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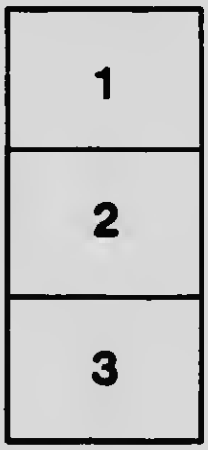

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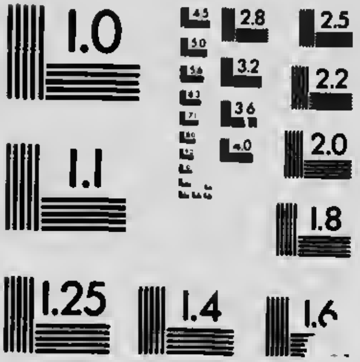

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Course in Banking

LESSONS III-VI

Money and Banking

LESSON III.

The Canadian Banking System.

Read: Money and Banking, Chapters 20 and 21.
Breckenridge, History of Banking in Canada, Chapters 1, 2, 3 and 4.

(A general knowledge of these chapters will be sufficient).

There are twenty-three banks in the Canadian banking system, possessing combined assets of $1,575,307,596 and liabilities of $1,330,488,768, according to the government returns of June 30, 1914. These banks have branches scattered throughout Canada from the Atlantic to the Pacific and many agencies and branches abroad. The system as a whole is so familiar to Canadian readers, and so complete is the information accessible elsewhere, that only the essential details of Canadian banking will be sketched, more attention being given to foreign systems. The full text of the Bank Act should be studied in connection with what is said here. Copies of the Act may be secured upon application to the Deputy-Minister of Finance, Ottawa.

Revision of 1913.

It is usual to revise the act every ten years. In the natural course of events it should have heen revised in 1910; but owing to conditions into which it is not necessary to enter here this did not take place until 1913. It is the Act as revised in that year, therefore, whose outline will be sketched.

The conditions under which a bank may be organized are as follows: An act of incorporation is obtained from Parliament by means of an application signed by five responsible men who are able to convince the Banking and Commerce Committee that the venture is a bona fide and sound one. If the committee reports favorably it may usually be taken for granted that Parliament will grant the charter. When letters of incorporation have been granted, after ten days' notice, the provisional directors may advertise for public subscriptions to stock, and cause stock books to be opened. No bank, however, can be incorporated with a capital less than $500,000, of which $250,000 must be paid in before it can begin business.

When these conditions have been met the provisional directors may, after four weeks' public notice, call a meeting of shareholders for organization purposes. At this meeting, the subscribers must elect five or more qualified directors to replace the provisional directors, and determine the date of the annual meeting, etc. A certificate from the Treasury Board—a committee of the Privy Council, usually five in number, of which the Minister of Finance is chairman permitting the bank to commence business may now be issued, provided that the following conditions have been met:

1. That the payments and subscriptions are all genuine and made in conformity with the law.

2. That the deposit of $250,000 with the Minister of Finance has been made, and is still in his hands.

3. That the directors are qualified and have been regularly elected.

4. That the expenses of incorporation and organization are reasonable.

5. That all other requirements have been met with.

When all these conditions are met, the $250,000—less $5,000 as an initial payment for the guarantee of note circulation—is returned, and a certificate issued, under which the bank may begin business.

> *Experience is an exhaustive dictionary; and experience has defined the conditions under which sound banking may be carried on. And if experience has emphasized one banking fact more than any other it is this — that the proper place to end unsound banking is where it begins. Banks are quasi-public institutions; they should, therefore, be organized under strict and definite regulations only.*

Bank By-laws.

The shareholders may pass by-laws regulating the following matters: the date of the annual meeting at which the shareholders elect directors; the number, quorum, qualifications, etc., of directors; limits of loans or discounts to directors or to any one person, firm or corporation; authority to contribute to guarantee and pension funds, etc. It was provided that copies of a bank's by-laws must be sent to the shareholders before the end of 1913, the year in which the Act was last revised, and thereafter within six months after the end of each fifth year.

The Board of Directors.

The property and concerns of the bank are managed by a board of directors who are elected annually, but who are subject to re-election. The qualifications of a director are as follows:

Each director shall hold stock of the bank as absolute and sole owner in his individual right, on which not less than $3,000 to $5,000 has been paid up, the amount varying according to the paid-up capital of the bank. This amount, however, may be increased by by-law.

The majority of the directors must be British subjects living in Canada. The rules are also laid down under which directors shall be elected, also the president and vice-president.

Shares and Shareholders.

Four or more of the directors, or twenty-five of the shareholders who own not less than one-tenth of the paid-up capital stock of the bank, may call a special general meeting at any time to consider matters of emergency.

Voting is by ballot, and each shareholder has one vote for each share owned. Shareholders may vote by proxy, but no shareholder who is also an employee of the bank is allowed to vote.

The capital stock of the bank may be increased at any time by by-law passed at a general meeting of the shareholders, subject, of course, to the approval of the treasury board. Provision is also made for the reduction of the capital stock if such action should become necessary.

There must be printed on each page of the stock book upon which subscriptions for new stock are recorded, and "on every document constituting or authorizing such subscriptions, on a part of the page and document, respectively, which may be readily seen by the person recording the subscription, or by the person signing the document, a copy of Section 125 of the Act," which provides for the double liability of the shareholders. The double liability feature is a most important safeguard for the depositor and noteholder, and should make for the sound conducting of a bank's affairs.

> *Not only in Canada but in the United States—in the National Bank Act and in the banking legislation of many of the different states—the double liability of shareholders has been made an integral part of the act under which banks are organized. The reason is that the depositors of the banks are creditors of an entirely different sort from those of other institutions. Moreover, this provision should make the shareholders doubly anxious to secure not only the keenest but the most cautious and conservative directors.*

Shareholders' Audit.

Until the Act was revised in 1913 the inspection of the head office and branches was left under the care of the banks themselves. This work was, on the whole, done efficiently and well. It is true there were several glaring cases of fraud and mismanagement, but considering the system as a whole, the inspection was efficient. Probably, in any event, too much stress has been laid upon inspection as a safeguard for Canadian banking. The safety of a bank depends, in last analysis, upon the skill and efficiency of its management, and the ability of officials to keep the assets sound and liquid. No amount of inspection will guarantee a bank against bad banking practice. That must be left to the ability, the judgment and the training of those in charge.

After the Farmers' Bank debacle, a demand arose for some sort of government regulation or inspection. It was felt, however, that such a procedure would throw too great responsibility upon the government. It would probably have led, among other things, to a demand for a government guarantee of note issues and deposits. In response, however, to the wish of a certain section of the public, the Act was so amended in 1913 as to provide for a shareholders' audit, in addition to the work of private inspection carried on by the banks themselves.

