyburn Security Company. In 1907 the direction of the enterprise was taken over by Mr. H. O. Powell, who was later to become general manager of the chartered bank. Mr. Powell had operated banks in the agricultural districts of the United States for many years and had encouraged mixed farming in Wisconsin, Minnesota, and South Dakota. At Weyburn, in a region where almost the only cash crop was grain, he urged the farmers of the surrounding community to raise dairy cattle, hogs, and chickens, to grow more green vegetables and the like, lending them money with which to get started.

Both the Weyburn Security Company and the community prospered, and in 1910 it was decided by the partners of the enterprise to apply to the Dominion Government for a regular bank charter for the banking part of the business. The charter was granted, and in 1911 the Weyburn Security Bank, with nine branches, was opened for business. Its subscribed capital was

$602,000, of which $301,300 was paid up. From June 3, 1911, until May 1, 1931, when it was formally taken over by the Imperial Bank of Canada, the institution was operated in all essential respects in the same manner as the other chartered banks of Canada, except that its deposit and loan business was confined to a comparatively small area in the Province of Saskatchewan.

Table 12 - Weyburn Security Bank
Condensed Statements as of the End of the Year[1]

(amounts in thousands of dollars)

ASSETS	1911	1915	1918	1921	1926	1929	1930
Cash, notes, cheques on and balances due from other banks	244	1,034	1,907	819	1,809	1,234	781
Dominion and provincial Government and other securities	-	28	1,209	294	1,265	1,228	69
Loans and discounts	693	897	1,149	2,121	2,554	2,895	2,100
Other assets	131	319	264	350	1,032	797	781
Total[2]	1,068	2,178	4,530	3,584	6,660	6,154	3,731
LIABILITIES							
Capital paid up	301	316	421	525	525	525	525
Rest or reserve fund	-	130	175	225	225	250	225
Notes in circulation	236	306	406	433	839	413	315
Deposits	504	1,377	3,572	2,354	5,003	4,153	2,584
Other liabilities	29	49	68	47	35	754	18
Total[2]	1,070	2,178	4,642	3,584	6,627	6,095	3,667
Dividend rate	-	5%	5%	7%	5%	7%	5%
Branches in operation (June 30)	9	14	19	24	26	30	30

(1) Figures condensed from Returns of the Chartered Banks.
(2) Canadian bank returns are not made out in the form of true balance sheets.

At the time of amalgamation it was operating 30 branches, the most distant being about 190 miles from the head office, although most of them were in the towns and villages within forty or fifty miles of Weyburn. The accompanying condensed statement (Table 12) of its affairs as of the end of various years indicates the progress of the institution.

The following extracts from circular letter sent by the general manager to his branch managers during the period of inflation and deflation following the war indicate the precautions taken by the Weyburn Security Bank during that period.

September 5, 1918

> "We must not think too much of profits this year but keep the Safety First idea in mind, and the only way to play the safe game is to get our money while the farmer has some to pay us. Speculation of every kind must be discouraged, and if a man has no money to invest, he should not be encouraged to borrow money for investment. The happy man, when the war is over, will be the man who owns what property he has free of encumbrance and on account of this is in an independent condition. No matter what happens a man without debts and with a reasonable amount of property which is productive will be independent of after war conditions, to a large extent. The farmer who has a half section paid for and stock and implements enough to work it can always make a living, but the man with a section or two heavily encumbered making a large property statement out of equities, later on may be covered with judgments so deep that he will never get out. You are doing your customer a favor to insist on his getting out of debt and keeping out of debt until after the re-adjustment."

January 16, 1919

> "The slump in the price of hogs came quicker than we anticipated and undoubtedly a good many buyers have lost a lot of money on shipments made within the last few days.
>
> "There is another line which is going to be hit soon and that is the automobile business. Some companies are already making cuts in prices, and one company is refunding a certain amount of last year's purchase price on account of the fact that the price was raised too high last year. . . .

"We are taking the stand that we will not finance any automobile business unless we know that it is going to be handled along safe lines. We have decided not to advance money to dealers to handle cars on time, and we wish all automobile lines referred to Head Office before any promises are made as to what the Bank will do."

October 2, 1919

"There is another thing to be taken into consideration and that is - that the past year has been a year in which the public as a rule have been inclined to over-expand, as a re-action from the curtailment of business which went on during the War. People felt that the War was over, and so there was no more necessity for holding business in check. The country is in the same position as a man who has been sick and in the hospital - the doctor's bills and hospital bills, together with some of the medicine, all have to be paid for now, and while the necessity for curtailment is not quite so apparent, still it is just as real and business must be kept within bounds.

"There is bound to be a re-action later on when the institution which is not on more than simply good sound basis will have hard sledding. The only way to do is to prepare before the pinch comes. This we intend to do. By taking care of only the necessary business we will grow, stand well in the community, and be in a position to take advantage of profits later on, when some other institutions may be calling in loans and driving business away. We have seen several such instances in the past twelve years, and each time our Institution has been in shape to take advantage of the good business offered and take a further step forward due to conditions."

December 2, 1919

"The present is not the time to reach out for more investments but the time to protect what you have. Get into shape so that no matter what happens you can hold what you already have. Do not try to make any money. There are times to make money and there are times to save what you have. Generally the hardest job of all is to save what you have made."

October 27, 1921

"For years before the War, experience taught Bankers that 10% of a conservative valuation of a man's assets was all that he could expect to repay out of a fair crop. If you will analyze your borrowing accounts you will find that some of them are double or more than double this percentage of the customer's net worth. This means that we have slow accounts to deal with in such cases and it will be impossible for us to extend much added assistance to a customer in this position. From three to six hundred dollars a year is about what the ordinary half or three-quarter section farmer is able to save for debt paying or other purposes in one year, with prices ruling as they did before the War and it will take good management to do this."

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"I have written you fully in this way so that you will know what to figure on when you send in an application for credit. We have no intention of making donations through credits if we can avoid it. We probably already have donated quite a little hoping that something would turn up which would help the customer out and let him pay us back, but we cannot afford to do much of this class of work. . . ."

January 3, 1923

"This good crop has made a wonderful change in the cash balances of the Bank as a direct result of improvement in the financial conditions of some of our customers, but there is a lot of work to be done yet before we have the people with the heavy loads up the hill."

The bank was able to come through the first post-war agricultural depression in good condition, although its losses had been considerable. From 1924 until 1929 its operations were moderately profitable--until the disastrous fall in agricultural incomes beginning in the latter year. The management, meanwhile, was taking every possible precaution to meet the difficult period ahead. During the year 1930 the bank had an aggregate of approximately 4,000 borrowing accounts in its 30 branches, the average loan being about $600.

And yet the Weyburn Security Bank's management, directors, and shareholders, before the end of 1930, felt impelled to sell the institution to a larger bank, with an aggregation of branches spread widely over the territory of the Dominion, because of doubt of profitable continuance in operation as an independent institution. The Minister of Finance gave his preliminary approval and a contract of amalgamation with the Imperial Bank of Canada was signed on January 20, 1931.

The Weyburn Security Bank in 1930 was confronted with a situation too difficult to be coped with by a bank of its nature and size. The institution was unable to spread its risks widely enough to ensure profitable continuance in operation as an independent bank during the period of stress which began in the autumn of 1929. Its loans were preponderantly farmers' risks, a large portion of which became practically frozen under the agricultural conditions prevailing.

CHAPTER IV

ADEQUACY OF SERVICE

The question of the adequacy of banking service relates to the requirements of both depositors and borrowers. From the depositors' viewpoint, adequacy, aside from the proximity of banking offices, relates principally to the question of safety, which has been dealt with in previous chapters. This chapter, therefore, is concerned largely with the adequacy of banking services in Canada to the borrowing community.

Availability of Banking Facilities

From an examination of the number and location of banking offices it appears that the various sections of the country are supplied with the technical equipment for adequate service. Table 13 gives the number of banking offices in the different Provinces at the end of the year 1931, the population of each Province, and the population per banking office. Similar figures are given for the United States as a whole and for representative States.

Table 13 - Banking Offices and Population in Canada and the United States

	Number of banking offices Dec. 31, 1931(1)	Population(2)	Population per banking office
Canada	3,970	10,374,196	2,613
Prince Edward Island	28	88,038	3,144
Nova Scotia	138	512,846	3,716
New Brunswick	101	408,219	4,042
Quebec	1,176	2,874,255	2,444
Ontario	1,400	3,431,683	2,451
Manitoba	222	700,139	3,154
Saskatchewan	394	921,785	2,340
Alberta	278	731,605	2,632
British Columbia	229	694,263	3,032
Yukon	4	4,230	1,058
Northwest Territory	-	7,133	-
United States	22,501	122,775,046	5,457
Massachusetts	345	4,249,614	12,318
New York	1,524	12,588,066	8,260
California	1,191	5,677,251	4,767
Wisconsin	878	2,939,006	3,347
Minnesota	892	2,563,953	2,874
North Dakota	246	680,845	2,768
South Dakota	263	692,849	2,634
Montana	157	537,606	3,424

(1) Number of banking offices in Canada from The Canada Year Book, 1932, p. 776; in United States, from Federal Reserve Board, Division of Bank Operations. United States figures include only national and State chartered banks and trust companies and branches thereof.

(2) Population of Canada and the Provinces from the census of 1931, The Canada Year Book, 1932, p. 91. United States figures are from the census of 1930.

Not only is the population per banking office in Canada smaller than in the United States, but with the approval of the head office each branch is able to make a loan, if necessary or desirable, as large as the most important branch of the entire bank; whereas the small unit banks of the United States are narrowly limited in this respect.

<u>Branch Banking and the Frontier</u>. - In the development of the great areas in the West of Canada, the banks have supplied service from the earliest stages of community growth. It has been the common practice to open branches along with the establishment of railway communications, and sometimes even in advance. Indeed the competition of the different banks in opening branches has been severely criticized as excessive, tending to increase the cost of banking service. Sometimes as a matter of prestige, but more often in an attempt to establish offices in time to enjoy the advantages of future growth, the banks have opened branches in new communities long before the business available was sufficient to pay expenses. In 1913 the president of the Canadian Bank of Commerce, which has had for many years a large number of branches in the western agricultural districts, stated that usually the newly opened offices operated at a loss for about three years, and that "It takes six or seven years at least before we have made enough money to cover the losses made in the first three years. . ."(1) While this statement was meant to apply to conditions before the war, a number of Canadian bankers have declared that it still holds good. At all events, it appears that competition among the banks has resulted in banking facilities being extended to every new community which might be expected to have any appreciable need for it--to say nothing of the duplication of branches in the cities and towns far beyond the reasonable requirements of the population.

