

BANK SHARES AS AN INVESTMENT.

Majority are Gilt-edged Investments, but Question of Liability is Important Consideration.

Since the failure of the Farmers Bank, discussions have been frequent as to the value of bank shares as an investment. They hold an unique place in the category of investment securities. Most of them are gilt-edged investments, but the liability attaching to them naturally debars them from being held by trustees or by investors who do not care to accept such a risk, however remote. But for this matter of liability, points out a writer in the London Financial Times, bank shares would stand at much higher prices than they do. As things are, it is possible at present to get yields of 4½ to 5 per cent. upon the best English bank shares—the average return upon the shares of six leading institutions is 4½ per cent.—while the shares of many leading colonial and foreign banks under British management offer returns of 5½ up to 6½ per cent. The special attraction about the share of a good bank is the knowledge that the liabilities are offset by nothing else but tangible assets. Fancy valuations for goodwill, over-valuations of plant and premises (through neglect to sufficiently write down) and other questionable items that frequently disfigure the balance-sheets of many industrial companies can have no place in the balance-sheet of a bank. Ready convertibility of the assets into cash is one of the first maxims of banking. Further, the total shown on the assets side of the balance-sheets of banks in many cases is probably an under-estimation.

Are These Secret Reserves?

It is a popular tradition that British banks, at any rate, hold secret reserves. We are unable to probe the secret to its foundation, but there is little doubt that one form of secret reserve at least exists—namely, the writing down of premises below their real value. In this matter the Bank of England, the keystone of the banking arch, sets a remarkable example, for in its own balance-sheet it does not take credit to the extent of one penny for its enormously valuable site and buildings in the city that cover a district in themselves.

In the past ten years a substantial fall has taken place in the value of English bank shares. This is due in part to reductions in dividends necessitated by the constant writing down of Consols and other gilt-edged security holdings since 1903. But the main reason for the fall has been simply connected with the readjustment in the yields of all high-class stocks. This may be seen from the fact that, whereas a decade ago the average return upon domestic bank shares, at the then current prices, was only about 4 per cent., the return obtainable to-day averages over 4½ per cent.

Fall in English Bank Shares.

The fall in English bank shares during the last few years contrasts with an advance in the shares of many banks working abroad, the remarkable increase of prosperity in such "new" countries as Canada, Argentina, Mexico and Egypt having been taken full and very profitable advantage of by the banks located there. In the matter of depreciation of investments it is probable that our banks have at last got down to bedrock, and in view of the brightness of the trade outlook and the steady development that is going on in the banking business of the country this probability enables us to take a distinctly cheerful view of the market. There is one point, too, arising out of the question of writing down investments that is worth making. The London and Provincial Bank, for instance, which since 1903 had devoted no less than £643,000 to writing down its securities. "At December 31, 1903, the security holdings of the London and Provincial Bank amounted to about £4,000,000, and they have since arisen to about £4,500,000. A depreciation of £643,000 upon such a holding would represent about 15 per cent., which is, of course, a serious matter for the shareholders in the sense that this sum would otherwise have been available for dividend. At the same time, it has assisted the management in retaining money in the business, since in all probability the whole of the £4,000,000 represented in the holdings of 1903 returns the same rate of interest as then, and the money set aside for depreciation has really gone either to buy fresh securities, and so increase the revenue, or to the general business of the bank, and so has increased its earning power."

Policy of Amalgamation.

There is one other consideration, affecting more especially British companies, that adds to the attractiveness of bank shares from the security point of view; we refer to the amalgamation policy that has been so actively developed of late years. Whether the elimination of the local banker through absorption of his business by the large joint stock bank has brought unmixed benefit to the trading community

is a matter that has been much debated; we do not propose here to express an opinion beyond saying that undoubtedly amalgamation has meant greater safety. The danger attaching to some of the old local concerns was that they lent too much upon one form of security, and that unduly large amounts were advanced to a few particular individuals. The failure of the City of Glasgow Bank was due to the latter cause. When the position of that Bank was examined it was found that the Bank had lent as much as £6,000,000 among four customers. Gilbert says:

"Almost every bank that has failed can point to some one, two or three large accounts to which it mainly attributes its failure." Banking developments of recent years, through the extension of the amalgamation principle, have greatly minimized the danger of the banks holding an undue interest in one particular industry or of advancing disproportionate amounts to a few individuals, while the concentration of control in the hands of a few immensely powerful institutions means that in times of stress funds can promptly be transferred from one district where the credit machine is running smoothly to the place that constitutes the center of disturbance.

Question of Liability.

We now come to the liability attaching to bank shares. This is a consideration which must be carefully studied by the prospective investor, for there is no one international law governing the liabilities of bank shareholders. Foreign countries and the colonies have their own legislation on the subject, and, again, some banks work under special charters which exempt them from certain of the provisions to which their rivals must adhere. In this country the liability of bank shareholders is limited to the amount of the capital subscribed, because the joint stock banks do not issue notes. The uncalled capital of the banks is often divided into two forms, part being callable liability and part reserve liability. To take an example, the shares of the London Joint Stock Bank are of the nominal value of £100, of which £15 has been paid up.

Of the balance of £85 uncalled £35 is callable—that is, it can be called up at any time for the purpose of the Bank, and £50 constitutes reserve liability, by which is meant that it cannot be called up except in the event of, and for the purposes of, the company being wound up. In the event of liquidation the liability of shareholders in limited companies extends in this respect to one year after the date of the transfer, but there is the limitation that all present shareholders must first be exhausted, and, further, that past shareholders are in no case responsible for debts incurred after they ceased financial connection with the company.

Calls on Capital.

In recent years the calling up of a portion of the uncalled capital has in numerous instances, particularly with foreign and colonial banks, involved handsome bonuses to the shareholders, owing to the premiums which the old shares commanded. The possibility of calls being made under less pleasant conditions must not be entirely lost sight of, but with most of the old established banking institutions the danger attaching to the uncalled liability is exceedingly remote. In this connection the writer recalls a conversation that passed a few years ago with an astute stockbroker who was about to invest a large portion of his private capital in the shares of one of our principal English banks. The broker conceived the idea of insuring against the uncalled liability risk and approached a friend who was a member of Lloyd's. The latter expressed himself as quite willing to undertake the risk for a nominal premium, but added naively that it would be like taking money under false pretences to accept the premiums, "because if the —Bank goes, then we go too, and half Lloyd's as well."

Canada's Law Is Rigorous.

On the score of liability for capital and note issue that attaches to the shares of banks abroad, it is impossible to make anything like an exhaustive survey; intending shareholders ought to obtain full information in each individual case. The law obtaining in Canada is particularly rigorous upon bank shareholders. The Canadian Bank Act of 1890 provides that in the event of the property and assets of any bank of issue incorporated thereunder being insufficient to pay its debts and liabilities, each shareholder shall be liable for the deficiency to an amount equal to the par value of the shares held by him, in addition to any amount not paid up on such shares. This Act excepts La Banque du Peuple and the Bank of British North America. The Companies Acts of Queensland, New South Wales, Victoria and Tasmania provide that no bank of issue registered as limited thereunder shall be entitled to limited liability in respect of its note issue. The Natal Bank works under a local law embodying a similar provision, but the Standard Bank of Africa and the Bank of Africa are not affected by any local Acts or Charters. In New Zealand each bank doing business has its private Act (the provisions of which govern the issue of notes by each respective bank) except the Bank of Australasia, whose Royal Charter is equivalent to an Act of the New Zealand Parliament.