

CANADIAN BANKING

IN

WARTIME

by

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CHAPTER I

INTRODUCTION

Writing of banking in his inimitable style, the late Stephen Leacock once declared ironically, "What a serious trade it has become!" He then went on to draw a picture of life in his home town of "Mariposa" in which the local banker never worked very hard and yet business came his way and "the world went very well then". Banking, however, is a major commercial undertaking in Canada today and with the complex problems introduced by the war has become a very serious trade. Moreover, it is one in which the keenest competition exists, despite the claims of critics that there is in Canada a "financial monopoly".

Broadly, banking is usually meant to refer to the operations of the ten commercial banks which are chartered under The Bank Act. There are, however, a number of savings banks, credit unions, trust, loan and mortgage companies, etc., some of whose activities are in certain respects similar to those of the chartered banks. Reference will be made to most of them but in the main this discussion of banking in wartime must necessarily be confined largely to the operations of the chartered banks. The effects of five and a half years of war on their liabilities and assets and

their ability to earn profits and pay dividends will be considered, as well as the extent of their co-operation with the Federal Government in the administration of foreign exchange control and ration coupon bank accounts and in the sale of Victory Loan bonds and War Savings Certificates. An assessment will then be made of their contribution to the national war effort. Finally, recent legislation affecting banking will be discussed as well as the outlook for the post war years. Central banking, a highly specialized field of banking, will only be referred to incidentally.

First, it is necessary to examine briefly the economic background of Canada before outlining the part played by the chartered banks and other commercial institutions. Early in the war years it became apparent that Canada was to make a major contribution in the form of agricultural and industrial production. Food, raw materials, finished goods and all the equipment and paraphernalia of modern warfare could, in time, be produced in large quantities thousands of miles away from the threat of enemy bombers. Even the ships in which the output of Canadian farms, mines and factories was to be transported to the theatres of combat could be constructed in the Dominion as well as the escort vessels and patrol ships necessary for the protection

of the merchant fleets. But such a vast program of agricultural and industrial effort would require not only vast quantities of capital, labour and materials but also a smoothly running efficient banking system to finance the various stages of production and the transportation of finished products to their destination. Canada was fortunate in having just such a system at the outbreak of hostilities.

All commercial banking is carried on by the ten chartered banks which, in September, 1939 were operating over 3,300 branches throughout the Dominion. In other words, for every 3,500 persons there was an office provided with all normal banking facilities. The comparable figure for the United States was one banking office for every 7,100 persons. Trained personnel aggregating approximately 20,150 were ready to meet all demands.

On August 31, 1939 the assets of the chartered banks totalled \$3,548 million and deposits in Canada \$2,567 million. The ratio of current loans to total deposits was only 40.09% indicating the ability of the banks to make substantial additional loans at the existing level of deposits. As loans offer a higher return than first grade securities all banks prefer to exploit this outlet as an alternative to adding to their investment portfolios. In 1939 Dominion of Canada bonds yielded on the

average between 1.54% and 3.28% interest. Under the terms of The Bank Act, however, a rate of interest on loans as high as 7% could be stipulated for by the banks. In practice, they sell some of their security holdings when there are prospects of expanding their loaning business.

Of the volume of deposit liabilities outstanding in August, 1939, viz., \$2,565 million, about two-thirds represented time deposits. This figure was a record at that time and compared with \$2,176 million in 1929, the previous high. Branches of the chartered banks tap all the real and potential sources of deposits throughout Canada and thus provide the country with an unrivalled system for mobilizing its cash resources and distributing them where they are most required.

Agriculture, industry and commerce were not the only potential beneficiaries of Canada's well organized banking system under wartime conditions. The Federal Government was faced with the prospect of having to raise vast sums of money to finance warfare on a scale not previously thought possible. The chartered banks offered a ready-made network of branches which would provide suitable machinery for the sale of war loan bonds and war savings certificates in addition to providing the Government with direct accommodation by way of advances, as and when required. Such an organization would also make

possible the immediate introduction of foreign exchange control measures, handled by bank personnel already trained in foreign exchange dealings, as well as any special schemes designed to restrict the sale or distribution of commodities in short supply.

The impact of war, then, found the banks well prepared to meet all emergencies. Measured by the surplus of deposits over loans and the character of assets, their position was strong and liquid. Reserves against public liabilities, notes outstanding and deposits in Canada consisted chiefly of Dominion Government securities; over 10% of all deposits in Canada, however, were held in cash, i.e., Bank of Canada notes or deposits with the Bank of Canada. The liquid position of the banks was due to a large extent to the easy money policy pursued by the Bank of Canada since its inception in 1935. By enlarging the cash reserves of the chartered banks, the Bank of Canada made it possible for them to expand their assets and deposits at a time when Canadian agriculture and industry were beginning to revive after the Great Depression of the early and middle 'thirties. When he appeared before the House of Commons Standing Committee on Banking and Commerce in 1944, Mr. G. F. Towers, Governor of the Bank of Canada, referring to economic conditions in 1939, said, "The volume of Canadian money has been expanded substantially above the 1926-1929 level and the

commercial banks kept in a liquid cash reserve position so that they were well situated to meet demands from the public for loans or to purchase government securities."

The active control of monetary policy and the influence exerted on the chartered banks by the Bank of Canada have provided the financial system with a flexibility and strength which were absent during the war of 1914-1918. While the Finance Act of 1914 did set up certain central banking facilities which became a permanent feature of the Canadian banking system in 1923, there was no broad conception of the economic effects of monetary expansion. The part of the Bank of Canada in controlling credit during the war, while not forming part of this discussion, cannot be overlooked entirely because of its tremendous influence on the financial organization of Canada and, in particular, on the operations of the chartered banks.

A study of the banking picture in 1939 and the developments which have taken place during the war must be viewed in the light of Canada's economic position as a whole. The Dominion entered the war with one of the best all-round crops in the country's history. In particular, the wheat harvest was unusually large and of a good quality. Cash income from the sale of farm products was the highest since 1928. The trend of business, which had suffered a temporary set-

back in 1938, had resumed its upward course even before the pressure of war orders began to be felt. The capacity of manufacturing plants was at least 10% greater than in 1929 and half as large again as in 1918 when Canada's industrial effort in the first Great War reached its peak. Important also was the fact that there was no repetition of the financial crisis of 1914 following the declaration of war. In 1939, there was no direct government control over the production or distribution of goods or services. Labour was free to seek employment wherever it could and prices of commodities were set by the free play of the forces of supply and demand. Control and strict rationing of foreign exchange had been thought of only by the experts of the Bank of Canada who prepared a set of regulations, months in advance of the outbreak of hostilities.

Five and a half years of war have witnessed tremendous changes in the whole economy of Canada. The Dominion has now become the third trading nation of the world, largely as a result of the enormous expansion in the output of war industries. During this period agricultural production has increased to the extent of 50% despite a decline of 23% in manpower because of enlistments in the armed forces and the inevitable drift to industrial areas. Employment generally has reached record figures. The national income is more than double its pre-war total having risen from \$4.5 billion to

an estimated \$9 billion in 1944. And Canada has trained, equipped and placed in the line of battle more than 750,000 soldiers, sailors and airmen.

This great expansion in Canada's economy has been facilitated by:

- (1) a controlled, non-inflationary degree of credit expansion;
- (2) heavy taxation which has enabled the Government to finance approximately 50% of all expenditures from current revenue;
- (3) borrowing from the public on a large scale;
- (4) temporary borrowing from the chartered banks;
- (5) restricting inflation through the institution of a series of price, wage and economic controls and rationing.

Speaking of the part of the chartered banks in the war effort, Mr. S. G. Dobson, General Manager of the Royal Bank of Canada and former president of the Canadian Bankers' Association, told the wartime conference of the American Bankers' Association in September, 1943, that "the banks' role in this wartime economy is to serve the public, to serve the Government by helping in every phase of wartime finance, to aid in defeating inflation, to facilitate the ordinary requirements of business, to stand ready at all times to meet any demands

of depositors and thus to contribute our utmost to sustaining the high confidence, the morale and the courage of the Canadian people." In the following chapters the influence of the war on the banking system will be examined and an appraisal made of the extent to which it has contributed to the success of the Dominion's war effort.

CHAPTER II
BANK LIABILITIES

The influence of the war on the operations of the chartered banks is best traced by an examination of the consolidated balance sheets and accompanying statements for the period 1939-1944. As might be expected, many changes in bank figures have been brought about by the increased tempo of industry and commerce and by the monetary policy of the Government acting through the Bank of Canada. Definite trends have also made their appearance. Most important of the changes is the unparalleled expansion of liabilities and assets which has taken place resulting in the first billion and a half dollar bank in Canada's history --- The Royal Bank of Canada --- in addition to two others over the billion dollar mark --- the Bank of Montreal and The Canadian Bank of Commerce.