An interesting commentary on the manner in which the branch banking system has cooperated in the opening up of Canada's great Western areas

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(1) See testimony of Sir Edmund Walker, <u>Proceedings of the Committee on Banking and Commerce</u>, 1913, p. 485.

is contained in the following extract from a letter of Professor J. Courtland Elliott of the University of Saskatchewan:[1]

> "In considering the relation of the chartered banks to the economic development of the Dominion, I feel it is essential that their influence be judged in terms of the tasks imposed upon them in a country undergoing rapid expansion. Within the limits of the existing legislation and in conformity with established banking practices, they have had to face the problems of assuring safety to their note holders and depositors on the one hand, to supply adequate funds to legitimate borrowers on the other, and attractive earnings to the shareholders on 'any other hand that may be left.'
>
> "If you will picture the westward surge of population in the early years of this century into the wheatlands of this west, into the mining areas of Northern Ontario and the Klondyke, you will realize the financial requirements imposed upon the banks. The map of the north was rolled back and it was essential that the banks be in the vanguard. To me this is a thrilling and romantic part of Canadian banking and if you were to travel through the pioneer settlements out here you would realize, I am sure, how grateful we Canadians should be for the initiative of Canadian bankers. They may have been over-prudent in certain of their activities, but, subject to my possible bias of judgment, it seems to me that the advantages of our system have outweighed the disadvantages, and I feel that the structure of the banking system was well adapted to the pioneering processes of economic development. The device of branch banking could diversify the risks, render reserves more efficient, and enable unprofitable operation in new territory."

Credit in the Agricultural Provinces

It is commonly asserted by Canadian bankers that the supply of bank credit extended to those areas in Canada which are in the process of economic development and expansion is considerably greater than to similar communities in a country served by independent unit banks. In the usual course of opening up new territories, loans of the branches at the beginning are said to be largely in excess of deposits. After the pioneer

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(1) Letter to B. H. Beckhart, quoted in Willis and Beckhart, Foreign Banking Systems, 1929, footnote, pp. 487, 488.

period has passed, wealth begins to accumulate, and gradually the deposits of the communities approach the volume of the loans. Testifying before the Select Standing Committee on Banking and Commerce of the House of Commons in 1923, Sir John Aird, general manager of the Canadian Bank of Commerce, declared in reply to a question regarding western branches of his bank:[1] "In the last revision, ten years ago I happened to be going through the mill then. The proportion of loans was about three to one of deposits, the proportion of loans today to deposits is about two to one. That indicates the West is growing richer and I think in another ten years they will balance very well if we have good crops."

Complaints have nevertheless been frequently made that Western Canada has not been adequately supplied with credit. As early as 1913, in reply to such allegations, Sir Edmund Walker, president of the Canadian Bank of Commerce, testified as follows:[2] "At a hundred and twenty-two branches of the Canadian Bank of Commerce, in the middle or prairie provinces, we have farmers' deposits amounting to $2,869,926, and we have loans to farmers amounting to $13,035,784. . . . five times as much as we receive in the way of deposits from farmers at those western branches."

Various other statements have been made by bankers from time to time concerning loans and deposits in the West. These have referred only to the branches of certain banks and have not completely answered the charges made with respect to the banks' general credit policy in the great agricultural regions. In the spring of 1931, however, the president of the Canadian Bankers' Association, speaking in behalf of all the banks, gave

(1) Proceedings of the Select Standing Committee on Banking and Commerce, 1923, p. 360.

(2) Proceedings of the Committee on Banking and Commerce, 1913, p. 484.

out a comprehensive official statement (April 17, 1931) which reads in part as follows:

"As regards alleged withholding of credit, it is regrettable that the names of these would-be borrowers have been withheld, because there are no means open to the banks to ascertain to what extent the allegations have a solid foundation and consequently no remedial action can be taken if there has been an error in judgment on the part of any local manager. Instead of visiting complaints with reprisal as appears to be feared, the banks will always welcome communications which would enable them to rectify any such error or to explain fully the reasons for their action in not entertaining credit applications.

"The banks desire to state that there has been no general withholding of credit and that they are to-day, as in the past, considering demands from their Western farmer clients and granting advances which appear justified--that is, advances which do not place the principal of loans in jeopardy, upon which there is a fair prospect of receiving interest and which may be repaid within a reasonable time. Banks do not in the usual course compile statistics regarding particular classes of business outside of the requirements of bank returns to the Government. But one bank, very strongly represented by branches in each of the Prairie Provinces has, for its own information, during the past two years carefully ascertained in all its branches in this area the volume of loans to farmers. At the end of December, 1930, the loans of this bank to farmers exceeded the loans to farmers at the same date in 1929 by 16¼%. If a like detailed examination were made in the branches of all the banks, the combined result would probably not differ materially from the foregoing. And this, too, notwithstanding the fact that the prices of commodities and the value of real estate show a substantial shrinkage.

"The full amount of all deposits originating in the Prairie Provinces is not equal to the loans made to the banks' customers in those provinces, and in addition there are large amounts represented by cash assets, municipal and other local securities and bank premises, all necessary and incidental to the carrying on of the business of the banks in the area.

"Some of the criticism of the banks is based on a misconception of their functions. Many critics appear to believe that these financial institutions should enter into a form of partnership with their borrowers, acting as 'silent partners' and providing funds at low rates of interest and for indefinite periods. The banks are debarred from performing this function by the very nature of their business which consists in the loaning of deposits, entrusted to their care, payable on demand. Moreover the Bank Act, under which they operate, specifically limits the lending powers of the banks with the very plain objective of preventing them from locking up their funds. There are very definite limits beyond which no banker, conscious of his responsibilities to his depositors and shareholders, should venture. It cannot be repeated too often or be too strongly emphasized that the deposits in the hands of the banks are not public funds. They belong to hundreds of thousands of depositors throughout the Dominion. And they are not the savings of wealthy people alone. The savings deposits in the banks which form the bulk of the loanable funds are the savings of that portion of the general public who put by a part of their earnings against a time of need and select the banks as the safest and most convenient depository; in other words, they are the funds of the friends and neighbors of the people who do most of the borrowing. These depositors are entitled to assurance that their savings will be so cared for that they will be available when wanted."

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"No other institutions are more vitally or sympathetically interested in the progress of agriculture in the Prairie Provinces than are the chartered banks of Canada. As evidence of this practical goodwill the Canadian banks have all promptly agreed to contribute to the share capital of the Dominion Agricultural Credit Company, Limited, now being organized on the initiative of Mr. E. W. Beatty, Chairman and President of the Canadian Pacific Railway Company. The Canadian banks believe that, even if diversified farming cannot be developed with an equal measure of success in all sections of the Prairie Provinces, it should be of great assistance to thousands of farmers by at least contributing directly to the maintenance of their own households. The welfare of the banks is dependent upon the welfare of their customers, and it will in the future, as in the past, be the earnest desire of the banks to serve this great farming community with such credit facilities as can be afforded in accordance with sound banking principles."

The above statement does much to clarify the controversy over the plentifulness of credit extended to agriculture and the movement of funds from small communities to large centers. Loans to farmers by one large bank are declared to have been $16\frac{1}{4}$ per cent greater at the end of 1930 than at the end of 1929, and the association assumes that the combined result of all the banks would not differ materially from this. It should be remembered in this connection, however, that generally farmers are expected to pay off most of their loans before the end of each year. Doubtless they were as a class in a better position to do this in 1929 than in 1930; so that the amounts outstanding at the end of the latter year do not necessarily mean that they had received more ample credit accommodation in 1930 than in 1929, but perhaps only that before the end of 1930 they were obliged to demand a longer time allowance for the repayment of a greater part of their loans. Even so, however, the increased amounts outstanding at the end of 1930 could only mean either that more credit had been extended, or that a larger proportion of the loans to farmers were being carried beyond the repayment period usually considered permissible in strict commercial banking practice.

The Bankers' Association asserts that the aggregate loans and discounts of the banks to customers in the Prairie Provinces are greater than the aggregate deposits originating in those Provinces. Presumably this is meant to describe a condition prevailing from year to year. It would seem by implication, moreover, to be in harmony with various statements of bankers as to the manner in which the financial requirements of the expanding and developing regions of the West have been met.

For the whole of Canada, current loans and discounts to the public by all banks have varied since 1920 from 50 to 70 per cent of the total deposits of the public. During the five years 1927-1931 they averaged 57 per cent. If loans and discounts in the Prairie Provinces are actually greater than the deposits originating there, those Provinces receive much more credit in relation to their deposits than the rest of Canada.

It is of interest in this connection to note the situation of the State and national banks in Minnesota, North and South Dakota, and Montana, just across the border from the Prairie Provinces of Canada. On the basis of reports of the Comptroller of the Currency the aggregate loans and discounts in these four States averaged less than two-thirds of deposits during the five years 1927-1931.

While the Prairie Provinces of Canada and the four Northwestern States referred to are predominantly agricultural, there are differences in population, in the stages of development, in the savings of the people, in the supply of capital funds, etc., which make it impossible to draw definite conclusions as to the adequacy of credit granted in the two regions. The information made public does, however, indicate the extent to which the more highly developed Eastern sections of Canada supply the credit facilities for the less developed agricultural regions of Western Canada. The evidence tends to show that the commercial banking resources of that country are distributed for lending and investment, in so far as safety will permit, where credit is most needed.

<u>The Term of Farmers' Loans</u>. - A common source of difficulty in the operation of commercial banks in agricultural communities, not only in Canada but also in the United States, is the length of time for which farmers usually require bank credit. In Canada the banks generally adhere, at least technically, to strict commercial banking practice, making loans to farmers of three or four months' maturity, even though it is known in advance that the notes will have to be renewed at least once, if not still further extended. Professor McGibbon, whose investigations in the Province of Alberta in 1922 were referred to in the preceding chapter, has

commented on this practice as follows:(1)

> "At many points in the province objection was taken to the period for which a farmer may obtain a loan. It was shown that the usual period a bank will grant a loan to a farmer is three or four months, whereas the farmer's operations commonly extend from six to eight months. He requires a loan granted in April that will mature in October, November or December. He can only obtain one to mature in July or August. The farmer's complaint is that the banker knows when he makes the loan in April to run until July or August that it cannot be paid at its due date. Yet bankers require the farmers to meet those conditions. When the note is renewed interest is compounded and interest charged upon the discount. Other conditions may be imposed. What the farmer wants is a loan made on the basis of a straight note for the whole period of his crop operations, that is, to the date when he will be in a position to settle up. . . .
>
> "There is practical unanimity of opinion among the bank superintendents examined that the chief reason the bank insists, in most cases, in loaning only for three or four months' periods is in the opportunity it gives the banker to review the farmer's condition and to require additional security if it is thought necessary.
>
> ". . . when the farmer at renewal is called upon to give security he is at a disadvantage, he already owes the money and cannot withdraw or curtail the season's operations."

