BANKING LAW OF CANADA

Instructive Paper by Mr. John F. Mallon on the Chief Features of Our Legislation

At a recent meeting of business men Mr. John F. Mallon was called upon to read a paper on the Bank Act of Canada, and presented the following interesting paper:

Our laws on general subjects are said to be a reproduction of legislation enacted elsewhere, generally in Great Britain. The Bank Act, however, is an exception to this rule. Our financial conditions are very different from those of the Mother Country, and our whole banking policy has been widely divergent from that of the United States. The Bank Act came into force July 1st, 1891, and applies to 36 banks then existing and any banks incorporated in future. The charters of all banks existing at the time of its enactment were extended for 10 years, or until July 1st, 1901, while the charter of any new bank created during the period expired at the same time. By the amending Act of 1900 the charters were again extended for 10 years, or until July 1st, 1911. The banks to which the Act applies are substantially in the same position as if their respective charters had been taken away, and they had been granted new charters.

Thus the life of a bank, apparently, is only ten years, and as all charters come to an end at the same time, it might seem possible for the country to be suddenly left without any authorized banks. The system appears to be admirably adapted to the circumstances of a young and growing country. During the session of Parliament preceding the date of the expiry of the charters the banks are called upon to answer such criticism as may arise from the existence of defects in their system made evident by the experiences of time. By the exchange of opinion between the bankers and the public the Bank Act is improved and the banking system is thus brought at each period of renewal to a higher degree of perfection.

INCORPORATION.

When a certain number of individuals have complied with certain requirements they are supposed to have applied for a charter, which Parliament could refuse, but which, as a matter of fact, would not be refused unless doubt existed as the bona fide character of the proposed bank. Then, on complying with certain other requirements and obtaining consent of the Treasury Board, the bank is ready for business. What has given the Government more concern than the manner of incorporation is the means of determining that each proposed bank is a genuine business venture, with enough capital at the back of it to make this certain and to warrant the granting to it of the franchise of issuing notes. In 1834, a New Brunswick Act required that public commissioners should count the cash in the possession of a proposed bank in order to ascertain if the actual capital had been paid in, and that no notes should be issued until half of the capital was actually paid in. But there was no requirement as to the minimum capital, nor was there any fixed time for the repayment of the remainder of the subscribed capital. In the report of the first committee on banking and currency, appointed after the Union of Upper and Lower Canada in 1841, it was recommended that the amount of capital be fixed by Parliament in each case, and the whole to be subscribed within 18 months from the date of the charter; the bank was not to begin business until the whole was subscribed and one-half paid up, and the whole must be paid up within two years from date of charter. In 1870, after a great deal of discussion the minimum was fixed at $500,000, of which $200,000 should be paid before business was transacted. But this was modified next year to a requirement that only $100,000 be paid up at the commencement, and another $100,000 within two years. It will be seen that in the Act of 1890 the conditions are more stringent than at any previous time. The bona fide subscription of $500,000 of stock must be secured, and of this $250,000 must be at once paid up, and the actual cash placed temporarily with the Minister of Finance and Receiver-General before the final certificate is obtained, to the effect that all the conditions required by law have been complied with. This certificate is required to be obtained within one year from the passing of the Act of Incorporation.

INTERNAL REGULATIONS.

The law concerning the relations between the shareholders and the directors are with a few exceptions such as might be adopted in the management of any large corporation. That the directors should not have power to remunerate themselves, except under authority of the shareholders (Sec. 18), was a provision of the earliest charter in Old Canada — that granted to the Bank of Montreal in 1821. That the directors, or a majority of them, shall be British subjects (Sec. 19), and that directors shall be responsible for the employment of bank officers, and shall require them to give security for faithful service (Sec. 23), were also features of the same charter.

The matter of loans to directors has always been a somewhat difficult question and comparative freedom is permitted, except that in the monthly return to the Government the aggregate of loans to directors must be shown. Shareholders are empowered by passing a bylaw to such effect, to restrain the Board of Directors to the extent that they may see fit in making such loans.

18. Banks may establish and contribute to Guarantee and Pension funds in order to ensure the fidelity and provide for the superannuation of their officers.

Formerly private bonds were the rule; now the bonds of guarantee companies are generally given or required.