Liabilities of the banks are divided into two categories: liabilities to the public, including deposits and chartered bank notes outstanding, and liabilities to shareholders, including paid up capital, reserve fund and undivided profits. Deposits are classified as demand and notice deposits, more familiarly known as current account

deposits and savings account deposits respectively. For statistical reasons the figures quoted below are yearly averages calculated from the monthly returns submitted by the banks to the Minister of Finance. The most important point to note in the growth of public liabilities is the expansion of deposits vis-a-vis notes, the explanation of which is given below.

LIABILITIES OF THE CHARTERED BANKS

To the Public				To the Shareholders
Year	Notes in Circulation	Deposits	Total Public Liabilities	Capital and Reserve Fund
(millions of dollars)				
1939	94	3,061	3,298	279,250
1940	91	3,180	3,411	279,250
1941	82	3,465	3,712	279,417
1942	72	3,834	4,102	280,583
1943	50	4,592	4,849	282,250
1944			(not available)	

During the period under review, 1939-1943, liabilities to the ^{public} increased by 47% while liabilities to shareholders grew by a modest .001%. In other words, despite the vast expansion in deposits which enabled the banks to lend or invest on a much larger scale than before the war, little was added to reserve funds during the first four years. It is usually the

case in a large business under efficient management that an increase in the capital employed will result in a lower cost per unit of the commodity produced and a correspondingly greater net return. However, higher operating costs brought on by wartime conditions, together with the taxation demands of the Government on a scale quite unprecedented in Canadian history, have reversed this general rule in the case of the chartered banks. They have been unable to pay large dividends and accumulate huge reserves as is explained in Chapter VIII which deals with bank profits.

A study of bank liabilities as a whole is not very enlightening and it is, therefore, necessary to go into more detail by examining the two main categories. Deposit and note liabilities will be considered separately and then liabilities to shareholders.

A. Deposits

Deposit liabilities of the chartered banks are classified as demand and notice deposits. In order to show the effect of government financing, however, deposits of the Dominion and provincial governments have been segregated from those of the public in the following table. The figures, based on Bank of Canada Statistical Summaries, recapitulate the trend during the war years:-

Deposits of the Chartered Banks

As at October 31	Demand Deposits	Notice Deposits	Government Deposits	Total Deposits in Canada	Total Deposits (including foreign)
(millions of dollars)					
1939	822	1,709	306	2,850	3,402
1940	941	1,599	237	2,774	3,252
1941	1,136	1,592	285	3,002	3,535
1942	1,609	1,709	286	3,594	4,209
1943	1,827	1,961	319	4,089	4,805
1944	2,144	2,489	323	4,933	5,795

On first glance, the most impressive feature of the above figures is the phenomenal growth in total deposits between 1939 and 1944, especially deposits in Canada. The rate of expansion appears to have increased as the war progressed and the financial requirements of the Government continued to make larger inroads on the national income. The relationship between Government financing and the expansion of bank deposits is an intimate one. The figures given below which are supplied by the Bank of Canada should, therefore, be examined before a further explanation of the changes in bank deposits is attempted.

Dominion Government Loan Flotations

Year	Net New Issues of Direct and Guaranteed Ob- ligations. (Sold to the Public)	Net New Issues of Treasury Bills, De- posit Certificates and Special Short- Term Issues (Sold to Banks)	TOTAL
(millions of dollars)			
1939	22.3	200.0	177.7
1940	289.5	325.0	614.5
1941	536.9	290.0	826.9
1942	1,537.5	632.8	2,170.3
1943	2,457.6	535.0	2,992.6
1944	2,635.4	248.2	2,883.6

In the case of every loan sold to the public the immediate result was an increase in the deposits of the Government held by the chartered banks accompanied by a decline in demand and notice deposits. The explanation is a simple one. As depositors purchase War and Victory Loan Bonds their savings are reduced insofar as their subscriptions are for cash and the proceeds of the cheques they drew are credited to the Dominion Government. On the other hand, when the Government sells its obligations to the chartered banks or to the Bank of Canada there is no subtraction from the accounts of depositors but the Government's account and spending power are increased to the extent of the obligations sold. Financing of this type is inflationary in character and for this reason has been restricted to what are considered reasonable amounts

having regard to the exigencies of the war.

Following every Victory Loan drive, demand and notice deposits, after an initial drop, have resumed their upward course as the Government has paid out the proceeds in meeting commitments for the prosecution of the war. Demand deposits have recovered first, then notice deposits. During the last two or three years, recovery has been noticeably rapid and a fresh peak has been reached before each new loan has been announced. The trend has been definitely upward but most marked in the case of demand deposits, indicating the liquid position in which industry and commerce find themselves.

There are several reasons for this easy financial condition. First, many firms have concentrated their resources on filling Government war contracts on which a modest but assured profit has been made. In wartime, Government financial machinery operates more speedily than in peacetime and the risk of goods being refused or considered unsuitable is negligible. Funds for work completed and deliveries made have, therefore, been forthcoming more promptly than would normally be the case. Second, in October, 1941 the Wartime Prices and Trade Board instituted a series of restrictions designed to curtail demand for the diminishing supply of consumer goods.

Minimum down payments and maximum time limits were prescribed for almost all commodities purchased on an instalment basis. Personal loans made by the banks for this purpose were similarly regulated. All charge accounts had to be paid promptly.

The result of these measures was a shift from credit to cash transactions with a consequent decline in the accounts receivable held by retail merchants. This trend, coupled with the ever increasing difficulty of replacing inventories, resulted in a vastly improved cash position. Distributors, in turn, were able to meet their commitments to manufacturers much more promptly than was formerly the case. Third, the higher level of economic activity and the more intensive employment of plant and equipment have enabled both industry and commerce to earn substantial profits, despite the depressing influence of the Excess Profits Tax and the burden of taxes generally on corporation incomes. According to a study of the Bank of Canada covering 665 companies, net profits after deducting depreciation, bond interest and income and excess profits taxes rose from \$242 million in 1938 to \$313 million in 1942 and were \$292 million in 1943. The cash position of these corporations has responded accordingly. Finally, many firms have been unable

to make expenditures on maintenance and replacement of plant and equipment which they would normally undertake. When this factor is considered along with lower inventories and receivables, it is evident that business has tended to accumulate cash during the war years, a movement which is clearly shown in the table of deposits appearing above.

During the period under review, notice deposits remained at about the pre-war level until 1943 when an upward trend became apparent. In the first few years of the war accumulated savings were invested in war loan bonds while new found prosperity encouraged many wage-earners and farmers to make purchases postponed since the days of the Great Depression. The threat of a shortage of supplies stimulated this movement until the Government introduced rationing of essential commodities in 1942. By 1943, spending had increased more than 60% since the beginning of the war. Meanwhile, Canada had virtually reached a state of full employment of material and labour resources. High rates of pay and a record cash return from the sale of farm products brought the incomes of both wage-earners and farmers to new high levels. Much of the unspent surplus has found its way into savings accounts in the chartered banks, resulting in the moderate expansion of notice deposits evident in the table under discussion.

Government deposits, on the other hand, have fluctuated widely during the war years. Although replenished from time to time from the proceeds of tax receipts, bond flotations and private sales of short-term securities to the banks, they have been drawn down rapidly as the requirements of war financing have been met. Nevertheless, a steady but unimportant increase is indicated in the figures given above. It must not be forgotten that the Bank of Canada is the principal banker of the Dominion Government.

The chartered banks, of course, are not the sole repository of the savings of the public. The great bulk of them, however, are accumulated in current and savings accounts since the chartered banks enter into the agricultural, industrial and commercial life of the country in such a large way. Several other types of institutions also compete for the savings of the public. Among these are the savings banks which may be divided into three types. The first of these is the Post Office Savings Bank operating through a number of post offices throughout Canada. Total deposits are not impressive but, in common with those of other types of savings banks, the trend has some slight significance. Next in this group come the provincial banking institutions of Ontario and Alberta concerning which annual statistics are not readily available.

The Province of Ontario maintains 22 savings offices throughout the province while in Alberta the provincial government accepts deposits through a number of treasury branches. The aggregate of the latter are relatively unimportant as will be seen in the table appearing below.

Finally, there are in the Province of Quebec two large savings banks which operate under the Quebec Savings Bank Act, the Montreal City and District Savings Bank and the Caisse d'Economie de Notre Dame de Quebec. Trust and loan companies and the co-operative credit unions also solicit savings which might otherwise find their way to the chartered banks. In the case of the credit unions, however, their appeal is to the small depositor who finds that 25 cents per week, or some other small sum, is all that he can put away for a rainy day. There are over 1,400 credit unions in Canada with total assets in excess of \$44 million. Life insurance companies also attract a large amount of savings. In 1943 total premiums paid aggregated \$229 million. The following table recapitulates the course of savings other than those absorbed by the chartered banks.