Interest Rates

There are no usury laws in Canada. The Bank Act provides, however, that the maximum interest rate which can be collected by legal procedure, where none is stipulated, is 7 per cent per annum. The common practice in making loans, as in many localities in the United States, is to discount the borrower's note, thus imposing a slightly greater charge than the nominal rate.(2)

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(1) D. A. McGibbon, op. cit., pp. 22-24.

(2) The borrower, receiving less than the principal amount of his loan, pays interest in advance on this principal amount for the full term of his note. Thus a borrower discounting a note for $1,000 at 7 per cent per annum for 3 months would actually receive but $982.50. His interest payment of $17.50 would amount to 7.12 per cent per annum on the amount received.

Interest rates among the various Provinces of Canada tend to be more nearly uniform than in the different regions of the United States, although in general the rates in the agricultural West of both countries are higher than in the industrial East.[1] Canadian rates remain approximately uniform from year to year, without relation to money rates in financial centers or the rate charged by the Dominion Treasury on advances to the banks. Interest paid on deposits is at a uniform rate throughout the country and the rates charged on loans by different banks in any given region are generally the same. The result is that competition among the different institutions must consist essentially of services offered. Inasmuch as all the banks are equipped to render a wide variety of banking services, effective competition must be confined mainly to the credit accommodation extended. In other words, apart from the business obtained through personal relationships of the local managers, competition can exist only in the quality of loans made and the amount of credit extended and promised. This state of affairs, to be sure, is not essentially different from that which exists in a community of the United States outside the larger cities, where there is more than one unit bank, since interest rates are generally uniform among different banks. Thus in both countries the competitive incentives are in the last analysis approximately the same.

For many years, both before and since the war, rates to borrowers in the large cities and industrial centers of Eastern Canada have usually varied from 6 to 7 per cent per annum, depending upon the size and credit

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(1) Except as otherwise noted, general observations regarding interest rates are based on verbal statements of a number of Canadian bankers, checked and verified one against another.

standing of the customer; whereas in the agricultural West of Canada outside the larger centers they have been generally, although not always, in excess of 7 per cent, the prevailing rate for the great majority of farmer borrowers being 8 per cent. At the hearings of the Select Standing Committee on Banking and Commerce of the House of Commons in 1923, certain members from western constituencies cited instances of charges of 10 per cent or higher.(1) The allegation that such rates had been collected, in isolated cases and for special reasons, was not denied by any banker; but before the same committee on the same day Sir John Aird, general manager of the Canadian Bank of Commerce, testified in reply to the demand of a member to know whether "the Western farmer is up against eight, ten and twelve per cent for a year," as follows:(2)

> "He is not. Let me correct you; the Western farmer is not up against nine and ten per cent. The percentage of money that is loaned out at that rate is an infinitesimal fraction. We have lots of money in the West; in Manitoba for the gilt-edged farmer at 6, 7, 7½ and 8 per cent, and the prevailing rate for 95 per cent of the loans in our banks is 8 per cent . . . "

As in the matter of the plentifulness of credit supplied, the criticism of Canadian banks on the score of interest charges emanates mainly from the agricultural West. In reply to complaints during the depression beginning in 1929, the Canadian Bankers' Association issued a statement (April 17, 1931) reading in part as follows:

> "As regards the rates of interest, a great deal of misconception is apt to result from vague statements. Throughout the Prairie Provinces, 76% of the loans by the banks bear a rate of 7% or under,(3) and 20% of the loans from 7% to 8%. In order to appreciate the conditions under which the banks are operating

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(1) Proceedings of the Select Standing Committee on Banking and Commerce, 1923, pp. 333 and 361.

(2) Ibid., p. 361.

(3) This lower average rate is no doubt due to the large proportion of Prairie Province loans to the wheat pools at 6 per cent.

> in the Prairie Provinces, it is necessary to consider that farmers' borrowings represent numerous small amounts, and it it well known that the handling of a large number of small items in all lines of business is more costly than handling large units. There are many points in Western Canada where the volume of business available is insufficient to pay expenses under present conditions and it would seem inevitable that a lowering of rates must result in a curtailment of banking service and facilities in such localities.
>
> "In the United States, interest rates of the Federal Reserve banks are not the same throughout the country. The interest rate charged to customers in recent months in Helena, the capital of Montana, the State adjacent to Alberta, by members of the Federal Reserve System, on the security of prime commercial paper and even on loans secured by warehouse receipts, has been 8%. Recent enquiries in Montana, where conditions are comparable to those in the Southern part of Alberta, reveal the fact that in the best banks farmers pay 8% to 10% and that the bulk of the loans for $500 and under is made at the latter rate."

The substance of the first paragraph of the above statement of the Canadian Bankers' Association is borne out in a general way by the data made available to the Federal Reserve Committee on Branch, Group, and Chain Banking by five different Canadian banks for 20 of their small Prairie Province branches. The average discount rate to all borrowers from those branches in 1930, as computed from the loans and discounts outstanding and the gross earnings from interest on loans and discounts, was about 7.3 per cent.(1) This figure is somewhat lower than the 8 per cent commonly reported to be the prevailing rate to farmer borrowers in the West and is doubtless due to lower rates for other types of loans, such as those to school districts, municipalities, etc. Inasmuch as the branches in question are all small offices, and rates on loans to large borrowers in the principal towns of the Prairie Provinces are generally lower than in rural communities, the average for all Prairie Province loans would naturally be

(1) Only one bank reported quarterly averages of loans and discounts outstanding while the others reported merely the amounts outstanding at the end of the business year.

somewhat lower. A very considerable percentage of the total loans in the Prairie Provinces in 1931, for example, was to the wheat pools, at the rate of 6 per cent per annum.(1)

Precise data are not available for a general comparison of interest charges of the Canadian branch banking system as a whole with the rates of the unit system of the United States. From the meager information at hand, it appears that lending rates are generally lower in the agricultural West of Canada than in some of our Western States. As for the industrial East of both countries, interest charges are known to be somewhat more variable in the United States, and appear to be on the whole somewhat lower. The common rate for small borrowers in most Northeastern States remains uniform at 6 per cent, as compared with 7 per cent in Eastern Canada. In some instances, however, the difference may be counterbalanced by the fact that Canadian banks do not generally require their borrowers to leave a compensating balance on deposit, as do many banks in the United States, particularly in the larger centers.

The general manager of the Canadian Bank of Commerce in his recent annual statement to the stockholders of that institution referred to interest rates in the Western Provinces as follows:(2)

> "The rates of interest charged in our Western provinces have met with frequent criticism. In answer, I point to the fact that the profit on our loans to farmers in the West is now, and has been in many former years, insufficient to meet the costs of the service we have provided, and the losses on loans which, because of extreme weather hazards, lack of diversified agriculture and constantly changing market conditions, are much higher than in the East."

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(1) Verbal statements of wheat pool secretaries, confirmed by supervisors of western branches of various banks.

(2) American Banker, January 13, 1933, p. 2.

The Local Manager

Since all the business of the Canadian banks is done in the first instance at the branches, discussion of the quality of service rendered by the branch system centers mainly about the local manager. The principal elements of criticism may be epitomized in the allegation that he tends to become a highly trained automaton, a rule-of-thumb banker, with dictatorial power to refuse credit accommodation and very little authority to grant it. A further criticism is that managers are too frequently shifted from one branch to another, often leaving a community before, or soon after, becoming personally familiar with its banking needs.

It is true that the more competent managers are generally shifted from the smaller branches to the larger ones as the more important positions become available. If they are possessed of exceptional ability, they will look forward to early promotion, which may result in taking them away from branches before they acquire a genuine understanding of the needs and economic possibilities of their communities. On the other hand, if they are of limited ability, they may remain indefinitely; but in neither case is the smaller community likely to be provided directly with service by bankers possessed of long experience and endowed with exceptional capacity.

Branch managers are nevertheless under the spur of their district superintendents, who expect them to obtain at least the bank's share of business in the community. If the inclination of the manager is that of over-conservatism, he is likely to find himself ultimately in a branch where there is little demand for progressiveness. If, however, he is inclined to extend credits unwisely, the rein of the superintendent is likely to be tightened.

If a prospective borrower applies for a loan above the maximum which the local manager can extend on his own responsibility, the manager may take the matter under advisement with his superiors, or he may refuse the accommodation outright, thus putting an end to the proposed transaction. In the former case he must submit the application with his reasons for its approval to the head office. Only a relatively small proportion of the loans applied for at a given branch, however, are above the discretionary limit of the local manager. The few that must be authorized by higher authority are usually referred, not directly to Montreal or Toronto, but to a district superintendent located in the principal city or town of the Province.

The small borrower starting in business may have to submit to a more searching inquiry into the probability of success of his venture than he does when he applies to an independent banker, who presumably may be more familiar with the character of the applicant. Commenting on this phase of branch operation, one Canadian banker made the observation that the prospective beginner of a new enterprise is likely to have the choice of applying to the branches of several banks in or near his community, which are in keen competition for desirable new accounts. If he fails to obtain accommodation from any local manager, the banker continued, there is nothing to prevent him from applying directly to one or all of the district superintendents in his Province, where he would be at once in contact with banking ability of presumably much wider scope. If he is not possessed of enough initiative and tenacity of purpose to do this, the banker remarked, he would not be likely to start a new enterprise of very much value, either to himself or to his community.

Apart from promotions or demotions, local managers are changed from time to time by some of the banks as a matter of policy. One general manager has declared that on principle his bank endeavors to shift its branch managers every two or three years. However, each branch is required to keep written records of the credit information relevant to each customer, and in addition, when the manager is moved away, the other members of the staff usually remain. In other words, the replacement of a local manager does not completely interrupt personal relations between the branch and its customers. Another object sometimes present in shifting managers is to bring the loans of a branch under the review of a new manager. The theory is that a manager who has not been responsible for making undesirable loans is more likely to pursue a strong policy of readjustment than the manager who has made those loans.

A number of the banks have furnished statements of the length of time the managers in charge of their branches in various regions in the spring of 1931 had occupied the position. One institution, which appears to be in this respect typical of the larger banks, reports as follows for 56 of its branches in one of the Prairie Provinces:

Tenure of Office of Branch Managers
in Western Canada

Under 1 year	9
From 1 to 2 years	9
" 2 " 3 "	11
" 3 " 4 "	5
" 4 " 5 "	1
" 5 " 6 "	3
" 6 " 7 "	3
" 7 " 8 "	1
" 8 "10 "	4
Over 10 years	10

As a rule the local managers in the older Eastern Provinces remain in their position somewhat longer than those in the West. Of twenty-seven branches of one bank which were chosen at random in Ontario, Quebec, Nova Scotia, and New Brunswick, the tenure of office of the managers was reported as follows:

Tenure of Office of Branch Managers
in Eastern Canada

Under 1 year	1
From 1 to 2 years	1
" 2 " 3 "	3
" 3 " 4 "	3
" 4 " 5 "	2
" 5 " 6 "	4
" 6 " 7 "	1
" 7 " 10 "	5
Over 10 years	7

Canadian banking authorities point out that there is something to be said on both sides of the question of periodical changes of local management. They generally admit that a banker permanently located in a given community is likely, other things being equal, to give greater weight to personal considerations and local sentiment in the granting of credit than would a branch bank manager in temporary residence. On the other hand, they point out that sound banking must in the nature of things be conducted on strictly business principles, independently of personal relationships and local sentiment. The Canadian branch system, they assert, tends to ensure banking along sound lines, while at the same time the desire of the local manager to make a good showing with the profit and loss account of his branch is likely to cause him to extend credit as liberally as safety will permit.