The general managers of the banks select a panel of not fewer than 40 auditors, who are approved by the Minister of Finance. From this panel the shareholders, at the annual meeting, select one or more auditors to make a report to the shareholders, covering the following:

(*a*) The accounts examined by them.

(*b*) The checking of the cash and securities.

(*c*) The statement of the affairs of the bank submitted at the annual meeting.

The auditors must also state:

(*a*) Whether they have obtained all the information and explanation they have required.

(*b*) Whether, in their opinion, the transactions of the bank that have come under their notice have been within the powers of the bank.

(*c*) Whether the cash and securities agree with the books of the bank.

(*d*) Whether, in their opinion, the statement referred to in the report has been properly drawn up so as to exhibit a true and correct view of the state of the bank's affairs, according to the best of their information, and the explanation given to them, and as shown by the books of the bank.

Every auditor of a bank has the right of access to the books, cash, securities, and records of the bank, and may require from the directors and officers such information and explanation as may be necessary for the performance of his duties. He may also visit any branch to look into its affairs if he deems it advisable. The expense of the audit is borne by the bank for which the service is rendered. The Minister of Finance may demand a special audit, in which case the expense is borne by the government.

> *Internal inspection has achieved at least as efficient results as government inspection, wherever the latter has been tried. The shareholders' audit may yield desirable results and prove an effective supplementary aid to internal inspection. But in last analysis the shareholders and the public must place their faith in the sound business practices of the men in control. It is both an art and a science to keep the assets sound and liquid; and that must be left to the judgment, skill and experience of the bankers themselves. For all the legislation in the world will not achieve these ends.*

Dividends.

Directors may declare quarterly or half-yearly dividends, but no dividend or bonus can be declared which shall impair the paid-up capital of the bank. Moreover, no dividend above 8 per cent. can be declared unless, after paying all bad and doubtful debts, the bank has a surplus or rest fund equal to 30 per cent. of its paid-up capital.

The leading banks of the world have been obliged by law to adopt the principle of compulsory reserves. In Canada, however, the banks are permitted to use their own judgment as to the amount of legal tender money which they shall hold by way of reserves in their vaults. The only regulation laid down in the Act which is compulsory is that, of the reserves which each bank's self-interest requires it to keep, at least 40 per cent. must be in Dominion notes. This regulation was established at a time when the Government felt it needed to find an outlet for its own currency. That time has long gone by and there appears at present to be no particular reason for enforcing this section of the law. The banks have found it very convenient, and have permitted the Government to bear nearly all the expense of holding Canada's gold supply, while they maintain a large part of their reserves in the form of Dominion legal tenders. In fact, only a comparatively small amount of the total value of Dominion notes outstanding is circulating throughout the country, the greater share being held in the vaults of the banks. Arrangements for issuing Dominion notes in exchange for gold and for redeeming them are made at the branch offices of the Department of Finance, namely: Toronto, Montreal, Halifax, St. John, Winnipeg, Victoria, Charlottetown, Regina and Calgary.

Beyond a doubt the Canadian system of voluntary reserves has worked exceedingly well. Legal minimum reserves impede, instead of helping, a bank's operations in time of crisis or monetary stringency. Generally speaking, the leading banking systems of the world require a fixed ratio between the legal tender money held in reserve and the demand obligations. It is perfectly plain that when that ratio has been reached, the demand obligations can not be increased without increasing the reserves. But in a time of crisis that is exactly what cannot be done. Gold and other legal money is scarce. At the first sign of panic, it is withdrawn from the banks and hoarded. If the crisis is world-wide, all the banks bid for gold at the same time and raise its value.

But if, as in the Canadian system, the banks can lend without regard to a fixed reserve, the situation lends itself to easier control. When it is found that loans can be secured on good collateral, confidence is restored; and the banks can gradually replenish their reserves as business conditions become easier.

> *Liquid assets are more important than heavy legal reserves. The good judgment of the banker, and the holding of sound, short-time paper, will provide a steady stream of payments to the bank, which are worth more than reserves of legal money, however important the latter may be. In a time of crisis, the important thing is to protect the customer, by granting him accommodation on good collateral. The necessity of maintaining a legal reserve may greatly hamper the bank under such conditions.*

Conditions of Note Issue.

The note issues of Canadian banks are limited to the amount of the paid-up capital stock, except from September to the end of the following February, when they may be increased by an amount equal to 15 per cent. of the combined paid-up capital and surplus, or reserve. On this issue a tax of fixe per cent. is payable to the Minister of Finance. The notes are payable on demand to bearer. No note can be issued for a sum less than five dollars, and higher denominations must be multiples of five.

In addition to the emergency circulation, designed to place the banks in a position to take care of the dealers and farmers at crop-moving periods, provision was made in 1913 for the issue of notes against the deposit of current gold or Dominion notes, or either, at any time. No tax is paid on such issues.

These "gold reserves", which form the basis of additional notes, are under the control of four trustees. Three are appointed by the Canadian Bankers' Association, and one by the Minister of Finance. It is the duty of the trustees to receive gold or legal tender from the banks, and to issue notes thereon up to the amount deposited. When any part of the amount deposited in the central gold reserves is not required for the purpose of issuing notes, the surplus, upon formal application, is returned to the banks. The central gold reserves are subject to frequent inspection and audit by the Department of Finance.

When all the provisions with respect to note issues are considered, it will be found that Canadian banks are in a peculiarly fortunate position as compared with the banks of other countries. No special security is demanded by the law as a basis for note issues—save in the case of the gold reserves—the notes being based upon the general assets of the bank. The Canadian notes are, therefore, possessed to the highest degree of the chief quality of an effective bank-note circulation—elasticity. They expand with ease, and contract by steady presentation through the various clearing-houses. They are as safe as any currency in the world; and form an almost ideal circulating medium for business men and the community at large.

Canadian banks may issue notes in pounds sterling at their agencies in any British colony or possession outside of Canada. The denominations of such notes are limited to one pound sterling or any multiples of that sum, and the amount issued in this way must be treated as a part of the general circulation of the bank.

Reference has already been made to the fact that each bank must maintain with the Minister of Finance a deposit equal to 5 per cent. of the average annual circulation as a guarantee of its note circulation. For all notes redeemed out of this fund, in the case of a bank that has gone into liquidation, the fund has the same rights against the estate of the failed bank as any other holder of notes. Interest at 3 per cent. is allowed by the government on the fund.

If a bank suspends payment of its notes, interest is payable thereon at the rate of 5 per cent. per annum until the day named for their redemption, of which public notice is given by the liquidator, after which interest payments cease. If after the expiration of two months from the date of suspension the liquidator has no funds to redeem the notes, the Minister of Finance may redeem them out of the Circulation Fund. If payment made from the fund exceeds the contributions of the failed bank, the other banks must recoup the fund pro rata for the amount of the excess, with right of recovery, of course, against the assets of the failed bank. For this purpose, however, no bank shall be required to pay in any one year more than 1 per cent. of the average amount of its notes in circulation.

