

# The Canadian Clearing House System

## The Purpose and Operation of the Clearing House System in Adjusting the Daily Balances of Canadian Banks

By G. W. MORLEY,

Secretary, The Canadian Bankers' Association.

What is a Clearing House—is the question often asked by the layman. Used in the original sense, it is an ingenious device to simplify and facilitate the work of the banks at a particular centre in reaching an adjustment and payment of the daily balances due to and from each other at one time and in one place on each day. In practical operation it is a place where all the representatives of the banks in a given city meet, and under the supervision of an officer (called the manager) selected by the member banks, settle their accounts with each other and make or receive payment of balances and so "clear" the transactions of the day for which the settlement is made. Stanley Jevons has well said "clearly the tendency in modern economic life is to do away with the instrument of exchange and bring us back to the direct exchange of commodity for commodity, i. e., to barter."

The Clearing House really reverts to a species of barter. These huge bundles of cash, cheques, bills of exchange, and negotiable paper which day by day are exchanged for each other, simply represent innumerable boxes, bales, barrels, munitions of war, and car loads of all kinds of merchandise, which have been exchanged for each other. For those who look behind the mere appearance of things, the clearing house is a colossal bazaar, like those which exist among African tribes or which existed in the days of antiquity. The only difference is that here not the goods themselves are exchanged, but the certificates that represent them.

But I must go a little farther than this in the definition given above, for though originally designed as a labor saving device the clearing house has expanded far beyond those limits, until it has now become a medium for united action among the banks in ways that did not exist even in the imagination of those who were instrumental in its conception. It, therefore, might be called a medium for united action upon all questions affecting the mutual welfare of the banks.

### Overlapping of Borrowing.

In this connection it is most interesting to know how far the banks have gone. In San Francisco, the clearing house appointed an examiner, independent of any bank, to make an inspection of all the banks and ascertain to what extent the overlapping of borrowing was carried on, and it is noteworthy that at a recent meeting of the Canadian Bankers' Association it was recommended that members of the clearing houses at various points compare notes as to such overlapping of borrowing in order to prevent the practice of the public "playing" one bank against the other in the question of lending money. It is likely that the recommendation will be adopted at all the clearing house points except Toronto and Montreal. John Brown, for instance, cannot, after borrowing money from Bank "A" to the extent of \$500 go to Bank "B" and borrow another \$500 without the knowledge of the two banks interested, that is at places where this rule will be put into effect.

### Clearing House Centres.

Clearing Houses are naturally established at the most important commercial centres. In Canada there are now twenty-five in number at the points mentioned below, three of which are in British Columbia, four in Alberta, three in Saskatchewan, two in Manitoba, eight in Ontario, three in Quebec, one in New Brunswick, and one in Nova Scotia. Of these Halifax led the way in 1887, followed by Montreal in 1889, Hamilton and Toronto in 1891 and Winnipeg in 1893. Fourteen of them have been established within the last ten years and two of these fourteen namely Kitchener and Sherbrooke have been added to the list since 1st January last. The following list of clearing houses in Canada, showing the totals for the year 1915, and the medium of settlement in each case, indicates how rapidly the system has been expanding:

| Clearing House.  | Total for year 1915. | Medium of Settlement. |
|--|----------------------|-----------------------|
| Brandon . . . . .  | \$ 27,132,123        | Draft on Winnipeg     |
| Brantford . . . . .  | 26,640,280           | Draft on Toronto      |
| Calgary . . . . .  | 169,758,599          | Draft on Winnipeg     |
| Edmonton . . . . .   | 105,834,955          | Draft on Winnipeg     |
| Fort William . . . . .   | 24,674,671           | Draft on Winnipeg.    |
| Montreal or Toronto. (According to where the head of the Bank is situated in whose favor the settlement is drawn). |                      |                       |
| Halifax . . . . .  | \$104,414,590        | Draft on Montreal     |
| Hamilton . . . . .   | 151,420,271          | Draft on Montreal     |
| Lethbridge . . . . .   | 19,740,223           | Draft on Winnipeg     |
| London . . . . .   | 89,774,787           | Draft on Montreal     |
| Medicine Hat . . . . .   | 13,503,194           | Draft on Winnipeg     |
| Montreal . . . . .   | 2,628,122,428        | Legals                |
| Moose Jaw . . . . .  | 42,634,319           | Draft on Winnipeg     |
| New Westminster . . . . .  | 13,460,086           | Draft on Vanc'ver     |
| Ottawa . . . . .   | 211,636,519          | Draft on Montreal     |
| Peterborough . . . . .   | 20,970,677           | Draft on Toronto      |
| Quebec . . . . .   | 158,325,906          | Draft on Montreal     |
| Regina . . . . .   | 87,122,611           | Draft on Winnipeg     |
| St. John . . . . .   | 77,533,868           | Draft on Montreal     |
| Saskatoon . . . . .  | 50,146,848           | Draft on Winnipeg     |
| Toronto . . . . .  | 1,185,956,257        | Legals                |
| Vancouver . . . . .  | 281,575,949          | Legals                |
| Victoria . . . . .   | 76,677,926           | Draft on Vanc'ver     |
| Winnipeg . . . . .   | 1,630,683,124        | Legals                |
| Sherbrooke (Opened since January) . . . . .  |                      | Draft on Montreal     |
| Kitchener. (Opened since 1st January) . . . . .  |                      | Draft on Toronto      |
|  | \$7,097,740,211      |                       |

### Redemption and Payment of Notes.

Owing to the elasticity of our note circulation in Canada which is assisted by the provisions of Section 70 of the Bank Act, clearing house certificates are not used as a medium of settlement as is the case in the United States. Section 70 of the Bank Act is worded as follows:

"The bank shall make such arrangements as are necessary to ensure the circulation at par, in any and every part of Canada, of all notes issued or re-issued by it and intended for circulation; and towards this purpose the bank shall establish agencies for the redemption and payment of its notes at Toronto, Montreal, Halifax, St. John, Winnipeg, Victoria, Charlottetown, Regina, and Calgary, and at such other places as are, from time to time, designated by the Treasury Board."