Branch Banking in the Economic Development of Canada

Various commentators have attempted from time to time to assign responsibility to the Canadian branch banking system, either for the rapid economic growth of Canada, or for the economic backwardness of the Dominion in comparison with the United States. It is commonly asserted by defenders of the unit banking system, for example, that Canada lags far behind the United States in economic expansion because of lack of aid and encouragement to new enterprises on the part of branch managers.(1) The fact is that Canada--with a climate on the whole less temperate than that of the State of Maine, and with navigation closed at her principal ports from November to May--has had in the past thirty years a substantial economic growth. So, of course, has the United States. The following figures will serve to illustrate the development of both countries:

Table 14 - Selected Data Showing Economic Development of Canada and the United States

	Canada(2)			United States(3)		
	1901	1929	Per cent increase	1900	1928	Per cent increase
Population	5,371,300	9,796,800	82	76,303,000	119,798,000	57
Commercial banking assets in thousands of dollars	$531,829	$3,528,468	563	$8,319,079	$61,392,160	638
Gross value of manufactures, per capita	$90(4)	$415	361	$152(5)	$531(6)	250
Gross value of agricultural production, per capita	$68	$166	144	$63(5)	$142(7)	125
Foreign trade (imports plus exports), per capita	$69	$268	288	$19	$81	326
Steam railroad per 1,000 inhabitants, miles	3.38	4.23	25	2.55	2.08	18 (decrease)
Surfaced roads per 1,000 inhabitants, miles	(8)	7.36	-	(8)	5.23	-
Registration of motor vehicles per 1,000 inhabitants	(8)	122	-	(8)	205	.
Electricity generated in P. U. plants, k.w.h. per capita	(8)	1,833	-	(8)	735	-

(2) Figures compiled from The Canada Year Books of various years.
(3) Figures compiled from Statistical Abstracts of the U. S. of various years.
(4) Year 1900.
(5) Year 1899.
(6) Year 1927.
(7) Year 1926.
(8) Data for early period not available.

(1) E.g., M. P. Beebe, president, Bank of Ipswich, South Dakota, American Bankers Association Journal, October, 1929, p. 358.

It is possible to argue that each country has progressed either because of, or in spite of, its banking system. But there are ample reasons to believe that the development of both has been due mainly to other causes. The most important of these causes is the natural wealth of the vast territories of the two countries, in conjunction with the industry, the energy, and the initiative of their respective populations.

CHAPTER V

BANKING CONCENTRATION IN CANADA

One of the most persistent controversies concerning the Canadian banking system is whether it constitutes a monopoly or "money trust." Perhaps the difficulty lies in the vagueness of the terms used. No attempt will be made here to state conclusions, but only to set forth the facts and tendencies of banking concentration in Canada, to examine the effectiveness of the competition existing among banks, and finally to present certain representative opinions as to whether or not a banking monopoly does in fact exist.

Tendencies Towards Concentration

At the beginning of the present century there were thirty-six chartered banks in Canada, with total resources amounting to about $460,000,000. The largest had resources of about $93,000,000 and the smallest, less than $600,000. The resources of the ten largest amounted to approximately $330,000,000 or over 70 per cent of the total banking assets of the country. At the end of 1931, exclusive of Barclays Bank (Canada) with resources of about $5,000,000, there were only nine banks, with total assets of approximately $3,000,000,000. Each of the two largest had resources of over $750,000,000 and the smallest, about $53,000,000. Total assets of the four largest amounted to about $2,400,000,000 or 80 per cent of the total for the country. The largest bank had about 26 per cent of the total banking resources of the country.

Of the thirty-six banks existing in 1900, four have disappeared through failure, one through liquidation with open doors, and twenty-two through amalgamation with other banks. Since 1900 thirteen new ones have been started. Of these, all except Barclays Bank (Canada), which was organized in 1929, have disappeared—three through failure, one through liquidation with open doors, and eight through amalgamation. Altogether since 1900 thirty-nine banks in Canada have gone out of business, seven through failure, two through liquidation with open doors, and thirty through amalgamation.

A list of the banks in operation on December 31, 1931, showing their resources and growth by absorption of the assets of disappearing institutions, is given in Table 15.

Table 15 - Growth of Chartered Banks by Mergers(1)

Bank	Date of charter	Resources July 31, 1900	Resources Dec. 31, 1931	Resources absorbed since 1900
Bank of Montreal	1817	$93,158,000	$761,157,000	$352,459,000
Bank of Nova Scotia	1832	20,561,000	262,732,000	90,792,000
Bank of Toronto	1856	19,492,000	120,792,000	-
Banque Provinciale du Canada	1900	2,160,000	52,796,000	-
Canadian Bank of Commerce	1867	47,546,000	592,513,000	223,814,000
Royal Bank of Canada	1869	18,337,000	782,584,000	255,617,000
Dominion Bank	1871	21,281,000	132,875,000	-
Banque Canadienne Nationale	1860	9,670,000	150,206,000	49,871,000
Imperial Bank of Canada	1875	20,279,000	136,918,000	3,938,000
Barclays Bank (Canada)	1929	-	5,101,000	-

(1) Sources: Returns of the Chartered Banks; and Willis and Beckhart, Foreign Banking Systems, p. 330.

It will be observed that with the exception of Barclay Bank (Canada) and the Banque Provinciale du Canada, chartered in 1929 and 1900, respectively, every chartered bank operating in Canada at the end of 1931 had been in existence since 1875 or longer. Two have changed their names--the Merchants' Bank of Halifax to the Royal Bank of Canada in 1901, and the Banque d'Hochelaga to Banque Canadienne Nationale in 1924.

The mergers have occurred at the average rate of nearly one a year, the last one having taken place on May 1, 1931. Thus, gradually all the smaller banks and many larger ones have ceased to exist, leaving the commercial banking structure of Canada in the hands of a few comparatively large institutions.

Under the Bank Act,(1) the approval of the Governor in Council, based on the consent of the Minister of Finance and the recommendation of the Treasury Board, is necessary before any bank amalgamation can take place, and in theory at least, these agencies of the Government must be convinced that a merger is actually in the public interest before it is approved. It is possible since about 1910 to discern some indications of a general policy, somewhat liberally applied, to the effect that mergers shall be permitted only to prevent danger of insolvency. Several banks have been taken over, however, while still unquestionably solvent, although it has been claimed that their general condition and prospects were such as to cause doubt that profitable operations could be continued. In other cases the fact that the institution had ceased to grow, or that its earnings had decreased substantially, has been deemed sufficient to justify its being taken over. As a consequence of these incentives to amalgamation, most of the mergers of the past 15 or 20 years have been arranged at the request of the disappearing institution, rather than upon the initiative of the absorbing bank.

(1) The Bank Act, 1923, Secs. 99-111.

A more clearly defined policy of the Government has been evidenced in recent years in the matter of maintaining a sort of rough equilibrium in the banking organization, particularly with respect to the distribution of branches.(1) Generally, the mergers permitted have tended to extend the geographical field of the purchasing bank's operations, rather than to have it acquire offices in regions where it is already strongly represented, so that competition among the branches of different banks is maintained. No mergers have taken place of any considerable proportion of the whole number of branches of all the banks operating in a given region, and in very few cases has the total number of branches been decreased. It should be pointed out, however, that with the present banking organization of the country it will be exceedingly difficult in the future to effect any merger which will not run counter to this policy.

According to law, the principal specific requirement for receiving a charter to start a new bank is the raising of $500,000 of subscribed capital, of which $250,000 must be paid up in cash before the institution can commence business. In practice, recommendations regarding the application for a charter are made to the Parliament by the Minister of Finance, who usually consults with the Canadian Bankers' Association before coming to a decision. Since 1910 seven new charters have been granted, but only three(2) banks have been opened. The others did not raise the required capital within the period of one year granted for this purpose. In most cases the time was extended for another year, but even with this allowance the capital was not

(1) C. A. Curtis, <u>The Canadian Banking System, 1910-1925</u>, pp. 162, 163. A doctoral thesis on file in the University of Chicago Library.

(2) <u>Ibid.</u>, pp. 151-153.

raised.(1) It has often been charged that the influence of the bankers and their association has been used to prevent the opening of new institutions. The bankers on the other hand claim that they have recommended charters even when doubtful that the new institution could survive. Cases are cited to prove their point, of the unused charters, as well as of the banks which have been opened and later disappeared through failure or were obliged to merge with stronger institutions.

Is Effective Competition Maintained?

That the existing Canadian banks are in fact separate and distinct institutions, not controlled by common share ownership or interlocking directorates, is evidenced by the following extracts from a letter from the Inspector General of Banks dated January 26, 1932.

> "With regard to the general question of monopolistic possibilities through share ownership, I have no hesitation in expressing the emphatic opinion that no situation of this kind exists. The shares of the chartered banks generally have a wide distribution and I know of no holder or group of holders in a position to exercise control in the manner suggested. Incidentally, it might also be mentioned that the director of any one bank does not in practice act as the director of another bank. The by-laws of some of the banks specifically prevent such a possibility.
>
> ". . . In the very nature of things, trust companies hold from time to time blocks of shares as executors of estates, but in addition to such holdings accounts are sometimes carried 'in trust' without the trust being specified, or are designated by a number or some other distinguishing mark. Personally I am satisfied that trust companies are never shareholders in their own right to any substantial extent; in fact I think it is often the case that they are not the actual owners of any bank shares whatever."

As an official of the Ministry of Finance, the Inspector General

(1) Ibid.

of Banks has access to the annual reports containing the names and the amounts held by all shareholders of the banks.

Although the banks are clearly not under common ownership or control, it will be of interest to examine the evidence of effective competition among them.

Customers' Rates. - As pointed out in preceding chapters, all Canadian banks pay the same rate of interest on time deposits, a custom admitted by bankers to be the result of agreement.(1) Interest rates to borrowers are usually the same for all banks in a given region, but the Canadian Bankers' Association has specifically denied the existence of any general agreement in the matter. Before the Select Standing Committee on Banking and Commerce of the House of Commons, the vice-president of the association testified as follows:(2)

> "Q. What about the rates to be charged to borrowers?
> "A. I think that in one or two instances there have been rates agreed on for certain classes of business, but on the whole there is no agreement.
> "Q. Municipalities?
> "A. Yes, municipalities. There is a certain class of business on which we agree on fair rates, but on the whole there is no agreement of any great importance."