Banks must make arrangements to redeem their circulation at par, and must maintain agencies for that purpose at Toronto, Montreal, Halifax, St. John, Winnipeg, Victoria, Charlottetown, Regina and Calgary, and at such other places as may, from time to time, be designated by the Treasury Board.

In making a payment a bank must, if required, pay in Dominion notes in denominations of $1, $2 and $5, not, however, exceeding $100 in any one payment.

It will thus be seen that Canadian bank notes are as safe and sound as it is possible to make them. They possess the quality of elasticity to a remarkable degree. They are superior to any government paper issue because of this very quality of elasticity. Canada is fortunate in possessing one of the most efficient bank-note systems in the world.

I. *Review Questions on Text.*

1. What, in general, is the difference between "general" deposits and "special" deposits?
2. What is meant by "kiting" cheques and drafts?
3. Outline the chief provisions of the first Dominion Bank Act (see Breckenridge).
4. Why will a bank usually make a loan to a depositor on more advantageous terms than to a non-depositor?
5. Should a bank pay interest on daily balances?
6. What is the value of a good banking connection?
7. Distinguish between investment and industrial loans.
8. Why are Canadian banks prohibited from making mortgage loans?
9. What were the characteristics of the earliest Canadian banks? (Breckenridge, Chapter I).
10. Describe the main features of the first private joint stock banks of Canada. (Chapter II).
11. Explain the causes of the failure of the free banking plan in Canada.

II. *Review Questions on Lesson.*

12. What force have bank by-laws?
13. What are the powers and duties of directors?
14. Should the double liability feature of Canadian bank shares be abandoned?

Questions requiring Written Answers.

15. What is the value of the shareholders' audit?
16. Explain the basis upon which note issues are made by Canadian banks.
17. Under what conditions may "investment" loans be wisely undertaken by the banks?
18. Raise any point that has given difficulty, either in the textbooks or the lesson.

LESSON IV.

The Canadian Banking System.

(Continued).

Read, Money and Banking, Chapters 22 and 23.

Breckenridge, History of Banking in Canada, Chapter 5. (A general knowledge, only, of this chapter is required).

Business and Powers of a Bank.

The business and powers of a bank may be very briefly sketched. Section 76 of the Act states that a bank may:

(*a*) Open branches and agencies.

(*b*) Deal in gold and silver.

(*c*) Discount and lend upon bills of exchange, promissory notes and other negotiable securities, or the stock, debentures and obligations of municipal and other corporations.

(*d*) Engage in and carry on such business generally as appertains to the business of banking.

Except as authorized by the Act, the bank shall not, directly or indirectly:

(*a*) Deal in the buying or selling of goods, or engage in any trade or business whatsoever.

(*b*) Purchase or deal in or lend money upon any bank stock, including its own—

(*c*) Lend money or make advances upon the security of lands, tenements or immovable property, or of any ships, or upon the security of any goods, wares or merchandise.

A bank may hold real property for its own use and occupation. It may take a mortgage on real estate or personal property by way of additional security for a debt already contracted. No bank, however, is allowed to hold property for its own use and occupation longer than twelve years.

Warehouse Receipts as Collateral Security.

A bank may lend money upon the security of standing timber and on the rights held by persons to cut or remove such timber.

Power is given to advance money for building ships and to take such security thereon as is permissible for individuals under the laws of the respective provinces.

Power is given to advance money on warehouse receipts and bills of lading.

The income of banks is derived from discounts, interest on their own capital, charges for exchange and collection, from investments, and profit from the issue of bank-notes. The banks are productive economic agents, performing important services for industry and commerce. They produce wealth just as truly as the factory and the farm. Through their activities the modern exchange economy is, to a large extent, made possible.

"*Section* 88."

Section 88 of the Bank Act has permitted the Canadian banks to become practically silent partners in the industrial and agricultural life of the nation. The clauses in Section 88 give the "exceptions" to the general rule that the banks may not directly or indirectly engage in trade and commerce; but these exceptions are so numerous and important that they have become the rule. The principal instances in which the banks may aid trade, commerce and agriculture, are as follows:

1. The bank may lend money to any wholesale purchaser or shipper, or dealer in products of agriculture, the forest, quarry and mine, or the sea, lakes and rivers, or to any dealer in live stock or dead stock.

2. The banks may lend money to a farmer upon the security of his threshed grain grown upon the farm.

3. The bank may lend to a manufacturer, upon the security of his goods and wares.

4. With the consent of the bank any of the above-mentioned goods may be removed for sale provided they are replaced with goods of like kind and quality, in which case the substituted goods shall take the place of the original security.

5. The bank shall, by virtue of such security, acquire the same rights and powers in respect to the products or grain so covered, as if it had acquired the same by virtue of a warehouse receipt; but the wages, salaries or other remuneration of persons employed shall constitute a prior claim.

All advances secured under Sections 86-88 have priority to the claim of an unpaid vendor, unless he had a lien upon the goods of which the bank was aware. One of the best features of this power given to the banks to advance money on goods in process of manufacture, is that the manufacturer can keep his business going and practically discount future sales to meet present needs. Notwithstanding all the criticism that has been launched against our banks, it cannot be denied that they have been a mighty force in the development of the nation's trade and commerce, and in extending national prosperity. As has been said, the banks are practically "silent partners" in Canadian industry.

Interest Rates.

A bank may agree upon the rate of interest which a borrower must pay, and may exact such interest in advance, but no higher rate than 7 per cent. is recoverable at law.

Canadian banks have been charged with levying a much higher rate of interest than 7 per cent.—as much as 8 to 12 per cent. having been charged, especially in the West. But critics should not lose sight of the fact that it costs more to transact business in the West than in the East. Rents, salaries and general expenses are much higher. While it is admitted that rates as high as 12 per cent. have been charged, it has generally been because of the great risk run. Borrowers who do not deposit to any extent, and who can not show successful records, must expect to pay more than the usual rates. However, it may be said that the ordinary rate of discount, throughout Canada, does not go higher than 6 per cent.

Banks may pay upon deposits any rate they choose. By a tacit understanding the Canadian banks pay 3 per cent. as a general rule; although the Weyburn Security pays a somewhat higher rate, 4 per cent. It may be said here that the chartered banks feel a grievance against the Government and Postal Savings Banks in that the latter also pay 3 per cent. on deposits. The Government institutions are not subjected to the ordinary risks of commercial banking, and do not give the same facilities as the chartered banks to depositors. In fact, the Government and Postal Savings Banks are little more than depositaries for the savings of the people. They hold a reserve of 10 per cent. in gold, and use the balance of the deposits for Government purposes. It is for this reason, therefore, that there is a general feeling among the chartered banks that 3 per cent. is too high a rate for the Government to pay—especially as the return should be adjusted to the pure interest rate, risk being practically eliminated.