23. A bond well and truly to execute the duties of cashier or teller of a bank include not only honesty, but reasonable skill and diligence.

Therefore, if he is negligent and unskilful in the performance of those duties or lacks capacity and care the condition of the bond is broken. Some banks have funds kept up by contributions from both bank and officers. This might not be practicable in a small bank, but it has proved successful in some of the large banks. The affairs of a bank are entrusted to a Board of Directors.

There are no longer in Canada special "discount days" on which the board sits and discusses the bills offered. It is necessary now to empower the manager at the smallest branch, by instructions given in advance, to transact the business of his established customers. New customers, if proposing important business, must wait the decision of the board, but old ones, if in good standing, are not usually willing to do so. The board as a rule sits once a week, and is asked to approve of the more important lines of credit. The president may be in such close touch that he knows the business as well as the general manager; but this, as a rule, he cannot be, and the latter is the real executive officer. The president, however, is in daily contact with the general management, and is able to judge as to whether the bank is being soundly and honestly managed, while the board, by the nature of the business discussed every week, should also be in a position to know whether the affairs of the bank are prospering or not.

25. Shareholders have one vote for each share. All voting by shareholders must be by ballot. Shares which have been transferred within 30 days preceding a meeting cannot be voted upon by either party. Shareholders may vote by proxy, but no person who is not a shareholder shall be permitted to vote as such proxy, and no manager, cashier, clerk, or other subordinate officer of the bank shall vote either in person or by proxy or hold a proxy for such purpose.

Mr. Justice Maclaren in his work on Banking, says: "The word manager in this case would probably not be held to apply to a managing director in a bank which has such an officer."

In the Bank Act of 1843 the expression was "the cashier or other officer," and it was held that the president was not an officer within the meaning of the clause. Proxies must be renewed at least every two years. In the early Acts, voting was arranged by a scale, so that while one share gave one vote, ten shares gave only five and thirty shares only ten, while no holding gave more than twenty votes. In granting new charters in the year 1855, the Legislature of Old Canada changed this to the practice which has been followed since —of one vote for each share.

QUALIFICATION OF DIRECTORS.

(2) Each director shall hold capital stock as follows: When the paid-up capital stock is one million dollars or less, each director shall hold stock on which not less than $3,000 has been paid up. When the capital stock is over one million and does not exceed three millions, each director shall hold stock on which not less than $4,000 has been paid up. And when the paid up capital stock exceeds three millions, each director shall hold stock on which not less than $5,000 has been paid up. The shareholders may raise the qualification, but they cannot lower it.

CAPITAL STOCK.

The capital stock may be increased or decreased by the consent of a majority of the shareholders obtained at an annual or special meeting, and approved by the Treasury Board. New or unsubscribed stock must be allotted pro rata, and any premium fixed thereon must not exceed the percentage which the reserve fund (surplus) bears to the paid-up capital stock. Before the consent of the Treasury Board can be obtained to a reduction of the capital, statements of the condition of the bank must be submitted, setting forth the reason why such reduction is sought. Before the present Act a special Act of Parliament was required for reducing the capital stock, or for increasing it. The reduction of the capital stock in this manner does not diminish the liability of the shareholders to the creditors of the bank, existing before such reduction is made, and the capital stock cannot be reduced below the sum of $250,000 of paid-up stock.

Several sections of the Amendment Act of 1900 are devoted to the purchase of the assets, etc., of one bank by another. Sections 29 to 44 inclusive, deal with the following subjects: Subscription of shares (29) payment of calls on new shares (30 and 31); and enforcement of same (32, 33 and 34); conditions under which shares may be transferred (35) provision that a list of transfers shall be made daily and exhibited for the information of shareholders (36); provision to prevent the selling of stock by others than the actual owners such as the sale of shares not owned with the expectation of purchasing later at a lower price (37).

37. This section was not in the former Act, and was designed to prevent gambling in bank shares, or engaging in transactions which are really betting on the rise or fall of the stock in the market.

Manner of transferring shares sold under execution (3); in case of death, bankruptcy, insolvency, or marriage of female shareholders (39, 40, 41 and 42); provision that bank is not bound to see to the execution of trusts (43); provision that executors and trustees shall not, when the real owner is indicated in the books of the bank, be subject personally to liability on the shares so standing in their names as executors or trustees. If the actual owner is living and competent, he is liable as if the shares stood in his name, and if dead or incompetent, his estate is liable (44). When the name of the real owner does not appear in the books of the bank, then the executor, trustee or administrator is personally liable.