It is a matter of common knowledge that rates to similar classes of borrowers are approximately the same among the different independent unit banks of a given community in the United States. The actual charges are in the long run no doubt determined partly by local competition.

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(1) See, for example, testimony in 1924 of Mr. C. E. Neill, at that time general manager of the Royal Bank of Canada and vice-president of the Canadian Bankers' Association, Proceedings of the Select Standing Committee on Banking and Commerce, 1924, p. 287.

(2) Ibid., p. 287.

Apart from the general uniformity of interest rates in each of the various sections of the country, it is a fact that such rates tend to remain constant in Canada, not only from month to month but from year to year. At first glance this might seem to result from banking concentration. It should be remembered, however, that in England, where concentration has been carried as far as in Canada, interest rates on customers' loans fluctuate quite as widely as in the United States.

Even in the United States, however, notwithstanding the large number of banks, the existence of a central banking system, and the facilities of a money market, fluctuations in customers' rates are confined mainly to large financial centers, particularly in the North and East. Moreover, they are much smaller than is commonly supposed. According to a study by Riefler,(1) of the research staff of the Federal Reserve Board, during the five years 1923 to 1927 the fluctuations of the open market commercial rate in New York City were from slightly over 3 per cent to nearly $5\frac{1}{2}$ per cent; that is, changes during the period amounted to about 80 per cent of the lowest rate. Fluctuations in rates charged customers by member banks of the Federal reserve system in the leading cities in different geographical regions during the same period, on the basis of notes rediscounted, were as follows:(2) New York City, from 4.09 per cent to 5.39 per cent, or a variation of about 32 per cent from the lowest rate; other Northern and Eastern cities,(3) from 4.76 per cent to 5.64 per cent, or a variation of about 18 per cent; Southern and Western cities,(4) from 5.47 per cent to 6.02 per cent,

(1) Winfield W. Riefler, <u>Money Rates and Money Markets in the United States</u>, 1930, pp. 72-76 and 233-235.
(2) <u>Ibid</u>. Figures include commercial loans and loans on securities, but not real estate loans.
(3) <u>Ibid</u>., p. 73. Includes the leading cities in the Boston, New York, Philadelphia, Cleveland, and Chicago Federal reserve districts.
(4) <u>Ibid</u>. Includes leading cities of all other Federal reserve districts.

or a variation of about 10 per cent. The rates mentioned above were those prevailing in the 36 cities in which are located either Federal reserve banks or branches of Federal reserve banks. They do not, therefore, indicate the rates charged by the thousands of small banks in towns and villages throughout the country, where interest on ordinary commercial loans tends to remain about the same from year to year.

One-bank Rule. - A feature of banking operation in Canada which is in common practice is the one-bank rule. By long tradition each customer is required to confine his borrowing operations to one bank, and the different institutions are said to cooperate in enforcing the rule. The only deviations are in cases of very large borrowing accounts of great firms or corporations, concerning which full information regarding every transaction is exchanged among all lending banks. Obviously the one-bank rule is of considerable advantage to the banker in keeping track of the financial standing of his customers, and since generally each bank has plenty of resources to supply all the credit any individual customer may justifiably require, it is doubtful whether any borrower is handicapped by being required to deal with only one institution at a given time.

Credit Control. - So far as can be ascertained, no definite attempt has been made by the Canadian banks collectively to control the total credit supply. In other words, no concerted effort appears to have been made to bring about the sort of regulation attempted in other countries by central banks through raising or lowering rediscount rates and through open market operations. In fact the Canadian Bankers' Association has specifically denied that such efforts are made. The following testimony of the vice-president in

1924 is of interest in this connection:(1)

"Q. I think I gathered from the evidence given last year, that the banks had on one or two important occasions decided on the restrictions of loans, bringing about a certain measure of deflation? Am I correct?

"A. The banks in Canada, so far as I know, have never agreed as a body to restrict loans. The restriction of loans comes through the head office to each bank. For instance, if the directors of a bank, on the advice of the general manager and executive officers decide that it is a good time to curtail loans, they do it themselves without any reference to any other bank or without consulting them.

"Q. There has not been any concerted action?

"A. Absolutely none.

"Q. If a particular bank or two or three of the leading banks believe from a study of the general conditions that loans ought to be curtailed, that would have a very marked effect throughout the entire country.

"A. It would make it a little difficult for the borrowers, but I do not think that the banks ever pressed borrowers unduly."

It is clear, however, that, because of the small number of banks in Canada, general credit control could in fact be exercised much more easily and effectively than in the United States, and it is possible that as a result of informal discussions a more or less common credit policy is sometimes followed. Moreover, the Minister of Finance, in time of emergency, undoubtedly has brought about a common policy in some respects.

<u>Establishment of Branches</u>. - One way in which effective competition may be said with certainty to exist among the Canadian banks is in the establishment of branches. As the number of banks has diminished the number of banking offices has increased, as will be evident from a glance at Chart 1 in Chapter I.

In all parts of the Dominion, except the sparsely settled areas

(1) <u>Proceedings of the Select Standing Committee on Banking and Commerce</u>, 1924, p. 287.

of the far North, the larger banks are represented by numerous branches. There is hardly a town or village in Canada of any importance in size which is not served by two or more banks, while practically all settled communities and rural districts are within reach of the offices of more than one institution by automobile or other means of transportation. Table 16 indicates the distribution by Provinces of the branches of the various banks as of June 30, 1931.

A further illustration of the wide distribution of the branches of different banks is provided by the information contained in Table 17. This has been compiled from a bank directory of Canada as of the end of February, 1931, by choosing at random 27 cities and towns in which are operated more than two banking offices. For convenience the population of each place is included.

Each of the larger banks appears to be determined to have representation and to do its share of the business in every settled community. Indeed this phase of competition, as will be made clear in the next chapter, seems to have been in the past considerably keener than was profitable for either the banks or the public. During the war, in fact, the Minister of Finance for a while called a halt to the opening of new branches to avoid wasteful competition, but after the armistice the race was resumed.

Table 16 - Branches of Canadian Chartered Banks by Provinces[1]
June 30, 1931

Name of bank	Prince Edward Island	Nova Scotia	New Brunswick	Quebec	Ontario	Manitoba	Saskatchewan	Alberta	British Columbia	Yukon	Total in Canada	Outside of Canada	Grand total
Bank of Montreal	1	14	14	133	247	40	62	72	57	2	642	17	659
Bank of Nova Scotia	9	41	38	24	144	8	25	12	7	0	308	41	349
Bank of Toronto	0	0	0	16	108	14	35	14	10	0	197	0	197
Banque Provinciale du Canada	5	0	19	284	26	0	0	0	0	0	334	0	334
Canadian Bank of Commerce	7	21	7	93	337	53	100	75	73	2	768	15	783
Royal Bank of Canada	6	62	22	91	288	76	132	80	64	0	821	104	925
Dominion Bank	0	0	1	8	105	12	4	6	4	0	140	2	142
Banque Canadienne Nationale	0	0	0	532	28	16	9	8	0	0	593	1	594
Imperial Bank of Canada	0	0	0	4	124	8	57	25	15	0	233	0	233
Barclays Bank (Canada)	0	0	0	1	1	0	0	0	0	0	2	0	2
Total	28	138	101	1,186	1,408	227	424	292	230	4	4,038	180	4,218

(1) From Houston's Quarterly Bank Directory, July, 1931. Figures include subagencies.

Table 17 - Banking Offices and Population of Selected Canadian Towns and Cities

City or town	Population(1)	Number of banking offices(2)	Number of banks represented
Alexandria, Ont.	2,006	3	3
Amherst, N. S.	7,450	4	4
Assiniboia, Sask.	1,454	3	3
Brampton, Ont.	5,532	4	4
Calgary, Alberta	83,761	22	7
Chilliwack, B. C.	2,461	3	3
Edmonton, Alberta	79,197	18	8
Estevan, Sask.	2,936	3	3
Fernie, B. C.	2,732	3	3
Gravelbourg, Sask.	1,137	3	3
High River, Alberta	1,459	3	3
Lethbridge, Alberta	13,489	6	4
London, Ont.	71,148	19	7
Melville, Sask.	3,891	3	3
Nanaimo, B. C.	6,745	3	3
Portage la Prairie, Man.	6,597	4	4
Red Deer, Alberta	2,344	4	4
Regina, Sask.	53,209	14	7
St. Thomas, Ont.	15,430	9	5
Saskatoon, Sask.	43,291	11	6
Stettler, Alberta	1,219	3	3
Swift Current, Sask.	5,296	4	4
The Pas, Man.	4,030	5	5
Vancouver, B. C.	246,593	80	7
Weyburn, Sask.	5,002	4	4
Winnipeg, Man.	218,785	69	8
Yorkton, Sask.	5,027	4	4

(1) Population figures from the census of 1931, The Canada Year Book, 1932, pp. 103-108.

(2) From Houston's Monthly Bank Directory, March, 1931. In some of the cities, such as Vancouver, Winnepeg, Calgary, and Regina, the larger banks are usually represented also by supervisory offices which do no banking business directly with the public. It is not always possible to determine from the directory whether these are included or not; consequently some of the larger cities in this list may be credited with two or three more banking offices than are actually operating there as branch banks.

Pertinent testimony on the basis of long experience in both Canada and the United States as to the degree of competition actually existing was given in 1923 by Mr. H. O. Powell, general manager of the Weyburn Security Bank. Before the Select Standing Committee on Banking and Commerce of the

House of Commons, in answer to a question he declared:(1) "The competition is very keen. The fact is that the competition in Canada between banks is far keener than it is in the United States." In the course of investigations in Canada for the preparation of this report, questions regarding competition were asked of a number of economists and business men who have had opportunities for considerable observation and experience. Without exception they all declared that there was intense rivalry for business among the different banks several observed that competition seemed to become keener as the number of chartered banks diminished.

Dividend Policies

One of the principal results to be feared from an unrestrained monopoly is that its owners will profit unduly from their privileged position. From this point of view it may be said with certainty that the shareholders of the Canadian banks have not received in recent years unusually high returns on their investment as compared with those of the member banks of the Federal reserve system. Dividends declared by eight of the ten(2) existing chartered banks in the ten year period 1920-1929 averaged 6.45 per cent(3) of their capital funds (paid-up capital plus rest or reserve fund). The corresponding average for the member banks of the Federal reserve system was 6.21 per cent.(4) In a comparison made in a later chapter for the three years 1927-1929 net earnings of Canadian banks on their reported invested

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(1) Proceedings of the Select Standing Committee on Banking and Commerce, 1923, p. 414.