Bank Mergers.

There have been several important mergers of Canadian banks in recent years; and a feeling grew up, which found wide expression in the press, that there was danger of the formation of a "money trust" in this country. Much good ink and paper were used up to show just how twenty-three men controlled the financial destinies of Canada, and how the merging of the interests of smaller banks with larger institutions meant less opportunity for the Canadian business man and the Canadian people. But nothing is farther from the facts.

Big, strong banks do not mean less competition, but more. At any rate, competition in itself may not mean lower rates to the borrower, but higher. Where four or five banks are doing the business of a small town where two or three alone are necessary, there are bound to be losses to all concerned. These expenses must be made up in some way, and in the end they come out of the public. It is better for all concerned that only sufficient branches be established to meet the demands of business; duplication of service merely means additional expenses to the banks and higher interest rates to the public.

Purchase of the Assets of a Bank.

In order, however, to safeguard all interests, the act as amended in 1913 put into force certain provisions to cover bank mergers.

Before a bank can enter into any agreement to sell the whole, or any portion, of its assets to another bank, it is necessary to obtain the consent of the Minister of Finance in writing. The agreement must then be submitted to the shareholders of the selling bank either at the annual or a special meeting. A copy of the agreement must be mailed to each of the shareholders, at least four weeks previous to the date of the meeting.

To effect the sale votes of shareholders representing not less than two-thirds of the value of the subscribed capital stock must be cast in its favor. The agreement may then be executed under the seals of the banks, and application made to the Governor-in-Council (practically the Cabinet) through the Minister of Finance, for approval.

If the agreement provides for payment in whole or in part in the shares of the purchasing bank the approval of the shareholders of that bank must first be obtained.

The approval of the Cabinet is not given until the Minister is satisfied that all the requirements of the act have been met, and the necessary publicity in the "Gazette" and certain newspapers given. The notes of the bank that is absorbed must be called in, redeemed and cancelled, as soon as possible.

> *Much has been said in Canada in recent years concerning the menace of the "money trust." In so far as this criticism has been directed against the banks it is utterly groundless. A great number of small, local banks would mean less competition, not more. There is strong competition among the banks in Canada, as is evidenced by the surprisingly uniform rate of discount in every section of the country. Competition has reduced inequalities to a minimum everywhere.*

Returns to Government.

Banks must send to the Minister of Finance a statement at the end of each month in a specified form. The Minister may call for special returns from any bank at any time.

Payments to Minister of Finance.

Within three years after a bank has gone into liquidation, the liquidator must pay to the Minister of Finance all amounts due to shareholders or depositors remaining unclaimed, together with interest due. The Government holds the money in trust, and must pay for six years interest at 3 per cent. on all interest-bearing deposits. Liquidators must also pay, within three years, to the Minister of Finance an amount equal to the excess of the outstanding notes above the amount to the credit of the failed bank in the Circulation Redemption Fund, the money to be held for the redemption of the outstanding notes.

If the property of a bank is insufficient to pay its 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.

Changes in Bank Statements.

The Act of 1913 made several important additions to the various statements that must be submitted by the banks, the chief of which are as follows:

Hereafter the gold and Dominion notes held by the banks must be stated separately. The same holds true of notes and cheques of other banks. By this change the notes of other banks can be arrived at, and the exact circulation in the hands of other banks ascertained. The former heading "Bank Premises" now reads: "Bank Premises at not more than cost, less amount, if any, written off."

"Deposits in the Central Gold Reserves" is an interesting item, the nature of which has already been explained.

"Loans to Cities, Towns, Municipalities, and School Districts" show the amount of temporary assistance granted by the banks to these several authorities. These advances are made in part in anticipation of taxes, but mostly in connection with proposed bond issues, where the by-laws authorizing them have already been passed. The amount of bank loans to municipalities is a good index of the future trend of the market for bonds, and should prove very helpful information to both brokers and municipalities with respect to future bond issues.

"Acceptances under Letters of Credit" on the liabilities side is offset on the asset side by "Liabilities of Customers under Letters of Credit, as per Contra." Although the bank is directly liable to its correspondents, these acceptances are drawn against bills of lading, and the obligation is further protected by the financial standing and credit of the customer himself.

"Bills Payable" is one of the most important of the new headings. It applies only to those banks who do a large business in Great Britain and Europe. "Bills Payable" is not defined by the Bank Act, but the intention is that the term should include all drafts, other than demand and sight, drawn upon and accepted by agents and correspondents in Great Britain and Europe.

These bills originate in the regular course of foreign exchange business. Some of them are thirty or sixty days bills sold to customers, who prefer this method of remittance to that of purchasing demand drafts or cable transfers. Others may arise through a desire to anticipate a change in the rate of exchange. They are known as "finance bills" as they arise through a monetary transaction and not through the shipment of goods.

I. *Review Questions on Text.*

1. Of what use is merchandise as collateral?
2. What are the risks run through lending on warehouse receipts?
3. From what sources is credit information secured?
4. What are the functions of the commercial note-broker?
5. What service does the dealer in commercial paper perform?
6. Should borrowers be obliged to keep on deposit 20 per cent. of their loans?
7. What were the causes of the crisis of 1873 in Canada? How did the crisis affect the banks?
8. What were the main changes made in the decennial revision of the Bank Act in 1880? What proposals were rejected, and why?

II. *Review Questions on Lesson.*

9. What is the substance of "Section 83" of the Bank Act? Why is this section so important?
10. What are the powers and business of a bank?
11. To what extent are warehouse receipts used as collateral security in Canada?
12. What are the regulations in the Act with respect to interest rates?

Questions requiring Written Answers.

13. What have been the advantages secured through bank mergers in Canada?

14. In what way do banks help to finance municipal undertakings?

15. How would you organize an efficient credit department for a bank?

16. Bring up any difficulty you may have met with.

LESSON V.

The Currency of Canadian Banks.

Read: *Money and Banking*, Chapters 30, 31, 32.
Breckenrldgc, *The History of Banking in Canada*, Chapter 5.

As far as Canada is concerned, government currency—the nature and extent of which will be later described—plays a small part in comparison with that furnished by the chartered banks. The currency provided by the latter consists of two constituent parts: (1) bank notes, and (2) deposit accounts.

The Function of Bank Notes.

Under normal conditions Canadian bank notes are not a legal tender, differing in that respect from the notes of the national banks of the United States. The effects of the war upon Canadian note issues and upon banking in general in this country will be fully discussed in a special bulletin. What is said here has reference only to the normal conditions under which the country's banking is conducted.

Canadian bank notes, then, simply consist of promises to pay legal money on demand, which means Dominion Government notes or Canadian, British and American gold coin. Silver and copper coin are legal tender for small amounts only —$10 and 25 cents, respectively.