ANNUAL STATEMENT.

45. At the annual meeting the directors must submit a clear and full statement of affairs.

46. The books, correspondence, etc., are at all times subject to inspection by the directors but no shareholder has a right to see any of the books of the bank.

A sub-section was added by the Amending Act of 1900, which enables shareholders to obtain fuller information. In case they so desire shareholders may pass a bylaw asking further statement from the directors.

47. Dividends when earned are to be declared not less often than half-yearly.

48. Directors who knowingly join in declaring a dividend or bonus which impairs the paid-up capital, shall be jointly and severally liable therefor. And if the capital is impaired, the directors shall make calls upon the shareholders to make good such impairment. And the net profits must be applied for the same purpose.

49. No dividend or bonus, or both combined, exceeding 8 per cent. per annum shall be paid unless the net rest fund, or surplus profit reserved, exceeds 30 per cent. of the paid-up capital, after deducting all bad debts.

RESERVES.

50. Of the cash reserves held by a bank (the proportion of such reserves to liabilities being entirely at the bank's discretion) not less than 40 per cent. shall be in legal tender notes of the Dominion of Canada.

NOTE ISSUES.

51. Banks may issue and reissue notes payable to bearer, on demand and intended for circulation, no note smaller than $5 and all notes to be multiples of $5.

The Government desired to provide, out of its legal-tender issues, the entire change making paper currency of the country, and first fixed the lowest note issuable by a bank at $4 (the old currency pound) and subsequently at $5. (Before 1871 banks issued notes for $1 and upwards). By the Amending Act of 1899 Canadian Banks may issue notes of £1 sterling, or any multiple of that sum, at any office or agency of the bank in any British colony, other than Canada, provided the laws of such colony do not prohibit them. The total note issue of a bank must not exceed the unimpaired paid-up capital. A bank must not pledge its notes, and no loan thereon shall be recoverable from a bank. A bank may not issue or re-issue notes during a period of suspension.

Sec. 53 makes the note issues a prior lien upon the estate of the bank, prior even to a debt to the Crown. This principle found a place in the Act, in the year 1880. But there were still two defects in the system. It was frequently alleged by those who admired the National Bank Act of the United States, that while the currency created by it might not be elastic, the notes could not by any reason fail to be paid in full, and to circulate throughout the entire area of the United States. While in Canada where the arena is enormous relatively to population, the notes of banks in one province used to pass at a discount in some of the others. And while it might be confidently asserted that all bank issues secured by being a first lien on the estate of the banks would be eventually paid in full, it was nevertheless true that because of doubt and delay the notes of a suspended bank always fell to a discount for the time being.

The distinctive features, therefore, of the bank note issues of Canada are: They are not secured by special deposit with the Government of bonds or other securities, but are based on the general assets of the bank issuing them. But in order that they may be not less secure than notes issued against bonds deposited with the Government, they are made a first charge upon the assets. (Sec. 53).

To avoid discount at the time of suspension of a bank, each bank is obliged to keep in the hands of the Government, a deposit, equal to 5 per cent. on its average circulation.

This is called the Bank Circulation Redemption Fund, and should any liquidator fail to redeem the notes of a failed bank, recourse may be had to the entire fund if necessary. In order that all solvent banks may accept without loss the notes of an insolvent bank these notes bear interest at 5 per cent. from the date of suspension to the date of the liquidator's announcement when he will be ready to redeem. (Sec. 54.)

(55) To avoid discount, for geographical reasons each bank is obliged to arrange for the redemption of its notes in the commercial centres throughout the Dominion. Dominion notes in denominations of $1, $2 and $4, to the amount of $100, can be demanded from a bank by anyone receiving payment of that, or a greater sum. One signature on all bank notes must be in the actual handwriting of a person authorized to sign. The Act forbids the defacing of notes.

63. Also, the making of any card, advertisement or the like in the form of a Dominion or bank note.

62-96. Every teller or other officer who receives a counterfeit or fraudulent note, is supposed to stamp it with the word counterfeit, altered or worthless,

BUSINESS AND POWERS OF THE BANK.