(2) Not included are: Banque Canadienne Nationale, for which complete data are not available, and Barclays Bank (Canada), chartered in 1929. The former declared dividends during the five years 1925-1929 averaging 5.05 per cent of its capital funds.

(3) Computed from reports published in Monetary Times, January 9, 1931, pp. 54 and 58-60.

(4) Computed from tabulations in Annual Reports of the Federal Reserve Board, 1925, p. 169, and 1930, pp. 135, 136.

capital are shown to have been substantially higher than those of the member banks of the Federal reserve system, but the Canadian banks did not increase their regular dividend rates during this period of exceptional prosperity. They have long been accustomed to follow a conservative dividend policy. During the period of prosperity prior to 1929 the shares of the Canadian banks did not rise to the same inflated price levels as the shares of many banks in the United States.

The Question of Monopoly

In 1922 Professor B. H. Beckhart, of Columbia University, undertook to obtain the opinions of well qualified and impartial observers regarding the existence of a banking monopoly in Canada. With this end in view he wrote to a group of Canadian economists, and received six replies, as follows:(1)

I. "The criticism that the Canadian banks constitute a banking monopoly is well founded. They all pay the same rate of interest on deposits and charge the same rate on loans. The loaning provisions are virtually identical. Moreover, if a new bank were seeking incorporation, The Canadian Bankers' Association reports upon the fitness of the incorporators to undertake the work of a bank and if their report to the Minister of Finance is not favorable the charter will be refused. Is not this monopoly?"

II. "We hear a lot in certain quarters about a 'money trust.' I do not deny the possibility of such a development but with the keenest competition between the chartered banks, it seems to me there is no practical danger of it."

III. "I think that this criticism (that the Canadian Banks do constitute a monopoly) is well founded. Through The Canadian Bankers' Association the Canadian Banks are, in many respects, one bank. In a great many respects uniformity is insisted upon and a bank that protests had better look out. It is almost inconceivable that any capitalists would seek a charter for a new bank and yet on the face of it there is nothing to prevent them."

(1) Willis and Beckhart, Foreign Banking Systems, pp. 476, 477.

IV. "There is no monopoly. Any group of reasonable men--and no others should be considered, can obtain a charter on providing $250,000 in cash, and meeting the provisions of the Bank Act. I have only to refer to the unhappy experience of the defunct Farmers Bank to make it clear that the stringent scrutiny of any application of a group of men for a charter is justified. On the other hand, among the banks themselves there is the keenest kind of competition, except in the item of interest paid on time deposits--which is determined by agreement at 3%. But when the Trust Companies provide checking accounts on which 4% is paid, so that there is no great hardship here; although some may say that such an agreement among the banks themselves to pay no more than 3% on time deposits may savour of monopoly."

V. "I do not believe that there is a banking monopoly in Canada. Of course there is considerable concentration of banking power. We have only 17 banks at the present time (1922); five of these have 75% and seven 85% of the total banking assets of the country. It is true also that under our Bank Act The Canadian Bankers' Association exercises important powers, that there is very close touch between the leading Canadian bankers, and that there is a common bankers' opinion in this country. It is true also that the rate paid on deposits is the same and that all through there are very slight differences in charges for services made by the banks. The competition shows itself in a competition of service, however. As already hinted, the spreading branches might be regarded as an instance of excessive competition.

"We have a free banking system and any new bank may be started in this country at any time, provided that the minimum capital can be raised, and that the backers of the project can satisfy the Committee of the House in regard to their honesty, competency and financial backing. It is true, however, that the most recent project for a Canadian bank, the Great West Bank, has fallen through. I think, myself, that the personality of the promoters had a good deal to do with this. One might also admit that a new bank would find it somewhat difficult to develop new business, especially in the first few years of its existence because the service rendered by the other banks is, on the whole, efficient."

VI. "There is some foundation, I think, for the criticism that the Canadian banks constitute a banking monopoly, but it is a monopoly of the loosest sort, involving at most, I think, certain bank agreements as to practices. Between the local branch managers there is a very keen competition. There is also very keen competition with regard to the locating of branches."

As is evident from these opinions, the answer to the monopoly question depends largely upon definitions. The banking resources of Canada are concentrated in a small number of institutions and, unquestionably, more of the obvious external features of a banking monopoly exist there than in the United States. Concerted action between the Canadian banks could doubtless be readily undertaken, unless prevented by public authorities.

On the other hand, it might be noted that the unit banks in many sections of the United States engage in uniform practices. Many of them are bound together in clearing house associations which enforce a high degree of uniformity. There is little evidence that the agreements as to practices are any more numerous among the Canadian banks, or affect a larger proportion of their activities, than in the case of the clearing house banks in the United States.

If by monopoly is meant the abolition of competition between banking institutions, then clearly it does not exist in Canada, since keen competition continues to prevail between the branches of the different institutions as well as in the location of new branches.

CHAPTER VI

THE COST OF BRANCH BANKING

Very little factual data have been available heretofore by which to compare the earnings and expenses of branch operating banks in Canada with those of independent unit banks in the United States. For the purposes of this investigation, however, some of the Canadian banks have furnished sufficient information to make possible a rough comparison.

It should be borne in mind, however, that on account of differences in banking practice and in the scale of commercial operations in the two countries, it is difficult to secure strictly comparable data. Gross earnings of the banks in the United States, for example, include, in the case of many institutions, the receipts from trust business, whereas such business is not engaged in by the Canadian banks. Moreover, there are various services performed by the banks of both countries, such as carrying small accounts, making out income tax returns for customers, and the like, for which charges may or may not be made; but it would be impossible to compare the actual value to the two economic communities of such free services as may be rendered. The larger Canadian banks, moreover, do an extensive business in foreign countries while only a few of the great banks in the United States operate abroad on a comparable scale. Finally it has not been possible to compare the accounting methods of the Canadian banks, either as among themselves or with those of the banks in the United States. Consequently the various ratios of earnings and expenses may not have been computed on exactly the same basis.

The differences, however, are not likely to be so great as to vitiate entirely the general conclusions indicated. For convenience attention will be devoted first to the expenses of operating the banking system; second, to gross and net earnings; and finally, to the cost of the system to the economic community as a whole.

Operating Expenses

Operating expenses of banks may be conveniently expressed as percentages of loans and investments, which for practical purposes may be considered roughly equivalent to their total earning assets. From information furnished by a number of Canadian banks(1) for the three years 1927-1929, accounting for about one-third of the total banking resources of the country and spread widely over the territory of the Dominion, a comparison may be made with the member banks of the Federal reserve system. The figures for both the Canadian banks and the member banks of the Federal reserve system as shown in Table 18 are averages weighted on the basis of the actual amounts of loans and investments of each group outstanding at the end of the years in question.

(1) Certain banks were unwilling to give this information, as a matter of principle. The others consented to give it only on condition that if included in averages for publication, no statement should be made which could be used to identify the particular institutions referred to. Hence the very general description in the text; but it is believed that the figures thus compiled do represent a fair average of the earnings and expenses of Canadian banks.

Table 18 - Expenses per $100 of Loans and Investments
Average for Three Years 1927-1929(1)

	Salaries and wages	Interest on deposits	Other expenses, including net losses	Total expenses
Representative Canadian banks	$1.78	$2.23	$1.38	$5.39
All member banks of the Federal reserve system(2)	1.28	2.15	1.77	5.20

(1) Averages weighted by size of loans and investments of the banks; i.e., the ratios were computed by aggregating the various items concerned for all the banks included in the tabulation for each country.

(2) Computed from data published in the Seventeenth Annual Report of the Federal Reserve Board, 1930, pp. 135, 136.

Another comparison, on a slightly different basis, between the same group of Canadian banks and various size groups of national banks in different geographical divisions of the United States is made in Table 19. For the Canadian institutions the figures are still the weighted averages described above, but for the national banks ratios for each bank were computed and then these were averaged for the banks in each size group, thus giving equal importance to each bank in the group. It is believed, however, that the differences in methods of computing the averages do not distort the comparison.

Table 19 - Expenses per $100 of Loans and Investments
Average for Three Years 1927-1929

	Salaries and wages	Interest on deposits	Other expenses, including net losses	Total expenses
Representative Canadian banks(1)	$1.78	$2.23	$1.38	$5.39
National banks:(2)				
United States				
Small(3)	1.94	1.94	2.65	6.53
Medium size(4)	1.30	2.23	1.80	5.33
Large(5)	1.19	2.13	1.72	5.04
New England and Middle Atlantic States(6)				
Small	1.43	1.90	1.73	5.06
Medium size	1.09	2.39	1.46	4.94
Large	1.06	2.19	1.52	4.77
Mid-continent States(7)				
Small	2.20	1.95	3.12	7.27
Medium size	1.57	2.04	2.30	5.91
Large	Not a sufficient number to permit a fair average			

(1) Averages weighted by size of loans and investments of the banks.

(2) Figures compiled by Federal Reserve Committee on Branch, Group, and Chain Banking; not weighted by size of loans and investments of the banks.

(3) Banks having between $250,000 and $500,000 of loans and investments.

(4) Banks having between $2,000,000 and $5,000,000 of loans and investments.

(5) Banks having $10,000,000 or more of loans and investments.

(6) Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, New York, New Jersey, Delaware, Pennsylvania, Maryland, and the District of Columbia.

(7) Louisiana, Texas, Arkansas, Oklahoma, Minnesota, North Dakota, South Dakota, Iowa, Nebraska, Missouri, and Kansas.

It will be observed from Table 18 that the total operating expense per $100 of loans and investments of the Canadian banks appears to be slightly higher than that of the members of the Federal reserve system. Allowing for possible discrepancies arising from the basis of comparison, however, the small difference shown in the table is probably not greater than the margin of error. On the other hand, when the various items making up the totals are compared, the differences are seen to be substantial. Salaries and wages and interest on deposits appear to be higher in Canada, while "other expenses, including net losses" are lower.

The higher outlay for salaries and wages in Canada results in part, no doubt, from the larger number of banking offices in proportion to the bank deposits of the country. The average total deposits of the 3,970 banking offices in Canada on December 31, 1931, amounted to about $475,000[1] as compared with an average of about $2,000,000 for the 22,501 offices in the United States on the same date.

It will be noted, however, that the comparison of operating costs is between a group representative of all banks in Canada and only the members of the Federal reserve system, which include very few of the thousands of small State banks whose operating costs run comparatively high. Clerical work in a large office can be concentrated and to a large extent done with the aid of mechanical devices, so that one teller or bookkeeper can do three or four times as much as he would be called upon to do in a small branch. A comparison illustrating this point was made several years ago by Mr. E. L. Stewart Patterson, on the basis of figures obtained "from one of the leading American banks where for the past ten years the average number of men per million dollars deposited has held steadily at about four and six-tenths,

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(1) <u>The Canada Year Book</u>, 1932, pp. 776-779.

whereas Canadian banks average twelve or thirteen men per million dollars of deposit."[1]

The aggregate amount of interest paid on deposits in Canada, notwithstanding the uniform rate of 3 per cent on time deposits, is higher than in the United States mainly because a considerably larger proportion of the total deposits in Canadian banks is time or "savings" deposits. The figures as of the end of 1929 are shown in Table 20.