The June statement (1914) shows that the greatest amount of bank notes in circulation during the month was $101,180,667. These notes find wide and easy circulation because of the safeguards with which they are surrounded. These may be enumerated as follows:

(1) The notes have a first lien upon the assets of the bank.

(2) They are protected by a five per cent. guarantee fund, made up of five per cent. of the annual average circulation of the Canadian banks. This fund is held by the Minister of Finance.

(3) If a bank should suspend payment the notes bear interest at 5 per cent. until the day named for their redemption, of which public notice is given by the liquidator, after which interest on the notes outstanding ceases.

(4) Shareholders in banks are under double liability.

It may be said, in passing, that not a dollar has been lost by a Canadian note holder since the present act went into force in 1890.

Notes are Elastic.

One of the striking features of the Canadian note issue is its elasticity—that is, its ability to expand and contract as occasion may require. This has not been true of the bank notes of the United States, nor of any European country. In these cases some sort of special security such as bonds or short-term commercial paper has had to be placed behind the notes. Up to the passing of the Federal Reserve Currency Act in the United States in 1913 the notes of the National Banks were secured by the pledge of government bonds. These conditions have been changed by the passing of the act mentioned, as it was recognized that the National Bank note circulation was too rigid and lacked the qualities of elasticity. But the systems of note issue of the American and European banks will be later described, and we may here confine our attention to the Canadian system.

Canadian notes are not based upon any pledge of any security with the government. Behind the notes will be found merely the general assets of the banks. They may be issued or retired upon presentation with the utmost ease. No special legal reserve is held by the banks against either the notes or the other demand liabilities. It is left to the banks themselves to determine what proportion of their demand liabilities (including notes) the banks shall hold in legal tender money. While the banks are not required by law to hold any legal reserves, they keep, as a rule, 15 per cent. of their demand liabilities in gold or Dominion notes. In addition to that, the call loans in New York and London, which are almost immediately available, may be regarded as a sort of secondary reserve. These call loans amounted in June, 1914, to $137,120,167.

Under ordinary circumstances the note issues of Canadian banks are limited to the paid up capital. This amounted, according to the June statement, 1914, to $114,811,775.

> *Canadian banks possess two distinct advantages over the system that has hitherto obtained in the United States: they have been left free to establish branches; and they issue notes on commercial assets. The result has been that a network of branches has been developed, which carries the most ample banking facilities to every part of the Dominion, and tends to equalize the rate of discount everywhere.*

Emergency Issues.

During periods of particular strain in the money market the Canadian banks may issue an additional supply of notes.

From September, to the end of the following February, the banks may issue above their ordinary limit an amount equal to 15 per cent. of their combined paid up capital and surplus. Upon this excess they must pay to the government a tax of 5 per cent. until it is retired. Obviously the banks make no profit upon notes issued under these conditions.

The revised act of 1913 provides for an additional method of issuing excess circulation at any time. The act provides for the establishment of a Board of Trustees at Montreal who may receive gold from the banks and issue notes thereon up to any amount whatsoever. Upon notes that are thus based upon gold no interest is paid. It may be expected that the banks will make large use of this privilege. It has been pointed out that no legal reserve is required of the banks in Canada, hence, in ordinary circumstances, they may temporarily withdraw gold from their vaults and issue additional notes when the country demands that method of payment. The privilege will be particularly helpful at times of moving the crops. Of course, in a period of crisis or in monetary stringency a bank could not weaken its position by withdrawing gold from its vaults for that purpose. The June statement (1914) shows that the banks had on deposit with the Board of Trustees, $3,050,000.

> *A banking system shows its real quality in times of stress and struggle.. That is the testing time for institutions as well as for men. Over and over again our banks have justified the confidence of the people in them, not only in times of smooth sailing when business seems to advance by the weight of its own momentum, but in times of danger and difficulty. The government has wisely provided for such emergencies; and our banks have invariably met with success every crisis they have been called upon to face. In the supreme test occasioned by the European war the banks once more have demonstrated their ability to take care of the business requirements of the people. They have more than justified the confidence the Canadian people have placed in them.*

Deposit Currency.

The same statement indicates that Canadian chartered banks have time deposits of $663,650,230 and demand deposits of $356,006,229. Deposits outside of Canada stood at $103,-061,603.

These are enormous sums, in the aggregate, and exceed the note circulation many times over. The important fact to be borne in mind in connection with the deposits is that they form a large part—by far the greater part, indeed—of the currency of the country. Business men draw cheques on these, and settle accounts in this way, and not by the payment of bank notes or Dominion legal tenders. Indeed, notes are used mainly in connection with retail trade, and for paying working men their wages. It is becoming the practice of Canadian banks to permit savings depositors to draw cheques against their accounts.

How Deposits Arise.

An enormous growth has taken place in the deposits of Canadian chartered banks during the past decade. These deposits do not by any means represent savings. Indeed, a very large part has arisen through loans granted on collateral, which have been left at the banks in the shape of deposit accounts. Business men settle their balances, as has been said, by cheque, and not by the payment of notes. As much of the deposits have originated in the first place through loans, it will be found that, as the loans increase, the deposits also grow.

Through deposits men have come back to the old stage of barter—refined barter, it is true, but still barter. They pledge the property they have—securities and so forth—at the bank, and by means of the purchasing power granted them exchange the goods they have for the goods of which they stand in need. Thus products on their way to completion in the factory, even before they are ready for market, may be pledged at the bank as a security for a loan; which, in turn, will permit the manufacturer to obtain the goods he needs. The bank insures the transaction. It loses if the goods are destroyed, or if the crop does not come to fruition. Thus, in last analysis, it may be said that the function of a bank is that of insurance.

To take another illustration: A farmer may need funds to buy a bill of goods, or to secure machinery for farm work. He may be out of funds, but has his stock and equipment and his crop sown. He cannot wait, however, until the harvest is gathered to secure the funds to meet his present needs. His only recourse is to go to the bank for the funds he needs.

On a two-name note he may borrow, say, $100. He then can make immediate purchase of what he needs. He looks to his crops, on their way to fruition, to liquidate the debt. When the wheat is placed on board the cars, or stored in the elevator, he can at once sell it and receive payment. He then discharges his debts at the bank. Of what does the whole transaction consist?

He simply "coins" his future goods—his crops—into a present means of payment. He exchanges his future products for the goods he needs, here and now. It amounts merely to the bartering of goods for goods. It is in this sense that credit may be said to be a refined state of barter.

Putting it in a short statement, credit may be defined as: "The coining of future goods into a present means of payment." Where credit is not based on the actual production of future goods it is unsound and speculative in nature. Much of recent Canadian operations has been of this class. Men secured credit at the banks, bought real estate and other speculative property, on the partial payment plan. They bought not as an investment, but merely looked for a rise in the market in order to sell at a profit. When they were suddenly called upon to pay they had not the means of meeting their obligations, and were forced to sell their holdings at a sacrifice. The market was glutted; prices fell and depression and hard times followed.