Deposits in Institutions other than Chartered Banks

	1939	1940	1941	1942	1943	1944
	(millions of dollars)					
Post Office Savings Bank	23.0	23.1	22.2	21.7	24.4	
Province of Ontario						
Savings Offices		39.8		36.4		38.4
Province of Alberta Treasury						
Branches		5.6		4.5		3.6
Montreal City and District)						
Savings Bank	81.6	79.9	76.4	74.4	84.0	103.3
Caisse d'Economie						
Credit Unions			22.7	33.6		
Trust Companies	36.0	35.5	38.6	37.9		
Loan Companies	29.1	28.3	28.6	28.0		
	(Canada Year Book)					

It will be noted that, in common with notice deposits of the chartered banks, deposits of the savings banks showed a decline in the early years of the war. Some recovery was made in 1943 but the greatest expansion took place in 1944. Deposits of the trust and loan companies, on the other hand, have remained virtually unchanged. A possible explanation of this contrast lies in the fact that the latter institutions do not encourage deposits of a transient nature but prefer those which will remain undisturbed. As a result, they are not in as close contact with the swiftly moving current of industrial and commercial activity stimulated by the war as are the chartered and savings banks.

The significant point in the above study of the trend of deposits is the great increase which has taken place in demand deposits of the chartered banks, reflecting the activity and monetary policy of the war years. This development has been paralleled to a limited extent by the growth in notice deposits of both the chartered and the savings banks, but has not been at the expense of deposits of the trust and loan companies.

During the reconversion period after the war, industry will have heavy expenditures to make in order to adapt plant and equipment to peacetime uses. Repair and maintenance work, postponed during the war because of labour and material shortages, will also have to be done. A rush to accumulate whatever raw materials are available for processing will create a further drain on the liquid resources of industry. A substantial decline in demand deposits can, therefore, be expected in the post war years. This will be offset to a certain extent by the fact that money spent in the ordinary course of business will be transmitted to other commercial and industrial organizations. However, much of it will likely find its way to savings accounts as labour reaps the benefit of the post war boom.

Political expediency and the desire to encourage private enterprise to employ as much labour as possible will influence the Government to reduce taxation with the direct and indirect benefit going principally to wage-earners. The latter will be able to save more than during the war period, even though an accumulation of unsatisfied wants may remain as a legacy of the war. It will be impossible to satisfy all of these in the first two or three years and hence it is suggested that demand deposits will show a decline while notice deposits will tend to increase. No contraction in the lending power of the chartered banks is, therefore, anticipated. This forecast is based on the assumption that the Bank of Canada will continue the easy money policy already in effect. Such is already the Government's announced policy.

Since 1934 the chartered banks have been submitting to the Minister of Finance an annual return which includes, among other items, a classification of demand and notice deposits. The figures for the war years are interesting for several reasons. First, they reveal that the number of demand deposit accounts increased by only 11% during the period under review while the number of notice deposit accounts increased by 22%. In view of the vast expansion of business and the entry of many newcomers into the manufacturing field it might have been thought that the number of demand deposit accounts would have increased

at a higher rate. However, the assumption must be made that most firms which solicited war orders already had a banking connection and operated a current or demand deposit account.

The greatest increase in the number of accounts, it will be noted, took place in the \$1000 - \$5000 category. This might well indicate that small companies were accumulating funds as the result of larger profits and lower inventories and receivables, and not that many new accounts were being opened. The fact that the number of deposit accounts in the category of \$1000 or less actually declined from 614,000 in 1939 to 602,100 in 1944 would seem to support this statement for it is in this category that most new current accounts are generally opened.

The growth in the number of notice deposit accounts, particularly in the category of \$1000 or less, can be explained by the unprecedented increase in the number of persons employed in war industry, many of whom never had a bank account before. Personnel of the armed forces have also been responsible for this development. As soldiers, sailors and airmen are moved about Canada, or are sent to distant battlefields, they require a bank account in which to deposit surplus funds and on which they may draw cheques in settlement of their various commitments.

Many maintain several accounts at different points for reasons of convenience. The wives of service personnel who are away from home frequently have to attend to the financial affairs of the family themselves and a number of them undoubtedly did not operate independent bank accounts when their husbands were at home. The following table, published by the Bank of Canada, summarizes the expansion which has taken place in the number of demand and deposit accounts since 1939.

Classification of Demand and Notice Deposits

As at October 31	1939	1940	1941	1942	1943	1944
(thousands of accounts)						
DEMAND DEPOSITS:						
\$1,000 or less	614.0	616.7	618.7	616.5	611.9	602.1
\$1,000 to \$5,000	53.1	57.8	64.7	77.2	94.3	120.1
\$5,000 to \$25,000	13.0	14.4	16.2	20.0	25.0	29.4
\$25,000 to \$100,000	3.0	3.2	3.8	4.5	5.1	5.8
Over \$100,000	.9	1.1	1.3	1.7	2.0	2.2
Adjustment Items	-	-	-	-	-	-
TOTAL DEMAND DEPOSITS	684.1	693.2	704.8	719.8	738.3	759.5
NOTICE DEPOSITS:						
\$1,000 or less	3,828.3	3,846.1	3,951.6	4,055.0	4,280.4	4,588.0
\$1,000 to \$5,000	290.2	268.8	264.6	280.6	342.8	454.3
\$5,000 to \$25,000	40.0	34.7	31.3	31.2	35.8	47.4
\$25,000 to \$100,000	2.8	2.4	2.3	2.2	2.4	2.8
Over \$100,000	.6	.6	.6	.7	.7	.7
Adjustment Items	-	-	-	-	-	-
TOTAL NOTICE DEPOSITS	4,161.9	4,152.6	4,250.4	4,369.7	4,662.1	5,093.2

The sharp increase in the volume of demand deposits during the 1939-1944 period was spread fairly evenly over all categories of deposits as may be seen in the table appearing below. Those over \$100,000, however, showed the most spectacular rise, indicating clearly the accumulation of funds by large corporations. Some of this accumulation was undoubtedly transferred to savings accounts in order that it might earn $\frac{1}{2}$ of 1% interest which is the rate the chartered banks pay on notice deposits. (Interest is not allowed on current accounts.) This fact is evident from the expansion in notice deposits over \$100,000. Aside from this trend, the greatest increase in notice deposits is noted in accounts of \$5000 or less which comprise more than 98% of all notice deposit accounts. In other words, the small man, the average depositor, was responsible for a very large share of the expansion in notice deposits. It is not surprising, therefore, that the Government takes such a keen interest in soliciting Victory Loan and War Savings Certificate subscriptions from wage-earners.

Classification of Demand and Notice Deposits

As at October 31	1939	1940	1941	1942	1943	1944
	(millions of dollars)					
DEMAND DEPOSITS:						
\$1,000 or less	89.0	96.5	105.2	118.5	132.7	142.1
\$1,000 to \$5,000	109.2	120.5	136.3	163.5	202.0	259.0
\$5,000 to \$25,000	132.4	145.7	164.2	201.7	252.2	295.8
\$25,000 to \$100,000	142.0	152.4	178.0	213.6	240.3	268.1
Over \$100,000	341.2	427.8	550.2	895.6	983.6	1,145.4
Adjustment Items	7.8	1.6	1.5	16.2	16.0	34.0
TOTAL DEMAND DEPOSITS	821.7	941.3	1,135.5	1,609.1	1,826.8	2,144.5
NOTICE DEPOSITS:						
\$1,000 or less	454.9	461.2	496.3	534.6	617.3	752.3
\$1,000 to \$5,000	538.2	537.3	522.3	548.8	671.1	880.2
\$5,000 to \$25,000	348.9	299.1	272.5	271.4	308.9	405.1
\$25,000 to \$100,000	123.3	105.7	91.6	98.9	105.4	122.0
Over \$100,000	190.1	190.7	195.6	247.8	250.8	322.7
Adjustment Items	3.7	5.4	5.4	7.2	7.7	6.0
TOTAL NOTICE DEPOSITS	1,709.2	1,599.5	1,591.7	1,708.7	1,961.2	2,488.9

The present rate of interest paid on notice deposits, other than those of corporations, 1½%, cannot be said to have had any large part in attracting the savings of the public. Prior to 1933 and throughout the first Great War the rate was 3%. But early in the depression years the Government adopted an easy money policy which was carried on by the Bank of Canada after its inception in 1935. Its purpose in peacetime was to stimulate business recovery; when war broke out it was continued

in order to keep the carrying charges on Government borrowings to the lowest possible figure. One of the results of this policy was the action taken by the chartered banks which depend on the return on their holdings of Government bonds for a large percentage of their income. They were forced to cut the rate of interest which they paid on notice deposits. This was done by concerted action in several instalments.