Table 20 - Deposits in Banks of Canada and the United States
December 31, 1929

	Total deposits[2]	Time deposits	Ratio of time deposits to total (per cent)
All Canadian banks[3]	$2,163,720,000	$1,434,405,000	66
All member banks of the Federal reserve system(4)	32,095,063,000	13,233,481,000	41

(2) Deposits of other banks and of United States and Dominion and provincial Governments, as well as deposits in foreign branches of Canadian banks, are excluded.

(3) <u>Returns of the Chartered Banks</u>.

(4) <u>Seventeenth Annual Report of the Federal Reserve Board</u>, 1930, p. 91.

To find a ready explanation of the lower outlays in Canada for "other expenses, including net losses" is more difficult. Data for net losses of the Canadian banks are not available for a sufficient number of

(1) E. L. Stewart Patterson, formerly superintendent of eastern township branches, Canadian Bank of Commerce, <u>Banking Principles and Practice</u>, edition of 1929, p. 337--textbook of Alexander Hamilton Institute. It is probable that the difference is not now so great as before the war when Mr. Patterson wrote the first edition of his book.

institutions to be included separately in the foregoing tables, but there is some evidence that they are substantially lower than in the United States. For certain Canadian institutions from which figures have been obtained for the three years 1927-1929, average net losses per $100 of loans and investments amounted to $0.11, while the corresponding figure for all the member banks of the Federal reserve system was $0.54. Probably the Canadian system as a whole saves money on general administration and overhead charges through centralized control of the banks, although the added cost of the large number of banking offices in the country may offset the gains.

Among the different size groups of national banks shown in Table 19, the "large" banks in the United States as a whole appear to operate at a somewhat lower cost than the Canadian institutions. For the medium size banks, however, the costs are nearly the same, and for the small banks the costs are considerably higher than for the Canadian institutions, the difference being especially marked in the case of the small banks in the great agricultural areas of the United States.

The difference between the large national banks and the Canadian banks are accounted for chiefly by the difference in cost of salaries and wages, which seems to be around 50 per cent higher in Canada than for the large national banks of the United States. In view of the greater number of employes per million dollars of deposits in Canada it might be expected that the difference would be even greater than the tabulated figures indicate. But salaries of personnel in Canada, especially in the numerous branches in small towns and villages, are considerably lower than in the large cities of the United States; and while many of the largest banks in the United States also operate as branch organizations, their branches for the most part are limited to their home cities.

If a comparison could be made, however, between the operating costs of the entire banking systems of Canada and the United States, a number of other factors would have to be taken into consideration. It must be borne in mind, in connection with the first of the foregoing tabulations, that the figures for the United States are averages which include the operating costs of the largest banks in the country, but leave out of account more than 15,000 State banks which during the period 1927-1929 were not members of the Federal reserve system. The great majority of the latter are very small institutions, and many of them are located in the Southern, Southwestern, Middle-western, and Northwestern States. Judging from the operating costs of the small national banks in those States, it may be assumed that the average operating costs of the nonmember banks are considerably higher than the average for the member banks. If, therefore, the nonmember banks could be included in an average of operating costs for all banks in the United States, the resulting figure should be higher than the average shown in the tabulation for representative Canadian banks.

Excessive Number of Branches. - As suggested above, there seems to be one feature of Canadian branch banking which makes for needlessly high operating costs. It is the unrestrained competition practiced by the banks in the establishment of branches, which has resulted in so many banking offices in Canada that their average deposits in 1930 were but litte more than one-fourth the average in the United States. The most striking manifestation of this competition is in the cities, although the towns and villages often have more banking offices than they would seem to be able to support economically on the basis of the business actually transacted. In the city of Montreal, for example, with a population of about 1,000,000, there were about 230 branches of the various banks in 1931. There were only about 660 commercial banking offices in New York City, which has a population more than seven times as great as Montreal. Toronto, a city of about 700,000 inhabitants, had about 300 banking offices, more than four times as many in proportion to its population as New York, nearly eight times as many as Chicago, three and a half times as many as Cleveland, nearly three times as many as Buffalo, two and a half times as many as San Francisco, and twice as many as Los Angeles.

A list has already been presented (see Table 17 in Chapter V) of other cities and towns chosen at random throughout the Dominion, showing the population and the number of banking offices, as well as the number of banks represented. This illustrates both the competition among the banks and the wide distribution of their offices in small communities.

The practice in the matter of establishing new branches in the cities, as explained by an official of one of the largest Canadian banks, is about as follows: The managers in branches neighboring on a given region decide that the bank should have an office in such and such a block, and so report to the head office. Whereupon an investigator is sent to look the situation over on the ground. If he reports favorably, a branch is established on an experimental basis, usually in premises rented on a short lease. The new office, with a staff of at least two men, operates for two or three years. If by the end of the trial period it has obtained as much as $150,000 of deposits, it is put on a permanent basis.

That competition in the number of offices is excessive and costly, the general managers of the Canadian banks are well aware. But they declare that no single institution can afford to refrain from opening a branch wherever the smallest profit can eventually be made, since some other bank would be sure to do so.(1) It is also felt in some quarters that any concerted attempt on the part of the banks to limit the number of branches in a given city or community would be likely to meet with public criticism on the score of monopolistic practices.

Gross and Net Earnings

Based on the data for the representative Canadian institutions referred to at the beginning of this chapter, Table 21 is a comparison between the gross and net earnings of banks in Canada and the United States.

Table 21 - Earnings and Expenses and Invested Capital per $100 of Loans and Investments, Average for Three Years 1927-1929(2)

	Gross earnings	Operating costs, including net losses	Net profits(3)	Reported invested capital	Net profits on reported invested capital (per cent)
Representative Canadian banks	$6.85	$5.39	$1.46	$10.91(4)	13.39
All member banks of the Federal reserve system(5)	6.66	5.20	1.46	16.61	8.79

(2) Averages weighted by size of loans and investments of the banks.
(3) Net profits available for dividends.
(4) From Returns of the Chartered Banks as of the end of each year.
(5) Computed from data given in the Seventeenth Annual Report of the Federal Reserve Board, 1930, pp. 135, 136.

(1) A good many branches in the West, as shown in a preceding chapter, have been kept open for considerable periods at an actual operating loss.

From these figures it would appear that the average earnings and expenses of Canadian banks per $100 of loans and investments are remarkably similar to those of the banks in the United States which are members of the Federal reserve system. As in the case of operating costs, gross earnings of the Canadian institutions appear to be slightly higher, but if a comparison could be made with the entire unit banking system of the United States, including all the small nonmember institutions, there can be little doubt that the gross earnings of the latter, like their operating costs, would prove to be higher.

Canadian net earnings(1) on the amount of invested capital reported in the Returns of the Chartered Banks (capital plus rest or reserve fund) are substantially higher than for the member banks of the Federal reserve system, as a result of the fact that the Canadian banks reported a lower ratio of invested capital to total loans and investments. If hidden reserves should be added to the reported amount of invested capital, it would affect the rate of net earnings of both Canadian and American banks. No data are available, however, to show the extent of hidden reserves in either country.

The Cost of Branch Banking to the Economic Community

Turning now from a consideration of the operating costs and profits of the Canadian banks--that is, of branch banking from the point of view of the shareholders--an attempt will be made to examine the various elements of

(1) The figures for net earnings of Canadian banks here tabulated cannot be compared even approximately with any published statements by individual banks, for the reason that the amounts of earnings carried in times of exceptional prosperity to hidden reserves are not reported in such published statements.

the outlay made by the economic community for the maintenance of the system. The chief item of cost is the interest rates charged to borrowing customers, discussed at length in an earlier chapter. The charges other than interest on loans consist of exchange charges on checks, charges for checking accounts when the deposit is below a certain minimum, rent on safe deposit boxes, commissions on purchase or sale of securities, foreign exchange, etc., etc.

The net cost of any banking system to the economic community it serves (apart from the shareholders and employes of the banks considered as such) may be expressed in a very rough approximation as the interest and other charges paid to the banks--i.e., their gross earnings--minus the interest received on deposits.(1) When the community as a whole is considered the important question relates to the actual out-of-pocket expense of all the customers of the banks collectively for the maintenance of the system. As in the case of operating costs, this may be conveniently expressed in percentages of loans and investments. Using the figures for the representative Canadian banks previously referred to, a three year comparison with banks in the United States is shown in Table 22.

Table 22 - Net Cost of Banking Service per $100 of Loans and Investments
Average for Three Years 1927-1929(2)

	Gross earnings (paid by community)	Interest paid on deposits (received by community)	Net cost to community
Representative Canadian banks	$6.85	$2.23	$4.62
Member banks of the Federal reserve system(3)	6.66	2.15	4.51

(2) Averages weighted by size of loans and investments of the banks.
(3) Computed from data given in the Seventeenth Annual Report of the Federal Reserve Board, 1930, pp. 135, 136.

(1) Such items as local and national taxes represent additional refunds by the banks to the economic community; as do also, in a sense, the salaries and wages paid to the operating personnel.

Altogether the figures tabulated above are sufficient to give only a very general impression. They would seem to afford some reason to believe that the maintenance of the Canadian banking system is slightly more costly to its customers than that of the member banks of the Federal reserve system as a whole. As in the analysis of operating costs, however, the comparison leaves out of account more than 15,000 State banks in the United States, nearly all of them very small institutions, which during the period 1927-1929 were not members of the Federal reserve system. The average gross earnings of these nonmember banks per $100 of loans and investments, like their operating costs, are certainly higher than the average for the member banks. Furthermore, losses resulting from suspensions, which are not included in the above figures, have been substantial in the United States whereas Canada had no bank suspensions in the period 1927-1929. Consequently, the indications from the available information are that the unit banking system of the United States costs the economic community as a whole as much per unit of banking accommodation as the branch banking system of Canada. This appears to be true in spite of the wasteful competition in opening excessive branches in Canada.

CHAPTER VII

SUMMARY

The Canadian banking system, composed of 10 banks with about 4,000 branches and operating under charters granted only by the Dominion Government, has provided a notable degree of safety for its depositors. Since 1923 there have been no suspensions of Canadian banks. In the eleven year period 1921-1931, during which nearly 9,000 State and national banks suspended in the United States, only one institution suspended in Canada, the Home Bank of Canada which failed on August 17, 1923, with 68 branches.