If Canada had borrowed—as the farmer in our illustration did—for productive operations she would have been on a sound basis, for the goods would have been forthcoming in due season to meet all obligations. There might have been a decline in prices due to a heavy selling movement, but there could not have been any period of lasting depression.

The Part the Banks Play.

What is the role of the banks in these operations? They guarantee that the obligations of the farmer, the merchant, or the manufacturer will be met. In other words, they issue their notes or grant deposit accounts, which afford an instant means of making payment. If the crops are destroyed or the merchant's goods lost by fire or failure, the banks ultimately carry the loss. In a very real sense, therefore, it may be said that the function of the banks is that of insurance.

> *The services thus rendered to the community by the institution of credit are inestimable. It should be noted, too, that the institution which thus coins saleable property into a means of payment for the borrower does so only after deciding that the goods at the basis of the transaction are marketable; that is, that notes or bills in any trade are safe business paper to discount. In a word, the act of coining property into an immediate means of payment is done on the responsibility of the lender; if the goods behind the paper are not saleable the lender—the bank—must stand the loss. Hence the supreme necessity on the part of the banker of judging correctly the value of the paper offered to him for discount.*

Notes and Deposits.

As against the huge deposits in Canadian banks already mentioned, the banks have a relatively small note issue — amounting to only $101,180,667 at this period (June, 1914). A borrower has the option of taking notes or running a deposit account. Wholesalers, manufacturers and men in general who are carrying on a large business generally keep their borrowings in the form of deposits, against which they draw cheques. Retail business men, farmers and small dealers make more intensive use of notes. But there is no essential difference in the credit afforded, whatever form it assumes.

Notes are merely promises to pay legal money, whether issued by the bank or the individual. The only difference between the note of the bank and that of the individual is the power of wider circulation of the former, due to its strong financial position. As, however, the bank note is used as currency, special safeguards are thrown around it to make it perfectly safe and secure. These safeguards have been already described.

Wide Use of Credit.

If one thing above another distinguished modern industry from methods of the past it is the wide use of credit. It especially characterizes the business activities of the great industrial nations—the United Kingdom, the United States and Germany. France, of course, also makes wide use of credit, but still clings to the use of money to a far greater extent than the other countries mentioned. The bank notes which circulate in France to a very wide extent are, of course, only a particular form of credit. But the use of the cheque and deposit business is not as highly developed there as in the other leading commercial nations.

Should Deposits be Guaranteed?

A demand has arisen in some quarters in recent years for government guarantee, or some other form of guarantee, of bank deposits. At present the depositor comes fourth as a claimant, if the bank fails. The order is:

1. The note holder.
2. The Dominion Government.
3. The Provincial Government.
4. The depositor.

However, the demand for a guarantee can hardly be met. Business men must accept business risks. The strong bank should not be burdened with the load of carrying a weaker bank, and thus lose the fruits of careful, conservative management. And the government should no more be asked to guarantee the security of a business man's account any more than it should guarantee his success in business. Men and institutions must stand or fall on their own merits.

Questions for Review.

I. *On Text.*

1. What brought about the exceptional prosperity in Canada between 1870-73? What caused the crisis of 1873?
2. Explain the reason for the multiplication of new banks in Canada during this period.
3. What bank losses were sustained because of the crisis of 1873?
4. What were the chief points considered in the decennial revision of the Bank Act in 1880?
5. What were the arguments advanced in behalf of a bond-secured bank-note issue? What arguments were advanced in favor of government inspection?
6. Why were bank notes given a prior lien?
7. What new bank charters were granted in the years 1882-1886?
8. What brought about the failure of the Exchange, Maritime, London and Central Banks?
9. It has been said that there are four factors to be considered with respect to the protection afforded to Canadian bank depositors and note holders, namely: legal tender reserves; call loans, stocks and bonds and other securities on hand; double liability of stockholders. Do you agree?
10. What is the relationship of Canadian banks to the work of Wall Street?
11. What are the conditions under which Canadian banks may make loans to manufacturers, wholesalers and farmers?
12. Do banks make more than a reasonable profit on their note issues? What factors must be considered in determining the profits on note issues?
13. What reserve is held by the government against deposits in the postal savings banks?
14. Why should bank notes be protected more than deposit accounts?

II. *On Lesson.*

15. Should Canadian bank deposits be guaranteed?
16. From the borrower's point of view, what is the difference between receiving bank notes and opening a deposit account at the bank?

17. Describe from observation the various methods under which deposits arise at a bank.

18. What is meant by saying that "credit is the coining of future goods into a present means of payment"?

19. What is meant by book credits? cheques? promissory notes? drafts? bills of exchange?

20. Show how these credit devices may serve as a medium of exchange.

21. How can a bank fail when its assets are greater than its current liabilities? What lesson does this impress upon the banker?

22. Why should any more care be taken by the banker to protect bank notes than to protect deposits?

23. "A bank wishes a strong reserve." "A bank wishes as small a reserve as possible. A reserve is idle money." Can these statements be reconciled?

24. Are the monthly bank statements of loans and deposits any index of the general business conditions of the country? Explain.

Questions requiring Written Answers.

25. Is there really less money in a country in times of business depression? If there is as much money as before, why can not the banks lend to the same extent as in times of prosperity? What actually do the banks lend?

26. "A bank should be free to give the community it serves the kind of service desired. If deposit currency is desired, let the bank have freedom in giving that service. Let the same be true of note circulation." Comment. What is meant by deposit currency? In what respects do notes differ from it?

27. State the arguments against government guarantee of bank deposits. Are you in favor of any kind of guarantee?

28. Bring up any difficulties.

LESSON VI.

The National Banking System.

Read: *Money and Banking*, Chapters 25 and 26.
Breckenridge, *The History of Banking in Canada*, Chapter 6.

By far the largest and most important example of a decentralized banking system is found in the United States. An attempt, however, to secure some sort of co-operation among the banking organizations of the country has been made recently by the passing of the Federal Reserve Act (1913), the nature of which will be described in Lesson VII.

There are three kinds of banking institutions in the United States that require consideration. These are, the national banks, the state banks, and the trust companies. The two latter do not issue notes—the trust companies, because they have no power to do so, and the state banks because their notes are subject to a tax of 10 per cent. by the national government. Hence, the function of note issue is reserved for the national banks, as was intended. These banks were established in 1863, and were an outgrowth of the Civil War. Mr. Chase, Secretary of the United States treasury, was obliged to find funds to finance the great war that was waging between the North and South. Among other measures—including the issue of $450,000,000 of United States notes commonly called "greenbacks"—he established the national banks. The banks of the several states were utterly inadequate to meet the needs of the nation, it is true; but Secretary Chase's idea was not so much to establish an ideal banking system as to find a market for his bonds. To that end it was decreed that a tax of 10 per cent. should be laid on the note issues of all but national banks. This effectively shut out competition, and compelled all banks that wished to exercise the function of note issue to enter the national banking system. The state banks, and trust companies—which, in the United States do a very large cheque and deposit business in addition to acting in a fiduciary capacity—are thus prevented from issuing notes. This is a loss that is little felt in the cities and larger centres, where the main business of the community is carried on by drawing cheques against deposits.