The Treasury Board has not designed any other places for redemption than those mentioned, and it is to be noted that one place is named in each of the nine Provinces of the Dominion where a bank must arrange to redeem and pay its notes, whether it has an office or agency in that Province or not. This provision was first made in 1890, but before that time notes of a bank were sometimes subject to a small discount in places remote from any of its offices.

### Emergency Measures.

The medium of settlement it will be noticed after reading the above list, is for the most part by means of drafts on Montreal, Toronto, Winnipeg and Vancouver, and at these four points alone do the banks settle in legals. It must, however, be remembered that the Great War has been responsible for many radical changes in the practices of the banks in settling balances at the clearing house points.

Prior to August, 1914, settlements at Montreal, Toronto, Winnipeg, Vancouver, Quebec, Halifax, St. John and Victoria were made in legals (Dominion notes), but the following month, when money began to get tight, the banks wished to concentrate and centralize cash reserves at convenient points, and accordingly arranged for settlement of daily balances by means of cash only at Montreal, Toronto, Winnipeg and Vancouver. It was decided that henceforth Quebec, Halifax, St. John and Victoria should settle by draft on Montreal. But in the beginning of October, 1914, the British Admiralty advised the Canadian authorities that it was likely

Victoria and Vancouver would be bombarded as a result of the operations of the German squadron (commanded by Von Spee) in the Pacific Ocean. The banks represented at the Pacific Coast, forthwith, made rush shipments of legals, gold and a large portion of their own notes to Winnipeg for safety, and it was arranged that Vancouver should settle by draft on Winnipeg.

### Payments in Bank Notes.

About the same time it was suggested that as provision had been made by a proclamation under the Finance Act (passed immediately after the war broke out) that the Chartered Banks of Canada were authorized to make payment in the Bank Notes issued by them instead of gold or Dominion Notes, they should settle at Toronto, Montreal and Winnipeg by means of interest bearing certificates payable to bearer issued against authorized circulation in denominations of \$1,000 and multiples thereof. If the Banks had taken full advantage of the privileges granted by the Government and had adopted the suggestion mentioned, it would have been within the range of possibility that the banks would have evaded or indefinitely postponed payment of their obligations; and it was possible that, as a result the country would have been placed to a certain extent on a flat money basis. The scheme, however, was not favorably considered and consequently no bank at the central points has been able to evade payment in legals. It is quite possible, however, that such a medium of settlement as was suggested might be adopted with advantage by the Winnipeg Clearing House says in October, November and December of this year and each year while the war lasts, owing to the largely increased volume of grain business undertaken during those months. In the late autumn especially the question of providing large legal tenders for the settlement of clearing house balances has become a serious problem in the western metropolis, and the Dominion Government was asked to arrange for telegraphic transfers between Banks of large legal tenders as between the offices of the Assistant Receiver General at Winnipeg, Toronto and Montreal, so that the necessity would be done away with for carrying large amounts of legals by the Banks.

In April, 1915, the Canadian Bankers' Association consulted the Vancouver Clearing House respecting these three questions:

- (1) Shall a return be made to the former plan of settling balances by legal tender?
- (2) Shall the present system be continued for a time—settlement by draft on Winnipeg?
- (3) Shall the following combined plan be adopted:—Settlement by draft on Winnipeg for all amounts of \$5,000 and less. Settlement for sums over that amount by telegraphic transfer to Winnipeg at expense of paying bank? It was finally agreed that, as all danger of bombardment had passed, on and after 1st May, 1915, the Vancouver Clearing House should settle daily balances by means of legal tenders and the Canadian Bankers' Association ruled that after the same date all other Clearing Houses in British Columbia (i. e., Victoria and New Westminster) were to settle by draft on Vancouver.

### Comparison of Clearing House Returns.

Far too much emphasis is laid upon the returns of the Canadian Clearing Houses by financial papers (especially by way of comparison) for the following reasons:

First.—While clearing house statements are valuable for the purpose of showing the business of the banks and acting as an idea of the internal trade of a certain neighborhood, it must be borne in mind that it is not an accurate statement of internal trade, because amounts of transactions taking place between two customers of the same bank do not appear.

Secondly.—On account of the fact that twenty-one out of twenty-five clearing houses settle by means of drafts on four centres, the figures of the clearing houses at these four centres are inflated. If one looks at the figures of the clearing houses mentioned above, he will see that the returns of Montreal and Winnipeg for the year 1915 surpass those of Toronto. It must be remembered, however, that all centres like Ottawa, Hamilton, London, Halifax Quebec and St. John and also Victoria (up to 1st May in that year) settle on Montreal, whereas all the clearing houses in the prairie provinces and Vancouver (up to 1st May, 1915) settle on Winnipeg. It must be borne in mind also that in Winnipeg when a local bank requires a supply of legals for settling purposes the manager of the clearing house usually arranges a sale of legals by another bank which takes in exchange a draft on Montreal. Anyone who

(Continued on page 18.)