The ratio of total assets of suspended banks to average total yearly assets of active banks during the same period was less than one-twentieth as great in Canada as in the United States. Even during the years 1901 to 1920 inclusive, before the present large number of suspensions in the United States began, the ratio of the assets of suspended banks to the average yearly assets of active banks was about seven times as great in the United States as in Canada.

Post-war agricultural conditions have proved a severe test for Canadian banks. The story of rising agricultural prices, rising land values, expansion of credit, and the overdevelopment of banking facilities prior to 1920 was much the same in the Prairie Provinces of Canada as in the Northwestern States across the border. The number of branches in the three Prairie Provinces increased over 50 per cent from 1916 to 1920. After 1920 both sections likewise experienced declining prices, declining land values, frozen bank loans, and profitless banking offices. In 1923 the president of the Canadian Bankers' Association testified before a committee of the

House of Commons that ". . . out of the 1,219 banks operating in Western Canada 419 are operating under an actual loss, an operating loss." As a result of these conditions many branches were discontinued. From 1920 to 1926 nearly one-third of the branches in the Prairie Provinces were closed, but the losses incurred were absorbed by the banks, that is by the proprietors or stockholders. Except for the branches and subagencies of the Home Bank, the reduction in the number of branches was accomplished without suspension of payments to depositors. The accounts of the closed offices were transferred to neighboring branches of the same or other banks.

The structure of the Canadian banking system is an important factor in its record of safety. The large size of the banks has made possible: (a) a wide diversification of assets; (b) large reserve funds for the absorption of special and regional losses; (c) adequate facilities for formulating and pursuing effective credit and investment policies; (d) ample resources for providing managerial ability; and (e) wide facilities for training the personnel in the traditional principles and practices of commercial banking. In Canada the facilities of large institutions have been made available to the smaller communities through the development of branch banking.

A further factor in connection with the safety record is the degree of adherence to commercial banking principles and the tendency to resist the practice of using deposits to supply capital funds. This is due in some measure to legal restrictions but in large part to management.

Safety to depositors does not appear to have been attained at the cost of adequate service to the community. Facilities for banking service are provided for all the settled regions of Canada, often in frontier towns and other communities too small to support independent banking institutions. There are more than twice as many banking offices in Canada as in the United States in proportion to the population, and nearly four times as many in proportion to the commercial banking resources of the country. While loans are generally made on business principles rather than on a personal basis, no evidence has been obtained that either communities or individuals have suffered from the withholding of credit warranted on the basis of sound banking practice. Banking funds in Canada have a high degree of mobility through the network of branches, and are readily shifted to communities where they are most needed. The evidence available shows that the loans of the branches in the great agricultural areas of the Dominion exceed their deposits, whereas for the country as a whole deposits exceed loans. This indicates that the newer regions of the country are financed in part through the loan of the surplus funds accumulated in the older and more thickly settled regions.

While the banking resources of the country have been gradually concentrated in a few large institutions, there is no evidence that competition between these institutions has been diminished. On the contrary competition is keen, both in the establishment of branches and in the development of business. In fact competition in the establishment of branches has resulted in what many observers have described as an overbanked condition. Towns of under 2,000 inhabitants all over the Dominion frequently are served by the branches of as many as three banks. Many villages of less than 1,000 have two or more banking offices. In the cities the multiplication of banking offices is equally apparent.

The costliness of competition in the number of banking offices is recognized by the general managers of the Canadian banks. There appears to be a conviction, however, that if one institution refrains from opening a branch wherever a profit can eventually be made some other bank would be sure to do so. At the same time it is believed by bank officials that a concerted attempt on the part of the banks to limit the number of branches in a given city or community would be likely to meet with public criticism as a monopolistic practice.

In view of the differences in banking practice in Canada and the United States and the difficulties of securing comprehensive data on earnings and expenses of banks, it is not possible to draw definite conclusions as to the relative costs of the two banking systems. The evidence available, however, does not indicate that the total cost per unit of business is higher for the Canadian system than for the American system, although the former maintains a much larger number of banking offices and personnel in proportion to the volume of business than the latter. On the contrary, the average gross earnings and the average operating costs (including net losses) of Canadian banks, in percentage of loans and investments, appear to be nearly the same as the averages for all member banks of the Federal reserve system. Taking into consideration the thousands of small high-cost nonmember banks in this country, there is reason to believe that the cost to the economic community of the unit banking system of the United States per unit of banking accommodation is at least as large as the cost of the branch banking system of Canada. In addition, the public in the United States has had to bear a much larger cost resulting from bank failures.

APPENDIX A

Statistical Tables

Canadian Bank Insolvencies since 1867
(Taken from The Canada Year Book, 1932, pp. 779, 780)

Name	Date of Suspension	Paid-up Capital	Reserve Fund	Liabilities	Assets	Paid to— Note-holders	Paid to— Depositors
		$	$	$	$	p.c.	p.c.
Commercial Bank of N.B.	- 1868	600,000	-	671,420	1,222,454	100	100
Bank of Acadia(1)	April, 1873	100,000	-	106,914	213,346	-	-
Metropolitan Bank	Oct., 1876	800,170	-	293,379	779,225	100	100
Mechanics' Bank	May, 1879	194,794	-	547,238	721,155	57½	57 1/2
Bank of Liverpool	Oct., 1879	370,548	-	136,480	207,877	100	96 6/17
Consolidated Bank of Canada	Aug., 1879	2,080,920	-	1,794,249	3,077,202	100	100
Stadacona Bank	July, 1879	991,890	-	341,500	1,355,675	100	100
Bank of Prince Ed. Island	Nov. 28, 1881	120,000	45,000	1,108,000	953,244	59½	59 1/2
Exchange Bank of Canada	Sept., 1883	500,000	300,000	2,868,884	3,779,493	100	66 3/8
Maritime Bank of Dom. of Canada	Mar., 1887	321,900	60,000	1,409,482	1,825,993	100	10 2/3
Pictou Bank	Sept., 1887	200,000	-	74,364	277,017	100	100
Bank of London in Canada	Aug., 1887	241,101	50,000	1,031,280	1,310,675	100	100
Central Bank of Canada	Nov., 1887	500,000	45,000	2,631,378	3,231,518	100	99 2/3
Federal Bank	Jan., 1888	1,250,000	150,000	3,449,499	4,869,113	100	100
Commercial Bank of Manitoba	June 30, 1893	552,650	50,000	1,341,251	1,951,151	100	100
Banque du Peuple	July 15, 1895	1,200,000	600,000	7,761,209	9,533,537	100	75 1/4
Banque Ville-Marie	July 25, 1899	479,620	10,000	1,766,841	2,267,516	100	17 1/2
Bank of Yarmouth	Mar. 6, 1905	300,000	35,000	388,660	723,660	100	100
Ontario Bank(3)	Oct. 13, 1906	1,500,000	700,000	15,272,271	15,920,307	100	100
Sovereign Bank of Canada(3)	Jan. 18, 1908	3,000,000	-	16,174,408	19,218,746	100	100
Banque de St. Jean	April 28, 1908	316,386	10,000	560,781	326,118	100	30 1/5
Banque de St. Hyacinthe	Jan. 24, 1908	331,235	75,000	1,172,630	1,576,443	100	100
St. Stephen's Bank	Mar. 10, 1910	200,000	55,000	549,830	818,271	100	100
Farmers' Bank	Dec. 19, 1910	567,579	-	1,997,041	2,616,683	100	Nil
Bank of Vancouver	Dec. 14, 1914	445,188	-	912,137	1,532,786	100	(2)
Home Bank of Canada	Aug. 17, 1923	1,960,591	550,000	19,678,747	27,434,709	100	(2)

(1) This bank was only in existence for 3 months and 26 days. Some of its notes were redeemed on its re-opening for a few days. The Dominion Government received 25 cents on the dollar on several thousand dollars worth of the notes which it held.

(2) Liquidation incomplete.

(3) These banks never suspended payment. Their branches were taken over by other banks which assumed all liabilities to depositors. Some years later, for technical purposes, these banks were put into insolvency.

Bank Absorptions in Canada since 1867(1)
(Taken from <u>The</u> <u>Canada</u> <u>Year</u> <u>Book</u>, 1932, p. 780)

Purchasing Bank	Bank Absorbed	Date(2)
Bank of Montreal	Exchange Bank, Yarmouth, N. S.	Aug. 13, 1903
	People's Bank of Halifax, N. S.	June 27, 1905
	Ontario Bank	Oct. 13, 1906
	People's Bank of New Brunswick	April 15, 1907
	Bank of British North America	Oct. 12, 1918
	Merchants' Bank of Canada	Mar. 20, 1922
	Molsons' Bank	Jan. 20, 1925
Canadian Bank of Commerce	Gore Bank	May 19, 1870
	Bank of British Columbia	Dec. 31, 1900
	Halifax Banking Co.	May 30, 1903
	Merchants' Bank of P. E. I.	May 31, 1906
	Eastern Townships' Bank	Feb. 29, 1912
	Bank of Hamilton	Dec. 31, 1923
	Standard Bank of Canada	Nov. 3, 1928
Bank of Nova Scotia	Union Bank of P. E. I.	Oct. 1, 1883
	Bank of New Brunswick	Feb. 15, 1913
	The Metropolitan Bank	Nov. 14, 1914
	The Bank of Ottawa	April 30, 1919
Royal Bank of Canada	Union Bank of Halifax	Nov. 1, 1910
	Traders' Bank of Canada	Sept. 3, 1912
	Quebec Bank	Jan. 2, 1917
	Northern Crown Bank	July 2, 1918
	Union Bank of Canada	Aug. 31, 1925
Imperial Bank of Canada	Niagara District Bank	June 21, 1875
	The Weyburn Security Bank	May 1, 1931
Banque d'Hochelaga(3)	Banque Nationale	April 30, 1924
Bank of New Brunswick	Summerside Bank	Sept. 12, 1901
Merchants' Bank of Canada	Merchants' Bank	Feb. 22, 1868
	Commercial Bank of Canada	June 1, 1868
Union Bank of Halifax	Commercial Bank of Windsor	Oct. 31, 1902
Northern Crown Bank	The Northern Bank	July 2, 1908
	Crown Bank of Canada	July 2, 1908
Union Bank of Canada	United Empire Bank	Mar. 31, 1911
Home Bank of Canada	La Banque Internationale du Canada	April 15, 1913
Standard Bank of Canada	Western Bank of Canada	Feb. 13, 1909
	Sterling Bank of Canada	Dec. 31, 1924

(1) The purchasing banks named in the latter part of the table are no longer in business.

(2) Dates given since 1900 are those of the Orders in Council authorizing the absorptions.

(3) The Banque d'Hochelaga after absorbing the Bank Nationale adopted the name Banque Canadienne Nationale.

APPENDIX B

Canadian Bank Act to be inserted here

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