It must be pointed out that while the current rate is $1\frac{1}{2}\%$, corporations and other trading establishments are not permitted to deposit funds in savings accounts for the purpose of earning this rate of interest. A rate of only $\frac{1}{2}\%$ of 1% is paid on such deposits. There is, therefore, little inducement to industrial and commercial firms to leave funds on deposit. That they have had to do so in the absence of suitable alternative outlets is evident from the increase in notice and demand deposits as explained above. As a matter of information, the chartered banks pay out approximately \$22 million annually in interest earned on notice deposits.

Indicative of the expansion in economic activity during the war years is the marked increase in the number of credit and debit entries which are passed through the $5\frac{1}{2}$ million deposit accounts operated by the customers of the chartered banks. In modern industrial countries cash trans-

actions are customary only when small amounts are involved. In the case of North America it has been estimated that approximately 6% of all business dealings are settled in cash while the remaining 94% are settled by means of cheques drawn against bank accounts.

The economic activity of Canada can be measured with some degree of accuracy, therefore, if the aggregate amount of the cheques paid by the banks and charged to the accounts of their customers is known. Only the figures for clearing house centres are available but these represent about 85% of all debits made to bank accounts. The aggregate of all cheques cashed in 1943, approximately \$54 billion, showed a continuance of the upward trend in evidence during the war years and represents an increase of about 70% over the comparable figure for 1939. The rise in bank debits exceeds that shown by other barometers of business activity during the same period.

The employment by the Government of many thousands of additional people for wartime work, the entry into the armed forces of thousands of others and the payment of allowances to dependents of soldiers, sailors and airmen have contributed substantially to the number of cheque transactions which have swollen the volume of bank debits.

B. Note Issue

Until 1938 bank notes in the hands of the public were chiefly those issued by the chartered banks in accordance with the provisions of the Bank Act. The setting up of the Bank of Canada in 1935 introduced a new policy designed to replace chartered bank and Dominion of Canada notes with Bank of Canada bank notes. The Dominion issue was replaced as rapidly as it could be withdrawn from circulation. Chartered bank notes were to be retired gradually over the ensuing fifteen years and the note issue privilege left exclusively in the hands of the Bank of Canada. The following table, based on Bank of Canada figures, illustrates this development. Particular importance is attached to the figures covering the war period.

Note Circulation in the Hands of the Public

As at October 31 Year	Chartered Bank Notes	Bank of Canada Notes	Total
	(millions of dollars)		
1937	112	111	223
1938	101	121	222
1939	95	159	254
1940	92	250	342
1941	82	362	444
1942	70	556	626
1943	46	723	769
1944	35	879	914

Because of legislative requirements, the steady decline in chartered bank notes outstanding cannot be related in any way to the vast increase in the demand for currency induced by the wartime rise in economic activity. No notes have been issued since January 1st, 1945 and those already in the hands of the public will be retired as they are presented for payment. (See Chapter X, 1944 Revision of The Bank Act.)

Bank of Canada notes, on the other hand, have shown a great expansion in keeping with the demand for more and more currency. Both issues together reveal an increase in the total note circulation outstanding of over 300% since 1938. Despite this sharp rise, the volume of currency in circulation is still a small part of the total money supply available for use, viz., about 15%. The total money supply, made up of currency and deposits in the chartered banks, has expanded only about 100% during the war years, a tribute to the careful monetary policy pursued by the Bank of Canada.

C. Shareholders' Equity

Liabilities to shareholders, which are summarized in the table at the beginning of this Chapter, are made up of what is called the shareholders' equity or investment. It is

comprised of the paid up capital of each bank together with the rest or reserve fund. The latter represents an accumulation of undistributed earnings and premiums received on the sale of bank stock over and above its par value. In reality, therefore, the reserve fund is a debt owed by each bank to its shareholders but one which is left unpaid in order that the depositors and noteholders may have the benefit of the additional protection which it affords.

It has been the practice of most Canadian banks to build up their reserve funds in times of prosperity in order to anticipate unavoidable losses for which adequate provision cannot always be made in times of depression. The figures appearing in the table below, yearly averages extracted from the Canada Year Book, reveal this trend. However, owing to the practice of setting aside further sums for unforeseen contingencies --- inner reserves --- which are not shown in the published balance sheets, it is not possible to obtain a clear picture of the true shareholders' equity at any given moment.

Capital and Reserve Funds of the Chartered Banks

Year	Capital	Reserve Fund	Total Liabilities to Shareholders
(millions of dollars)			
1938	145	134	279
1939	145	134	279
1940	145	134	279
1941	145	134	279
1942	145	135	280
1943	145	137	282
1944	145	140	285

Little or no change has been made in the capital structure of the chartered banks in recent years. The last increase was in 1935. Reserve funds, which reached a peak of \$162 million in 1931, were subject to substantial reductions during the lean years of the 'thirties as the banks transferred funds to meet unforeseen contingencies and to maintain their dividend rates at fairly high levels. The latter were cut several times after 1930 but even in 1933 the average annual rate was just over 9%, excluding Barclay's Bank (Canada) whose dividend distribution is not made known to the public.

After declining to \$132 million in 1934, reserve funds were built up gradually during the period of recovery

until at the outbreak of war they aggregated \$134 million. Since 1939 there have been some further additions and by 1944 reserve funds totalled approximately \$140 million. The small gains made during the war years is accounted for largely by the heavy taxation demands of the Government. Dividend rates have actually been cut since 1939 when they averaged just under 9%. The factors influencing the dividend policy of the banks are elaborated in Chapter VIII which deals with Bank Profits.

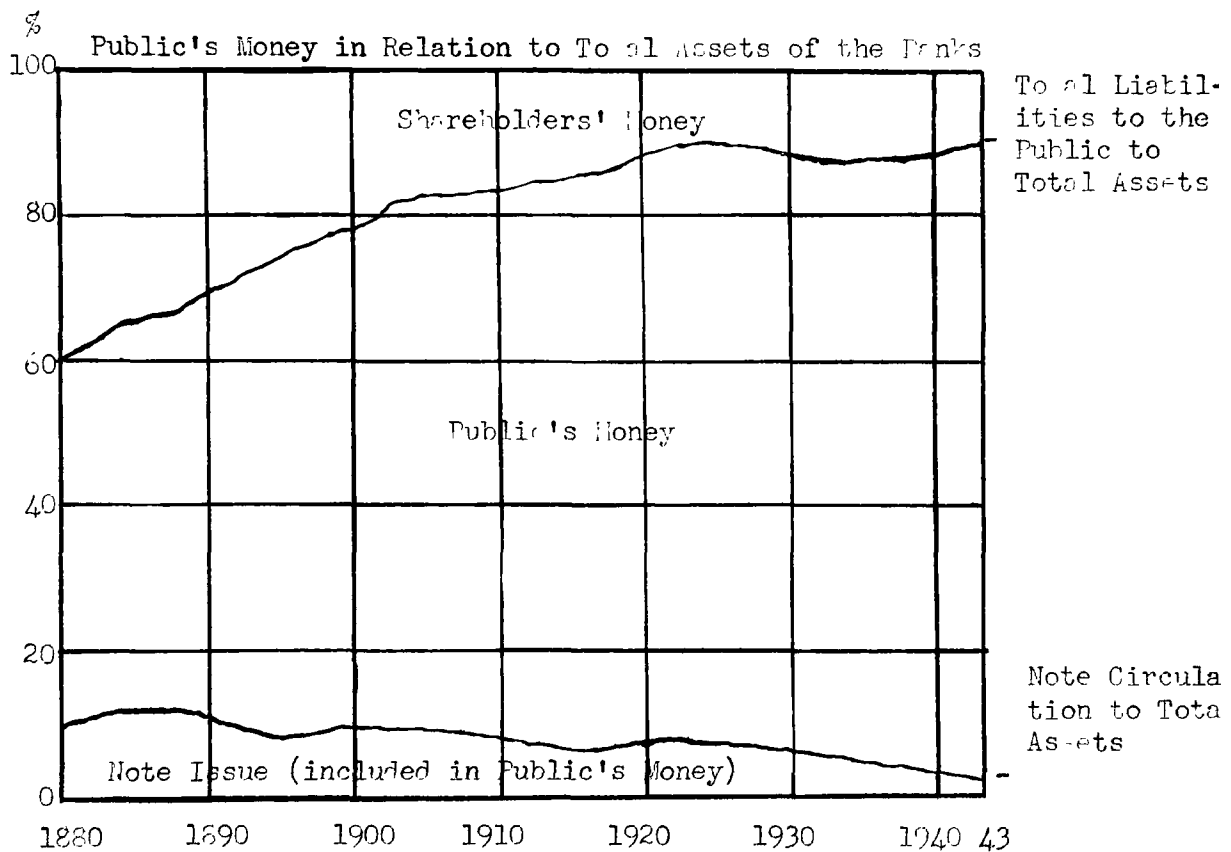
It is sufficient to note at this point that despite the business boom created by the war the stake of bank shareholders, which in normal times would be increased under similar conditions, has actually been augmented to a limited extent only. This might lead to the conclusion that the banks will have insufficient reserves to provide for contingencies which might arise in a post war business depression. From the evidence produced before the House of Commons Standing Committee on Banking and Commerce in 1944, it is clear, however, that substantial sums have been transferred to inner reserves with the dual purpose of replacing withdrawals made in the 'thirties and accumulating resources to take care of future emergencies. No estimate of these amounts is possible as this information is not made available to the public.

