LOANS' AND DISCOUNTS SYSTEMS

Of Europe and America Compared — Difference in Methods—Two Classes of Loans Commonly Employed Overseas.

The inherent test of the soundness of any loan or credit is its ability at maturity to liquidate itself. So spoke Mr. J. T. Talbert, vice-president of the National City Bank in an address before the American Institute of Banking. He pointed out the difference between the American and particularly the U.S. system of loans and discounts and that which exists in Europe.

A loan is a present advance of cash or of credit against a belief in its future payment. Credit means belief. A loan may be either in the form of a cash advance, or of a credit upon an open account, or against a written promise to pay, which in the ordinary form is the promissory note of commerce. The effect of a loan is the same, in whatever form it may be made. When a loan is made a credit thereby is created, a new power to purchase goods or to pay debts is born, an active and potential force is set in motion, and that force exists and continues to exert an influence until it is quieted by the extinguishment of the debt.

Ability to Liquidate.

The inherent test of the soundness of any loan or credit is its ability at maturity to liquidate itself. Now we begin to arrive at an understanding of the reason why mercantile loans of high class are everywhere considered desirable. It is because of their inherent power of self-liquidation. A secured loan may be immeasurably safer against risk of eventual loss, because of the security placed behind it, but such loans may be far less desirable as banking risks because of the uncertainty of their repayment without sacrifice at a given time.

Seeing now the safety of trade loans, and the reasons from a banker's point of view why they should be so regarded, we come to consider two classes of loans (growing out of legitimate trade transactions) which are commonly employed in Europe. It is our purpose to contrast the use made of these credits in Europe with that made of actual trade loans in this country. The first of these two classes, of course, is acceptances, whether made by banks or by firms. The second is the ordinary trade note, made on short time and bearing two or more signatures. In Europe it is the usual practice where credit is extended between tradesmen to settle the transaction by one or the other of these methods. The resulting paper runs anywhere from 30 to 120 days, although from 60 to 90 days is the custom.

Three Kinds of Acceptances.

Acceptances are of three kinds. All embody the same principle, and involve but slight modifications in detail. A merchant instead of borrowing cash or taking book credit of his bankers may arrange to borrow the use of the bank's credit for a certain length of time and up to a certain amount. To make this credit available he draws his time drafts on the bank. The bank accepts these drafts for a commission varying with the circumstances, but the customary charge is ¼ of 1 per cent. After procuring the bank's "acceptance" the merchant may use these credits directly in the settlement of his trade bills, or he may sell the acceptances through bill brokers in the open market. In the case of acceptances made by prime banks (that is banks in the highest standing and credit) the paper always finds a ready sale at advantageous rates. If instead of selling the accepted bill in the open market the tradesman chooses to discount it with another tradesman, the merchant receiving it may readily rediscount such a bill at his own banker's, or he may sell it through brokers, with or without his endorsement.

Credits are Safely Absorbed.

Drafts flow in from all quarters of the earth whence goods are imported, and these credits are silently and safely absorbed. Let us examine now into the secret of the matter. It is not a mystery to bankers engaged in international trade, but it is none the less a subject of absorbing interest to all who study it. There are two explanations of this enormous and apparently easy power to absorb trade indebtedness. The power of a bank to accept a draft enables it to make use of, and to sell for a legitimate profit, its credit on short time without parting with its reserve money. Through the sale of this credit trade goes on and is financed while the banks' cash reserves are held to meet current demands or to serve as a basis for direct loans and advances. The acceptances of leading London banks amount normally to about twenty million pounds sterling, or say roughly $100,000,000. London banks, therefore, through their power to grant acceptances are enabled to lend for legitimate uses in trade vast sums without depleting their reserves one pound and without impairing to the extent of a single farthing their power to make additional loans or cash advances directly to borrowers. The same is true in practically all the great European countries. In our own country, because banks are not permitted to lend their credit, the granting of $100,000,000 of additional loans in any central reserve city would mean the immediate withdrawal from the channels of trade and the locking up of $25,000,000 of gold or legal tender money.

In the U. S. there is no system of acceptance at all. Time drafts drawn by foreign shippers on American importers must all go to London for acceptance. American banks are deprived of that business because they are denied the right to accept drafts or to lend their credit. So drastic is the law in respect of this in the case of national banks that it is made a criminal offence to accept a draft or a check on open account, or even against securities in hand, or under any circumstances except against an actual balance subject to check on the bank's book at the credit of the drawer. This law was, of course, not designed by its framers to hamper legitimate trade transactions, but such is its effect in actual practice. No distinction in such cases is made between actual trade drafts or checks and those which represent speculative operations. Therefore the operations of lending and of discounting are confined among our banks to advances of cash or of book credits to a customer, subject to his check, against which, of course, a reserve must be carried; or to the purchase of notes, misnamed "commercial paper," which may be offered in the open market by note brokers, generally on single names and unsecured. The purchase of such securities involves the necessity of paying out by the bank of the total amount of the proceeds of such notes to the depletion of its cash reserves and to a corresponding extinction of its power to lend. Trade paper bearing two or more names of the better class practically is unknown in America.

CABLED NEWS FROM LONDON.

Canadian Northern Issue Fully Subscribed—Reciprocity and Investments.

(Cable Correspondence by Special Arrangement with The Montreal Star).

March 16.—The Canadian Northern issue of £1,000,000 was fully subscribed. In order to secure its success, the bankers adopted the unusual course of having the issue underwritten firm.

Another issue is noted, that of the India Government, of a new 3½ per cent. loan of £3,500,000 at 96.

Underwriting arrangements in progress foreshadow numerous issues by various industrial companies. There is also a good deal of private selling of bonds of various kinds in the money market, and reports are current of the placing of a line of 4 per cent. debenture stock of the Canadian Northern Railway at a little under 101, with principal and interest guaranteed by the Province of Manitoba.

Reciprocity and Investments.

Two or three leading financiers, when asked, attributed the fewness of transactions now taking place in Dominion government stock to the reciprocity agreement. The market is also slow for provincial government and municipal securities.

These authorities recall how easily the British investor was led to desert the South African market and to sag in his interest in Argentina.

Canada's present favor is largely due to the greater range of her securities, including government stocks of many kinds, municipal issues, railways, mines and industrials of great variety.

What some of the most conservative-minded financiers here fear chiefly is the growing tendency to draw small British investors into purely speculative Canadian concerns. A temporary setback in Canadian conditions and the consequent failure of these concerns to earn dividends must, they believe, set up a mild kind of general anti-Canada panic here, and put an effectual check upon the flow of British capital into Canadian developments of all kinds.

March 18.—Application has been made to the London Stock Exchange to list the following Grand Trunk securities: £700,000 guaranteed 4's, and £1,400,371 perpetual 4's.

Rise in Hudson Bays.

March 18.—The rise in Hudson's Bay shares on American account is attributed here to the belief that the shares will be split by agreement with the board at the annual meeting in June, but I have the highest authority to state that the question has not even been discussed among the directors, nor is it likely to be, certainly not with a view of action in the near future.

New companies registered here include the Sydney, Cape Breton and Montreal Steamship Company, capital £70,000. The parties concerned are E. F. and W. Roberts of Liverpool, Bowring & Company, and the Dominion Coal Company.

British Columbia Railway Issue.

March 22.—Subscription lists were opened to-day for £600,000 4¼ per cent. perpetual consolidated debenture stock of the British Columbia Electric Railway Company at par.