The national banks may issue notes on depositing government bonds as security at the Treasury of the United States. The bonds, of course, remain the property of the several banks, which receive the interest upon them. Notes may be issued up to the par value of the bonds, but in no case may they exceed the market value if it is less than par. The bonds protect the notes if a bank should fail, or if it should withdraw from business. In addition to this security for eventual repayment, each bank must keep at the Treasury a cash fund equal to 5 per cent. of its circulating notes, to provide for their immediate redemption if presented. This is a redemption fund, be it noted, and not a guarantee fund, such as the Canadian banks keep at Ottawa.

Each individual national bank may issue notes only up to the amount of the bonds deposited, and the maximum is limited by the paid-up capital. The changes with regard to note circulation under the Federal Reserve Currency Act passed in 1913 will be later described; it suffices, in the meantime, to say that under this act provision is made for a greatly extended note circulation on the basis of discounted commercial paper.

Security of National Bank Notes.

Through this strict regulation, national bank notes are made secure beyond any question. Their redemption in legal tender money, owing to the compulsory system of reserves, is no less sure. Hence, the notes circulate freely, and with little likelihood of being presented by the public to the issuing bank, for redemption. Not only every individual, but every bank, treats them as safe currency, and pays them out in the ordinary course of business. Hence, presentation of the national bank note for redemption at the counter of the issuing bank, rarely takes place. Nor does presentation take place with regularity at the National Treasury, where the five per cent. fund for redemption is kept. Thus, when national bank notes are once put into circulation their tendency is to remain there.

In addition, the national banks are anxious to keep the notes in circulation once they have bought the bonds for their protection and deposited them with the Treasury. It costs something to buy bonds, and it may involve a loss to sell them. These factors have operated in giving the United States a perfectly safe bank note currency, but also a very inelastic one. In other words, the currenc yhas hitherto lacked the capacity to expand or contract, according as the conditions of business demand. The Canadian bank note, on the contrary, has the element of elasticity to the highest degree. As no special security is pledged for its support the bank does not hesitate to redeem it when occasion requires, or when it is obliged to do so through clearing house transactions.

> *The gravest defect in the national banking system has been the lack of elasticity in the note circulation. The demand for money in that country*

is irregular; so that an amount of circulation that has been ample for ten months of the year has frequently proved deficient for the remaining two months. This has caused stringency in the money market and involved heavy commercial losses. The federal reserve act was passed, in part, to remedy these defects.

Reserves Against Deposits.

National banks are required by law to keep a stated proportion of legal tender money—specie or notes—against their deposits. There is no legal reserve for the protection of the notes, as they are regarded as absolutely secured by the bonds behind them. It should be carefully noted that what has been said applies to national bank notes. As will be shown in our next lesson, a reserve must be kept against federal reserve bank notes. In a word, the student should observe that henceforth two kinds of bank notes will circulate in the United States: (1) national bank notes, and (2) federal reserve bank notes.

The legal reserve against deposits differs in different places, the general principle being that there shall be larger reserves in the bigger centres of population and smaller reserves in the less important communities. Before the passing of the federal reserve act of 1913 the following provisions obtained with respect to the percentage and location of reserves: In the first group of cities a reserve of 25 per cent. of the demand deposits was maintained; in the second, a similar proportion, but half of it might be deposited at larger reserve centres; and in the third group—called "country banks"—the reserves fell to 15 per cent.; but here again part might be loaned elsewhere, the banks being required to keep only 6 per cent. actually on hand in their vaults. The final result of the reserve system as a whole was that the national banks, on the average, did not hold more than 15 per cent. of their deposits in cash. The rest was forwarded to the larger banks in the more important centres, finally being concentrated in the three central reserve cities—New York, Chicago and St. Louis, and of these three principally in New York. Most of these reserves went to New York, because there are situated the great exchanges of the nation, affording opportunities for the employment of capital. So much criticism was directed against this system, whereby the funds of the different sections of the country were concentrated in New York, that a radical change was effected by the Act of 1913, which will later be carefully described. It suffices to say here that the reserves held against demand deposits were reduced to 18, 15 and 12 per cent. of the demand deposits of the central reserve, reserve, and country banks, respectively. Moreover, under the new act an attempt has been made to keep the reserve funds of the banks in the localities in which they have originated. One important departure of the new act is the requirement placed upon each bank of holding 5 per cent. of its time deposits in legal money.

The provisions for determining what shall constitute the "lawful money" of the reserves are somewhat complex. In the reserves may be counted the specie and legal-tender notes of the United States, so long as a paper legal tender exists. But Clearing House certificates—unknown in Canada—which represent lawful money specially deposited for the purposes of the Clearing House Association, of which the bank owning them may be a member, and the cash reserve of five per cent. of its circulation, which every bank is required to keep in the Treasury, are also to be counted as part of the reserve against deposits.

> *It will be observed that much stress is laid upon the holding of legal reserves by the national banks of the United States. Fixed reserves undoubtedly carry with them an element of security; but too much may be expected of them. In time of stress a bank must lend to support its customers; but fixed reserve requirements may hamper or put an enl to the granting of credit. In Canada, on the contrary, there are no legal requirements with respect to reserves — the banks themselves determine what amount of legal money they should keep in their vaults to meet emergency conditions. The Canadian practice is more efficient provided that the banks never lose sight of possible dangers, and prepare to meet them.*

Capital Requirements.

By an act of May, 1900, the minimum capital required for the organization of a national bank in places with a population of three thousand or less, was made $25,000 in the hope of bringing the system within the reach of the poorer and more sparsely settled districts. The majority of the State banks in the Western communities—where small banks are most needed—have an even smaller capital than $25,000, hence it is difficult to start a national bank in these districts. It is a serious question, however, whether the move is in the right direction. In the crisis of 1893 the failures of small banks were strikingly numerous; and the danger of failure in the future is not very greatly reduced with the entrance of national banks into the field. Few persons in the very small places have the necessary experience to conduct a banking business, and the proper distribution of risks among a wide circle of customers can seldom be secured. It is also clear that the addition to the system of a large number of small banks renders much more difficult the task of adequate examination and supervision, which have not been any too well conducted in the past.

Bank Inspection.