Considerable discussion was aroused in the House of Commons Committee when this point was raised by two of the members. It was argued that a true picture of the financial position of an individual bank could not be given to the public unless the aggregate of the inner reserves were made known. The banks have many reasons for not wishing to publish this information as is explained in Chapter VIII on Bank Profits.

It must be pointed out that while the liabilities of the chartered banks to the public are technically payable on demand, payment of those to shareholders is in fact deferred indefinitely. Capital is, of course, not repayable unless a bank is liquidated, and then only if all obligations to noteholders, depositors and other creditors have been met in full. The reserve fund can then be distributed but only with the approval of the board of directors. In point of fact, however, it becomes part of the capital of the bank unless required to meet contingencies as described above. Fluctuations in liabilities to shareholders have, therefore, little significance compared with fluctuations in liabilities to the public.

The Dominion Bureau of Statistics has published an interesting chart which is reproduced in part below. It illustrates the gradual but significant change which has

taken place in the relative importance of liabilities to the public and liabilities to shareholders since Confederation. The trend has continued throughout the current war period.



The above chart has also a social significance which must not be overlooked. It indicates clearly a change in the ownership of bank assets which began soon after 1880 and was continued with little or no interruption until the

end of the first Great War. The relative proportions of the shareholders' money and the public's money remained virtually the same throughout the 'twenties and 'thirties. From 1938 on, the tendency of the shareholders' investment to become less and less important was resumed, and there is no reason to suppose that this movement will be reversed in the near future.

The conclusion is evident. The chartered banks have become giant public utilities in which the shareholders' capital forms but a fraction of the total available resources. Over 90% of the earning power of the banks arises from funds deposited by the public. The banks are in theory as well as in fact trustees of these funds and are expected to account to the public as well as to their shareholders for the use to which they have been put.

CHAPTER III

BANK ASSETS

Parallelling the great expansion in liabilities, assets of the chartered banks have also grown to unprecedented figures during the war years. In the following table, the three main categories are recapitulated for the period 1938 - 1943 in order that a comparison of the trends may be made. The figures are yearly averages based on the monthly returns made by the banks to the Minister of Finance.

Assets of the Chartered Banks

Year	Loans	Securities	Cash [*]	Total [%]
(millions of dollars)				
1938	1,201	1,440	262	3,349
1939	1,244	1,540	279	3,592
1940	1,324	1,579	297	3,707
1941	1,403	1,727	318	4,008
1942	1,370	2,073	350	4,400
1943	1,334	2,714	423	5,148
1944		(not available)		

* Includes specie and Dominion or Bank of Canada notes.

% Includes other assets.

Apart from the rapid expansion, the outstanding development of the war years has been the change in the character of bank assets, a movement which began in the early 'thirties. Until 1936 the most important item was that of loans; since then securities have formed the bulk of assets. The relative proportions

of the two have changed even more noticeably during the last three years as the following table reveals. Here they are expressed as a percentage of note and deposit liabilities for the same period as well as for certain representative pre-war years.

**Ratio of Loans and Securities to
Note and Deposit Liabilities**

Year	Loans to Notes and Deposits	Securities to Notes and Deposits
1930	74.6	17.1
1936	40.9	47.7
1938	40.1	48.1
1939	38.4	47.5
1940	39.6	47.3
1941	38.9	47.8
1942	34.5	52.1
1943	28.2	57.4

The explanation of the steady decline in the relative importance of loans and the concurrent increase in the importance of securities lies in the fact that since 1930 there have not been the same opportunities for loaning funds as in previous years. At the height of the 1929 boom the chartered banks had \$2,280 million out in loans and held less than \$500 million in investment securities. The demand for funds was great and the return more attractive than that on high grade bonds.

By 1936 loans had dropped to \$1,141 million while security holdings had expanded to \$1,331 million. The Bank of

Canada's easy money policy had been inaugurated in the preceding year and, in the absence of good loans, the banks were forced to purchase more and more securities in order to find employment for surplus deposits. This movement was greatly accelerated by the Government's program of war finance. By 1943 security investments were actually double the amount of loans and the movement shows no sign of changing its course. The accumulation of securities during the war and the relative decline in the volume and importance of loans have meant more than just a falling off in the earning power of bank assets. The banks have been placed in a liquid position quite unparalleled in their history. Normally, cash, that is, Bank of Canada notes and deposits with the Bank of Canada, form the banks' first line of reserves to protect depositors. Next come investments in short and medium-term securities, mostly those of the Dominion Government. Finally, there are, of course, loans to agriculture, industry and commerce and to individuals. The first two categories of assets, cash and securities, are considered as liquid reserves since the latter are easily convertible into cash by selling in the open market or to the Bank of Canada. Loans, on the other hand, are usually made for a fixed period of time -- one, two or three months, and often longer. Call loans and demand loans, of course, are repayable on demand. It is customary for the banks to keep cash reserves of approximately 10% against their

deposit liabilities and a very much larger percentage in the form of high grade securities. The latter varies in different cases.

The war has completely changed some of the usual practices. The sharp increase in the volume of demand deposits vis-à-vis notice deposits has made it more important than ever to maintain large liquid reserves. While it has not been found necessary to increase the usual cash reserve ratio, security holdings have been carefully selected with the dual object of assisting Government war financing and bolstering liquid reserves with high grade investments. Were this not true, the banks would have placed their surplus deposits in securities other than those of the Government which offer a higher return and almost as much safety.

The marked change in the character of bank assets during the war years, then, has placed the chartered banks in a more liquid position than ever before. To the noteholder and depositor this can mean only one thing: the chartered bank notes which he carries in his pocket and the savings which he has left on deposit are better protected than they have ever been. He has, to a greater extent than formerly, the resources of the Dominion of Canada behind him.

While the financial operations of the Government during the first Great War also produced an expansion in the security holdings of the chartered banks, loans increased steadily and were, at times, greater in volume than during the present war. Loans continued to make up the bulk of bank assets, however, owing to the dependence of private enterprise upon bank financing in order to carry on wartime industrial operations and to the more moderate financial requirements of the Government. The movement in this war has been quite different as is explained later in this chapter.

A. Loans

In this study, only loans current in Canada will be considered since they illustrate the changing economic conditions in the Dominion induced by the exigencies of war finance. In point of fact, loans made outside Canada form only a small portion of total advances. As in the case of deposits, the figures appearing in the table below are extracted from the Statistical Summary of the Bank of Canada. They are taken from bank statements of October 31st; on that date comparatively few special loans to customers to finance purchases of Victory Loan bonds were outstanding.

Loans of the Chartered Banks

As at October 31 Year	Call	Current	Government	Total
	(millions of dollars)			
1938	66	848	137	1,051
1939	53	952	131	1,136
1940	41	1,024	113	1,178
1941	37	1,147	86	1,270
1942	25	1,008	70	1,103
1943	38	985	53	1,076
1944	56	954	38	1,048

Loans have been broken down into three categories; call loans which are made chiefly to brokers and investment dealers, current loans to the general public, and loans to provincial governments, cities, towns, municipalities and school districts.

First of all it will be noted that following the outbreak of war there was a sharp upturn in the aggregate volume of loans outstanding which was sustained well on into 1942. This is not surprising when it is realized that thousands of firms throughout Canada were endeavouring to adapt their plant and equipment to the production of war materials. In addition, inventory had to be accumulated, personnel engaged and trained, and necessary organizational expenses met. Industry naturally turned to the banks for temporary assistance. Loans, therefore, reflected to a limited extent the expansion which was taking

place in industry. When compared with the growth in deposits and the general expansion in economic activity during the first three years of the war, the increase in bank loans was very moderate.