Canadian banks are banks of issue, of discount and of deposit. In addition to its right to discount, lend money, make advances, and take certain collateral securities, a bank is given express power to deal in gold and silver and bullion, bills of exchange, promissory notes and other negotiable securities, or the stock, bonds, debentures and obligations of municipal and other corporations, or Dominion, Provincial, British, foreign and other public securities.

64. A bank must not engage in any business except banking, and it must not lend money on the security of real estate or other real property. These were features of the first charter (1821). A third provision, to the effect that a bank must not lend on its own stock, was adopted by New Brunswick in a charter granted in 1832. For a few years this provision was relaxed under Dominion legislation, but it was again enforced and is now regarded as a fixed principle of the Act.

65. A bank has a first lien on shares of its own stock, or any dividends due thereon, when the stock is held by a debtor. This also appears in the first charter (1821).

With the system of transferring shares in the United States such a lien might work unjustly, but in Canada it does not operate unfairly to any third party. No stock certificate, as the phrase is understood in the United States, is ever given by a bank. Shares are transferrable only on the books of the bank.

67. A bank may hold real property for its own use; and

68. Although it cannot lend on real property, it may take such to secure a debt already contracted. And if the bank acquires the title to such real property it cannot be held longer than seven years—unless the period is extended not exceeding five years longer—making twelve years in all.

73. A bank has ordinary power to lend money on warehouse receipts and bills of lading.

74. Also may lend money to any person engaged in the business of a wholesale manufacturer of any goods, wares and merchandise upon the security of the goods, wares and merchandise manufactured by him or procured for such manufacture.

(2) The bank may also lend money to any wholesale purchaser, or shipper of, or dealer in, products of agriculture, the forest, quarry or mine, or the sea, lakes and rivers, or to any wholesale purchaser, or shipper of, or dealer in live stoch or dead stock, and the products thereof, upon the security of such products, or of such live stock or dead stock, and the products thereof.

72. A bank may also lend for the building of a ship or vessel and take a mortgage or other security.

76. Material or goods on which a bank has a lien, by warehouse receipt or pledge, may be converted by manufacture without the bank losing its lien.

77. All advances so secured have priority to the claim of an unpaid vendor, unless he had a lien on such goods, of which the bank was aware.

78. In case of default, bank may sell goods by auction.

80. A bank is not liable to any penalty or forfeiture for usury, and may stipulate for and receive, or may take in advance, any rate not over seven per cent.

81. And no negotiable instrument shall be void on the ground of usury. These sections relating to usury are considered unnecessary. Prior to 1858 usury laws existed in Canada and these are inherited from that period.

84. A bank may receive deposits from any person, whether qualified by law to contract or not, and may repay, unless the money is lawfully claimed by another. But deposits under this authority must not in any one case exceed $500. And the bank shall not be bound to see to the execution of any trust in relation to such deposits.

RETURNS TO GOVERNMENT.

85. Banks must send to the M. of F. and R.-G. a statement to the close of each month. This return covers a very full statement of assets and liabilities under uniform headings, and is published in the Government Gazette.

86. Special returns may be called for at any time.

87. A list of shareholders must be supplied each year, with addresses and number of shares held. This information is published in a blue book and is examined by investors who try to judge by the changes from year to year as to the estimation in which certain banks are held.

88. In accordance with a policy gradually being recognized throughout the world, an addition was made to the Act in 1890, by which banks are required to report to Government the unclaimed moneys in their hands. These statements also appear in a blue book for the information of the public. The liquidator of a bank after three years must pay over all such amounts remaining unclaimed, together with all interest due, and the Government shall hold these in trust for the owners, continuing interest where it was contracted for, at 3 per cent. per annum. A liquidator must also after three years pay to the Government an amount equal to the outstanding circulation, to be held in trust for the holders of such notes.

CURATOR.

In case a bank suspends payment the Canadian Bankers' Association (incorporated 1900) shall at once appoint a Curator to supervise the affairs of the bank, who shall have all powers, and do all things necessary to protect the interests of the creditors and shareholders, and he shall continue those duties until he is removed from office, or until the bank resumes business, or until a liquidator is duly appointed to wind up the business of the bank. (This is part of the Amendment Act of 1900).