Bank inspection in the United States is conducted by government inspectors. On the whole it has not met with all the success that could have been desired. It has not prevented failures; indeed it would be too much to expect it to have done so. As has been said before, inspection can do little more than check up the accounts, verify the cash on hand with the statements in the books, and act, in a general way, as a restraining influence upon unsound banking. But it is hopeless to expect examination in itself to do more than reveal fraud or unsound banking, after the mischief has been done. We must look to the training, the experience and the integrity of the bankers themselves to safeguard the banks of the nation.

That Government inspection has not accomplished the results desired is evidenced by the fact that in several centres the Clearing House Associations themselves have inaugurated an inspection system of their own, to supplement the Government work. This should be a sufficient answer to those Canadians who have found in Government inspection or supervision a panacea for all our financial ills.

National Banks, State Banks and Trust Companies.

As already stated, the national banks by no means occupy the whole field of banking in the United States. Side by side with them are the state banks and trust companies chartered under the laws of the several states.

The trust companies are as a rule simply banks of deposit, differing from state banks only in that their business is less restricted by law, and that they engage widely in investment operations. In addition there are innumerable private banking firms. Most of those which call themselves "bankers and brokers" are, as a rule, brokerage firms acting mainly as financial middlemen, and often solely as agents for speculators. Though some among them maintain a considerable deposit business, and thus are bankers in the strict sense, deposit banking tends to be confined to the incorporated banks and trust companies.

The State Banks.

The state banks of the United States—including in that term all the institutions outside the national banking system—do a business very nearly equal in volume to that done by the national banks. The total deposits of the two groups are almost the same in amount. But the state banks are not as strictly limited in their operations as are the national banks, especially with respect to the amount of legal money reserves that must be held against deposits. There are, indeed, strict requirements with respect to reserves in several states—especially in New York and Massachusetts where trust companies and state banks are required to hold substantial reserves in cash—but the requirement is usually for such a small amount of cash as to be useless. The state banks, as a rule, may manage their cash holdings in such a way as will secure most profit for them. This means that they reduce their reserves to the smallest minimum that is consistent with safety. Therein they follow the procedure of the English joint-stock banks. Like these English banks they keep deposits with other financial institutions, to which they turn in case of emergency. The national banks of New York especially, have acted as the custodians of the reserves of state, as well as of national banks.

The whole American system of deposit banking has thus brought in the past, a great concentration of responsibility upon the national banks of the reserve cities, and especially of New York, Chicago, and St. Louis, but particularly of New York. The national banks of New York have occupied a position similar to that of the Bank of England; they have been the depositories of the really available stock of free cash, and therefore the nerve centre of the whole sensitive system. Naturally, a panic in New York has meant imminent danger to the whole line of national banks allied with that centre through depositing part of their reserves there. There has been a bold attempt to remedy this situation, and to reduce the dangers inherent in it, by decentralizing the reserves of the nation under the Federal Reserve Act. The plan adopted will be explained in detail when we come to consider the changes in the national banking system effected by that Act.

Money at Call.

The funds which reach New York banks as the deposit of "reserves" of other banks, are put to such uses as will yield a reasonable return, while at the same time they remain available to meet any sudden need for them to take care of home requirements. These bankers' deposits are peculiarly subject to large and sudden drafts; hence each New York bank holding them tries to keep a large volume of assets within instant command. The resort is mainly to demand loans secured by stock exchange collateral. It is true that floating funds accumulate at every great financial centre—at London, Paris, Berlin, as well as at New York. But such loans occupy a more prominent position in the banking field in New York than elsewhere; and the fluctuations in interest rates are greater and more abrupt than in the European money markets, and their connection with stock exchange speculation is closer. But what is more important, these demand loans are deceptive with regard to their real availability to the lending banks. While any one bank may call them, and so strengthen its position when pressed by demands from depositors, the loans are no real resource to the banks as a whole. A huge superstructure of deposits in the country at large has thus had a foundation in New York narrower than is indicated by the apparently available resources of the individual banks.

> *As pointed out, the call loans in New York could not all be regarded as immediately available in time of crisis; but in normal times they form splendid secondary reserves for the banks in the interior which have forwarded their idle funds to New York to find temporary investment. These call loans are almost immediately available for individual banks or for small groups of banks. Even funds that might be used in the ordinary way as commercial loans may well be sent to New York; for banks must keep part of their resources in an immediately available form. This, it may be said in passing, is the justification of Canadian bank loans on the New York stock exchange.*

Centralized Banking.

In most advanced countries general banking operations are carried on by a comparatively small number of banks, each of them large, and each of them having branches. This is particularly true of the deposit banks of Great Britain and Canada. In the United States branch banking has been virtually unknown. Thousands of banks, scattered all over the country, have gone their way independently. This reveals deep-seated habits and traditions. A prejudice against large-scale institutions, as tending to monopoly, also accounts for it. Still other important factors are the federated political system and the strength of local feeling. The ease of establishing small institutions, however, and the competition between the innumerable banks has led to the creation of many small banks, giving credit facilities to the remoter and poorer districts. On the other hand, these conditions brought about grave problems—a sort of anarchical situation arose among the banks. They failed to work together; there was a vast helplessness in times of stress. All this brought about the passing of the Federal Reserve Currency Act, in an attempt to remedy the situation.

Banks exist to make profits. They must lend beyond the amount of their capital or go out of business. Now, banks lend in two ways: (1) by issuing notes; (2) by granting deposit accounts. The nature of the business carried on in the community in which the bank is placed will determine what sort of accommodation business men will require. It avails little to lower the capital required for a bank in beginning business if the conditions of note issue are such that the bank can not profitably meet them. In most country districts loans are desired in the form of notes. This explains why, even although banks of very small capital may be started, the United States as a whole has suffered from the lack of proper banking facilities.

Emergency Note Issues in the United States.

It was frequently claimed in the summer of 1914, during the crisis that arose through the European war, that if the federal reserve banks had been organized more quickly there would have been no need to have had to resort to clearing house loan certificates and to the provisions of the Aldrich-Vreeland Act of 1908 for additional currency, and that the country might have had the use of the new elastic federal reserve currency at once. However, that was not done; and national banks had to fall back upon the former methods of issuing an emergency currency, which may here be described.

The emergency circulation, used by the national banks of the United States in times of monetary stringency, may first be described. This currency is known as "clearing house loan certificates" and should be distinguished carefully from "clearing house certificates" which are certificates representing lawful money or bankable funds and are used by the clearing houses in lieu of cash in settling balances. As will be recalled, the clearing house certificates, under the law, may be counted in as part of the legal reserves of a bank.

The clearing house loan certificates, on the contrary, are not legal tender money in any sense, and are merely certificates of obligation issued by the clearing house to member banks as a money medium during periods of financial stress or panic. They were first issued in November, 1860, in the stormy days preceding the outbreak of civil war.

(*Continued in next Bulletin*).

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