The peak year was 1941. Late in 1942 loans began to decline despite the fact that production and employment figures continued to mount. Actually Canada did not reach the peak of production and full employment until early in 1944. There were several reasons for this reversal in the trend of borrowing. As far as their cash position was concerned businesses both large and small were in a much more liquid state than in the early years of the war. Receivables turned over faster, Government accounts were paid promptly and inventories were difficult to replace. Further, in the initial stages of conversion to war production, many plants had been obliged to lean on their bankers for financial assistance. Later, Government financing was forthcoming on a much larger scale and bank borrowings were, therefore, not required to the same extent.

During the war years, call loans to brokers and investment dealers declined steadily until 1943 when renewed interest in the stock market reversed the trend. Loans to provincial and municipal governments and school boards have fallen off substantially since before the war. The decline

has been consistent and reflects improved revenues, balanced budgets and a lessening of local government dependence on bank borrowings. No exception can be taken to this favourable development in public finances. Offsetting this decline to a limited extent is the fact that some undertakings have necessarily been postponed because of a shortage of labour and materials. Funds will have to be found for these projects at a later date, either by way of taxation or by way of borrowing.

A number of other factors also influenced the early expansion and subsequent contraction in loans during the war period. At the end of 1939, advances to finance the large wheat crop were unusually heavy and they remained at high levels during the ensuing two years as the wheat carryover grew in size. Some expansion took place in 1941 when the chartered banks made substantial advances to finance the purchase of Victory Loan Bonds. The gain was temporary, however, and by early 1942 aggregate loans had fallen to their previous level.

It might be concluded that the early expansion in loans was due mostly to the abnormal financing of the wheat carryover and that the increase in economic activity generally had very little effect on bank loans. Such is not the case as the following breakdown of loans, published by the Bank of Canada, will show.

Classification of Bank Loans in Canada

As at October 31	1938	1939	1940	1941	1942	1943	1944
(millions of dollars)							
Agriculture -							
Grain Loans	92	211	236	292	294	246	209
Other Loans	57	57	53	48	46	50	58
Forestry	75	57	46	44	42	43	53
Mining	9	6	6	7	9	10	13
Fishing	9	7	7	11	10	8	12
Construction	39	46	52	50	49	46	39
General Manufacturing	138	136	198	245	214	259	202
Railways and Public Utilities	25	36	22	20	14	13	6
Merchandising	134	134	139	156	123	100	122
Financial	250	220	207	214	148	167	210
Municipal and School Districts	114	112	100	78	66	48	33
Provincial Governments	23	19	15	9	4	5	5
Other Loans	94	102	104	101	87	82	88
	<u>1,059</u>	<u>1,143</u>	<u>1,185</u>	<u>1,275</u>	<u>1,100</u>	<u>1,077</u>	<u>1,050</u>

During the first three years of the war, loans for manufacturing purposes rose substantially while advances for merchandising and construction increased moderately. In the case of the manufacturing industries, the increase was stimulated by the need for converting to war production and turning out war materials as rapidly as possible. Much financial assistance was required from the banks before the Government organized its financial machinery well enough to effect prompt payment of its obligations. The need was not so great after 1941 as the figures show and bank loans declined accordingly.

Merchandising loans exhibited a similar expansion until 1942 when a serious decline set in. There are several reasons for this sharp reversal in the upward trend which had been continuous since early in 1939. Merchants were forced to curtail credit granted customers under the terms of the Wartime Prices and Trade Board order issued in October, 1941, and a higher proportion of cash sales was the natural result. Inventories declined substantially with heavier buying and the difficulty in replacing stocks. Bank financing, therefore, became unnecessary in many cases owing to the liquid position of a number of firms; in other cases, requirements were reduced to low proportions.

The construction industries were assisted very generously by the Government and bank advances have therefore, fluctuated within a narrow range. Loans in 1944 had declined to the pre-war level. In the case of agricultural loans, other than those to finance the wheat crop and carryover, there has been some liquidation as farmers have improved their financial position. Cash income from the sale of farm products has more than doubled since 1939, partly as the result of the Government's subsidy policy and partly as the result of an increased demand from outside Canada. Forestry loans declined slightly until 1944 and advances to provincial and local government bodies have fallen off for the reasons given above. Railways and utility companies

have had their facilities taxed to capacity by a record demand for their services. Profits have expanded accordingly enabling fixed as well as current obligations to be reduced substantially.

Financial loans include not only advances to brokers and investment dealers but also special loans to trust, loan, mortgage and insurance companies as well as loans to individuals against approved stocks and bonds. Call loans have been considered already. Special loans, which aggregated over \$58 million in 1939, rose to \$68 million in 1941 but declined rapidly until in 1944 they amounted to only \$28 million, accounting for practically all the drop in financial loans. Individual loans exhibited some fluctuation in accordance with the movement of the stock market. Reaching a low figure of \$84 million in 1942, they climbed to \$125 million in 1944, reflecting renewed buying by both investors and speculators.

Certain broad conclusions can be drawn from the trend of bank loans since 1938 which have some social significance. First, farmers, particularly those of Western Canada, are in a better financial position today than they have been for a number of years. Not only is their standard of living improved but ^{the} with/additional cash income of the war years they have been able

to liquidate such accumulated debt. A large part of this was owed to the chartered banks; much of it had been considered uncollectible before the war. The farmers, then, will enter the post war period enjoying relative prosperity for the first time in over a decade.

The reduction of private debt has been further encouraged by the Government's restrictions on instalment buying and credit purchases. People have become accustomed to paying cash for many articles formerly secured on credit. This has had the dual effect of discouraging purchases beyond the means of the average person and encouraging saving for the future. Saving was a lost art for a number of people before the war. Today the credit standing of many who were formerly considered poor risks has improved substantially, not always through their own efforts it is true.

The same may be said of retail stores which, in normal times, would require credit from their bankers or suppliers. Government controls have reduced the volume of accounts receivable on their books, placed them in a more liquid position and made them less dependent on bank borrowings. Many firms which formerly were obliged to request renewals of maturing obligations now have retired or are retiring their bank loans. The inevitable result will be the enhancement of their credit standing after the war

when their prospects of securing accommodation from banks or suppliers will be considerably bettered. To sum up, retail business in common with industry, has strengthened its working capital position greatly during the war.

Another effect of the Government controls referred to above has been a curtailment in the activities of companies financing the production of durable goods for civilian use. A scarcity of materials and labour has also contributed indirectly to this movement. Their financial position is also much more liquid than before the war.

One noteworthy development in the loaning business of the chartered banks has been the extension of accommodation to many thousands of new borrowers in order to stimulate purchases of Victory Loan Bonds. About 25% of their customers' subscriptions have been financed in this way. All the banks have offered special rates of interest and easy terms of repayment. The response has been most gratifying. Many customers have been introduced to the loaning department of their banks for the first time. Further, a large number of persons who had never had any direct contact with banks before have opened deposit accounts following the completion of an instalment purchase of Victory Loan Bonds. The result should be a wider use after the war of the personal loan facilities offered by the banks. This is a lucrative field which has been fully exploited by the small loan

companies since the early 'thirties. The following table, compiled by the Dominion Bureau of Statistics, illustrates the progress made by these companies during the past few years.

Small Loan Companies under Dominion Charter

As at December 31	Loans	Total Assets and Liabilities
	(millions of dollars)	
1930	.6	.7
1933	1.2	1.5
1935	2.9	3.1
1938	4.7	5.2
1939	5.0	5.4
1940	6.2	6.8
1941	7.5	7.9
1942	6.4	9.0

The above figures of assets represent the combined resources of the three small loan companies which carry on business under charters issued by the Dominion Government. Their operations are restricted by the Small Loans Act which was passed in 1939 and which came into force in the following year. Under its terms loans of \$500 or less are limited to a rate of interest not exceeding 2% per month on outstanding balances which rate must be calculated to include all service and other charges.

In addition to the small loan companies, over sixty money-lenders licensed under the Small Loans Act submit annual

returns to the Dominion Government. Their activities are substantially the same as those of the small loan companies and progress for the undermentioned years is reported as follows:-

Licensed Money-Lenders under Dominion Charter		
Year	Loans	Total Assets and Liabilities
(millions of dollars)		
1940	3.5	10.1
1942	4.6	10.5

Capital for the activities of the small loan companies and licensed money-lenders is furnished by shareholders, partners or by way of advances from the chartered banks. In 1942 their combined loans outstanding aggregated \$13 million which figure is small compared with total loans of \$1,103 million outstanding on the books of the chartered banks in the same year. The percentage of the latter figure making up personal loans is not available; it is certain, however, that the banks would be interested in acquiring much of the \$13 million small loan business if they could do so.