INSOLVENCY OF BANKS.

The first of the insolvency clauses is that fixing the double liability, while several sections are devoted to provisions for enforcing it. The early banks of Old Canada had no provision for a double liability of shareholders, but the charter of the Bank of Nova Scotia (1832) contained the provision, while the Committee for Trade recommended its adoption by Old Canada, and long before Confederation (1867) it was recognized as a principle. There was a time when many doubted the practical value of the power to call on shareholders, for a second payment to the extent of the face value of their shares. Questionable things were done to avoid paying.

Shares were transferred by the knowing ones just before failure, to others with whom money could not be collected. Or it was found that the real holder was already a debtor to the bank, and could not meet this in addition to his other liabilities.

In the failures of recent years the percentage of the double liability collected has prevented the creditors from suffering. The conditions laid down by the Act make it almost impossible to avoid payment for any reason except inability.

Section 94 makes it clear that failure on the part of a shareholder to pay calls re double liability, shall operate a forfeiture by him of all claim to any part of the assets of the bank. Such calls and any further calls being recoverable from him nevertheless. And Sec. 96 says: Shareholders do not escape liability unless their stock has been transferred more than 60 days prior to a suspension of payment. By Sec. 90, which was inserted in the Act of 1890 the liability of a bank for any moneys deposited, or dividends collected, continues notwithstanding any statutes of limitations. Sec. 91 provides that suspension for 90 days, either consecutively or at intervals during 12 months, constitutes insolvency and forfeit charter, except for purposes of liquidation. The Act is full of penalties, both in the shape of fines and imprisonment. In enforcing promptitude in making Government returns and for over issues of circulation, they are certainly severe and effective. Sec. 100 is intended to prevent private bankers from using titles which might convey the idea of incorporation, such as "Bank," "Banking Co." etc. In dealing with this subject I have endeavored to bring to your notice the general features of the Bank Act of Canada, not dwelling on each section of the Act, as too much detail only serve to make this already too lengthy paper more tiresome.

Before taking my seat, however, I would like to read a paragraph from an address by Mr. B. E. Walker, to the Congress of Bankers at Chicago, delivered in 1893.

AN OLD STORY.

Queen Elizabeth of England was not a thoroughgoing spinster, for she had so little prejudice against the practice of smoking that she permitted Sir Walter Raleigh his pipe in the royal presence. She was sufficiently a woman, however, to twit him openly on his devotion to the weed, and it was on one of these occasions—or so the author of "The Soverane Herbe" shrewdly surmises—that the knight replied:

"I can assure Your Majesty that I have so well experienced the nature of it that I can tell even the weight of the smoke in any quantity I consume."

"I doubt it much, Sir Walter," replied Elizabeth, holding it was impossible to weigh smoke, and mayhap scenting a joke, "and I will wager you twenty gold angels that you do not solve my doubt."

Gallantly accepting the wager, Raleigh filled his pipe with a weighted quantity of tobacco, smoked it out and then, weighing the resultant ashes, announced the weight he had smoked away.

"Your Majesty cannot deny that the difference has disappeared in smoke."

"Truly, I cannot," answered the Queen. Ordering the wager to be paid, she turned to the courtiers around her and said: "Many alchemists have I heard of who turned gold into smoke, but Raleigh is the first who has turned smoke into gold."

A LITTLE MISTAKE.

Words are the only means of expressing some ideas. As two of the characters argue in one of Doctor Hale's stories, gestures will not express the Declaration of Independence nor the "Elegy in a Country Churchyard." A funny instance of the failure of signs appears in a story told by The New York Sun:

"I shall never forget my first visit to Madrid," said a lady. "I was the only member of our party who knew any Spanish, and I knew but one word, that one being 'leche'—milk — but by means of gestures we managed to get along until breakfast was served. Then, as luck would have it, the maid brought my coffee without any milk in it, and also, as luck would have it, I promptly forgot the one word of Spanish I knew, and which of all words was the one most wanted at that moment.

"This time neither gesture nor yelling was of any avail, so at last in desperation I seized a piece of paper and a pencil and drew a picture of a cow. Thereupon the maid tripped off and came back with three tickets to the bull fight."