Personal loans have been more in demand than ever during the war years. Although many of the chartered banks have adopted special methods to attract this type of business, the small loan companies have continued to enjoy widespread popularity. Their advertising is pointed and intensive. Their collection methods, while more forceful than those used by the banks, have produced excellent results, their loss ratio being extremely low. Much of the business which they handle would not appeal to most of the banks but there is undoubtedly a fairly large amount of personal loans which could be diverted to them by the use of a more vigorous advertising campaign.

The Canadian Bank of Commerce was the first to pay particular attention to personal loans. A special personal loan department was set up a few years ago in all large branches with very good results. Most of the other banks now feature personal loans in their advertising material but none has installed the elaborate machinery devised by the Canadian Bank of Commerce. Before 1939 a fifty dollar loan was not looked on with much enthusiasm by the average branch manager while the small loan companies eagerly sought such business. The war has brought a change in outlook and loans of this type are now welcomed by all banks. As a matter of interest, approximately two-thirds of all bank loans outstanding today are for amounts less than \$500.

It will be to the advantage of both the public and the chartered banks if every effort is made in the post war period to cultivate and expand this more intimate relationship with small borrowers.

Credit unions have been securing a fairly large portion of the small loan business during recent years. Loans granted in 1942, the latest for which figures are available, aggregated \$11 million, over half of which were made in the Province of Quebec. While the co-operative movement has been growing steadily, it appeals mostly to the small farmer, fisherman, or businessman who in the ordinary course of events would not be eligible for bank credit. It cannot be said that it offers serious competition to the chartered banks.

In passing, it will be noted that the trend of advances made by the small loan companies, licensed money-lenders and the credit unions has been in the opposite direction to that of total bank loans. Their combined lending operations have continued to expand during the war while those of the chartered banks have declined since 1941. In fairness to the banks, however, it must be pointed out that if personal loans of the type made by the small loan companies, credit unions, etc., were segregated from other bank loans the trend would be found to be upward also.

Two types of special loans have come into existence as a result of wartime conditions. In order to encourage landlords and householders to purchase their winter's supply of coal during the summer months and thus relieve the pressure on the railways during the crop-moving period, the Wartime Prices and Trade Board in 1942 requested the chartered banks to discount notes given to dealers by purchasers. The Commodity Prices Stabilization Corporation Limited, a Government agency, undertook to guarantee a percentage of all notes discounted by the banks which were outstanding on October 15, 1942, the aggregate amount involved not to exceed \$5 million. The plan was not utilized to any extent by the public in that year but was continued in 1943, the maximum amount guaranteed being reduced to \$0.5 million. In effect, the arrangement enabled purchasers to spread their payments over eight or ten months at the usual bank rate of interest -- terms more liberal than those granted by many coal companies to their customers.

In the fall of 1942 the chartered banks were asked to co-operate with the Commodity Prices Stabilization Corporation Limited by making loans to lumber companies for the purpose of increasing the production of lumber and logs. The guarantee of the Corporation was again provided but was limited by a

predetermined formula to a percentage of all loans outstanding. The plan was retained during the 1943-1944 season with some modifications to encourage producers to make greater use of the banks' facilities.

B. Securities

Until 1929 an average of about 15% of the deposits of the chartered banks was invested in Government and other first class securities while the balance, except for cash reserves, was loaned to the banks' customers. Between 1929 and 1932, loans fell off steadily but purchases of securities did not wholly take their place. In other words, the decline was accompanied by a fall in total assets. The decline in cash reserves which had also commenced in 1929, was halted in 1932 and from then on additional securities acquired by the banks more than offset the falling off in loans. This development was continued until 1936. In the following year when bank deposits had passed the 1929 level, the percentage of deposits invested in Government securities had risen to nearly 50. During the 1937-1939 recovery in loans, security holdings remained relatively unchanged.

The war period has witnessed an acceleration in the rate of expansion of security holdings. Just before the war

the ratio of securities to total deposits was approximately 58%, but by 1943 this figure had grown to 66%. The following table from the Bank of Canada's Statistical Summary outlines this development and furnishes a general breakdown of security holdings.

Securities of the Chartered Banks

As at October 31	<u>Dominion and Provincial</u>		Other	Total
	Under 2 years	Over 2 years		
(millions of dollars)				
1938	451	669	289	1,409
1939	617	736	308	1,662
1940	716	567	237	1,520
1941	724	683	236	1,643
1942	1,427	670	282	2,379
1943	1,784	781	305	2,870
1944	2,020	1,232	370	3,622

The enormous expansion in security holdings during the war years is attributable almost entirely to Government financing. Two major operations must be referred to first, although their influence on bank assets was not as great as might have been expected. In 1939 and again in 1941 the Government sold two special short-term issues of securities to the chartered banks, the first in the amount of \$200 million and the second in the amount of \$250 million. These operations were of an expansionist nature in that they tended to produce an increase in bank assets and a corresponding increase in bank deposits. For reasons which

are given below, they did not in fact have much effect.

Normally when Victory Loan Bonds are sold to the public deposits are drawn down while the Government's account is credited with the proceeds. This may result in little if any change in the banks' position as a whole unless there is widespread borrowing from the banks to pay for these purchases. The effect of utilising the savings of the public to take up Government bonds is to withdraw a certain amount of purchasing power from the public and to transfer it to the Government.

Early in the war the Minister of Finance made it clear that the Government did not intend to borrow direct from the banks to any great extent. Inflation was to be avoided, but the Minister went on to say that a moderate and carefully controlled expansion of credit was desirable in order to facilitate the necessary increase in war production and employment. Taxation and borrowing from the public were to be exploited fully.

The Government has stood by its policy as the record shows. Having regard to the enormous financial requirements of the war, borrowing from the chartered banks has been on a relatively small scale. The expansion in credit resulting from the two operations referred to above was in fact offset to a certain extent by a reduction in other bank investments. The

banks were actually net sellers of securities at the time of their purchase of the two special issues with the result that the net increase in their security holdings was smaller than would normally have been the case.

In addition to these special loans, the Government has borrowed from the banks regularly, first by way of treasury bills, and latterly by way of deposit certificates. Since 1935 there has been a good market in Canada for treasury bills which provide the Government with short-term funds at very low rates of interest. Formerly the banks placed most of their loanable short-term funds in New York and London, but with the opening of the Bank of Canada trading in treasury bills became a permanent feature of the Canadian money market. In 1942 the issue and sale of treasury bills was supplemented by deposit certificates which have since become the major instrument of the Government for short-term borrowing.

Treasury bills purchased by the banks are usually for a term of three months and bear an average rate of interest of less than .5%. Deposit certificates, though negotiable like treasury bills, are not intended to be traded in and are usually for a term of six months; they bear interest at a rate of .75% per annum. More than \$2,380 million treasury bills and deposit certificates were outstanding at the end of 1944 compared with

\$355 million at the end of 1939. Undoubtedly these short-term obligations of the Government have an inflationary effect but increases in the volume outstanding have been kept to what are considered moderate proportions. Many issues are made in anticipation of tax receipts or the proceeds of Victory Loan campaigns. Accordingly they are retired or reduced when sufficient funds became available.

Short-term financing has a number of attractive features from the standpoint of the Government. It is a relatively simple matter to arrange the sale of an issue of treasury bills or deposit certificates compared with the elaborate mechanism required to float a Victory Loan bond issue. The chartered banks are always in the market for a certain amount of short-term paper to make up their liquid reserves. Government issues are not only the safest security but are also the most liquid; this is important in that it should become necessary for the banks to realize on some of their assets to meet an unusual demand for cash.

The return on short-term paper, as explained above, is very low. From the point of view of the Government this provides an inducement to utilize this type of financing. The cost of borrowing to the country is a substantial item in the national budget. However, despite the magnitude of financial operations during the present war, the cost of servicing the

accumulated debt is much lower than during the last war. In 1914 the average rate of interest paid on Government borrowings, including bonds, debentures and treasury bills, was 3.6%. By 1921, after demobilization had been financed, the rate had risen to 5.2%. In 1939, just before the outbreak of war, the average rate of interest paid on the Government's funded debt alone was only 3.5%, and by 1943 this had fallen to 2.6%.

The easy money policy of the Bank of Canada has made such a development possible while the refunding at lower rates of several bond issues which have come due has contributed substantially to the fall in the average interest rate. As far as the chartered banks are concerned, the steady decline has had a serious effect on bank earnings as is discussed in Chapter VIII. This becomes apparent when the changing character of bank assets is also taken into consideration.

It is evident, then, that the principal contribution of the chartered banks to the war effort has been to assist Government finance, first, by direct purchases of special short-term securities, and second, by investing surplus deposits in other Government securities. While holdings of the banks have expanded enormously, practically all of this increase has been

in Government securities having a term of less than two years, including treasury bills and deposit certificates.

As a rule, the banks do not purchase new issues of Victory Loan Bonds. In order to find an outlet for the ever-increasing volume of deposits, however, they do invest in other Government issues, principally those which have been current in the market for six months or more. In practice, they are obligated to purchase any Government bonds which their customers are desirous of selling to them. In 1943 sales to the banks were estimated to aggregate \$334 million while the total for the first four years of the war was thought to exceed \$600 million. However, it must be pointed out that the banks do not retain all the securities which they buy from the public. Statistics indicate that the aggregate of special short-term issues of Government obligations bought by the chartered banks over a period of time is not far behind the rise in their holdings of Government securities of all types. This conclusion is reached if due allowance is made for issues which mature and are redeemed and for bonds which are resold to the Bank of Canada and other Government agencies.

It follows, therefore, that a large percentage of the annual increase in the banks' holdings of Government obligations is made up of special short-term issues, treasury bills and deposit certificates. As far as purchases and sales of long-term securities are concerned, the practical effect of these operations is that

the banks are, for the most part, acting as intermediaries between the Bank of Canada and the public.

The chartered banks have thus become holders of a very large proportion of the national debt of Canada. It is estimated that in 1939 this figure amounted to about 35%, but after four years of war it was well over 40% of the debt payable in Canadian dollars. There are some people who object to the Dominion Government having to pay interest on such a large scale to one financial group in the country. However, if the banking system is to play its full part in the war effort it must be prepared to implement the policy laid down by the central bank. The chartered banks have co-operated in this respect to the limit of their resources.

G. Cash Reserves

Prior to March, 1935 the cash reserves of the chartered banks consisted of notes issued by the Dominion Government, gold coin and bullion and subsidiary coin. Most of the coin and bullion was in the physical possession of the banks themselves, but some was on deposit in the Central Gold Reserves which were managed by the Department of Finance. Insofar as these reserves were in gold, or in Dominion notes backed by gold, they were subject to the expanding or contracting influences of monetary gold imports or exports

arising from Canada's balance of international payments. These influences made themselves felt as long as Canada remained on the international Gold Standard.

After the formation of the Bank of Canada the chartered banks surrendered their gold reserves and Dominion notes to the new central bank in exchange for deposits with and notes of the Bank of Canada. Since March, 1935, the chartered banks have been legally bound to carry reserves in these forms amounting to at least 5% of their deposit liabilities in Canada. In practice, they have continued to regard 10% as the minimum consistent with sound banking practice. The following table, from the Bank of Canada's Statistical Summary, summarizes the development brought on by the war.

Cash Reserves of the Chartered Banks

As at October 31 Year	Cash in Canada	Total Deposits in Canada	Percent of Cash to Deposits in Canada
(millions of dollars)			
1938	286	2,518	11.2
1939	300	2,850	10.5
1940	304	2,774	10.9
1941	318	3,002	10.6
1942	407	3,594	11.3
1943	453	4,089	11.0
1944	588	4,933	11.9

During this period, cash reserves almost doubled, most of the expansion having taken place in the last three years. As the above figures show, the rate of expansion has continued to increase each year. This development was stimulated by the wartime policy of the Bank of Canada which had two objectives: first, to provide the chartered banks with sufficient reserves to meet all credit requirements and withdrawals of cash, and second, to place them in such a cash position that they would be able to purchase enough Government securities to maintain a stable and orderly market.

A central bank normally has several means at its disposal to accomplish this end. Open market operations and adjustment of the rediscount rate are the two devices most commonly employed. By "open market operations" is meant the buying or selling of securities in the open market by a central bank to effect an increase or decrease in the volume of cash in the hands of the public and the commercial banks.

The Bank of Canada has utilized this method throughout the war to effect an expansion in chartered bank reserves. No adjustment in the rediscount rate has been made with this object in view. In fact the rediscount rate of the Bank of Canada --- the rate of interest at which collateral paper may be re-discounted with or advances secured from the Bank by the chartered banks --- remained at 2½% from the inauguration of

the Bank until February, 1944 when it was reduced to 1½%. This reduction was effected mainly for the purpose of indicating to the public that the current easy money policy would be continued not only during the remaining months of the war but also in the post war period. No rise in interest rates generally should, therefore, be anticipated. There was no implication in this action that the chartered banks would borrow more from the Bank of Canada. As a matter of fact, they have been borrowers on infrequent occasions and then only for insignificant amounts.

The Bank of Canada's action in expanding chartered bank reserves has been influenced at various times during the war by several factors. First, in 1939, there was the abnormally large wheat crop of that year which required heavier bank loans than usual to provide the necessary financing. Second, the immediate financial requirements of the Government following the outbreak of war made it necessary to sell \$200 million in short-term securities to the chartered banks.

The purchase of securities by the Bank of Canada in the open market made it possible for the banks to meet these demands without sacrificing their customary cash reserve ratio. In 1940, fluctuations in cash reserves were considerably greater than in peacetime, chiefly as a result of the operations of the Foreign Exchange Control Board. When the Board is purchasing

foreign exchange in large quantities, it may sell treasury bills or other liquid securities in order to obtain sufficient funds to do so. Usually the Bank of Canada, acting as banker and agent of the Board, buys these securities. As the Board disburses the cash acquired in this way, the cash reserves of the chartered banks are increased correspondingly. If the Bank of Canada, in the light of the monetary policy being followed at the time, does not intend to permit this increase it sells securities in the open market until the cash base or cash reserves of the chartered banks have been restored to their former level. The reverse procedure is followed when the Board sells foreign exchange and it is desired to maintain chartered bank reserves at their existing level. Fluctuations are inevitable during the currency of these operations. The increase in 1940 over 1939, illustrated in the table, does not reflect any great expansion in cash reserves, but actually during the calendar year 1940 the increase was \$28.5 million as the result of Bank of Canada action.

Cash reserves rose even higher in 1941. Foreign exchange operations of the Bank of Canada would have brought them to higher figures again had it not been for compensatory action. The Bank sold securities in the open market to offset purchases of foreign exchange which it had made. Further, the Government transferred certain large deposits from accounts in

the chartered banks to accounts in the Bank of Canada. The reverse action was taken when it became necessary to sell foreign exchange in the middle of the year. The increase in cash reserves during 1941, then, was due to operations of the Bank of Canada other than those concerning foreign exchange.

The great expansion which took place in 1942 was closely related to the fiscal requirements of the Government. War expenditures mounted more rapidly than receipts from taxation and bond issues sold to the public. Security holdings of the chartered banks during this period actually increased more than the volume of money. As pointed out earlier in this Chapter, most of the increase consisted of deposit certificates sold to the banks. By October, \$645 million were outstanding, but \$205 million were retired in November from the proceeds of the Third Victory Loan.

Again in 1943, the increase in cash reserves was substantial. The accompanying expansion in security holdings was made up chiefly of special short-term issues, mostly deposit certificates. The outstanding amount of these certificates rose by \$275 million during the calendar year. On September 1st the banks bought \$200 million of 1½% notes maturing in 1945. Most of the increase in cash reserves was necessary in order to maintain the cash ratio position of the chartered banks in

view of the great expansion in deposit liabilities which took place during the year. Some of the increase in reserves, however, was stimulated by deliberate action of the Bank of Canada. This was explained as being necessary to provide some leeway in the over-all position of the chartered banks; it was considered desirable to eliminate as far as possible large temporary fluctuations in the cash position of individual banks, caused by the unprecedented scale of the Government's financial operations. An even greater expansion in reserves took place in 1944. It was accompanied by a sharp rise in security holdings of the chartered banks, only part of which was made up of short-term paper. Reflecting the easy cash position of the banks, the cash reserve ratio reached a record high figure for the war years. In September the daily average was 12.6% compared with a daily average of 10.4% in 1939.

The House of Commons Standing Committee on Banking and Commerce, which sat in the spring and summer months of 1944, reviewed at some length the operations of the Bank of Canada and their effect on the cash reserves of the chartered banks. Members put forth various proposals, some of which are worth noting at this point. First, the perennial suggestion was made that greater use should be made of the Bank's power to expand credit. The Governor, Mr. G.F. Towers, pointed out

that between 1938 and 1944 the total amount of money in Canada, -- bank deposits and currency -- had increased by 90%. However, by the use of controls on spending, high taxation and successive Victory Loan campaigns the inflationary influence had not been substantial. The Governor went on to say that any greater use of the Bank's power to expand the country's credit would have resulted in uncontrollable inflation.

Along with this proposal was the suggestion that any secondary expansion could be prevented by requiring the chartered banks to carry cash reserves of 100% instead of the statutory 5%. The Governor made it clear that such a policy would result in the substitution of non-interest earning cash for interest-bearing securities and that the chartered banks could not afford to lose the attendant revenue. They would have to adjust interest rates paid on notice deposits downward and increase service charges to the public. "The policy followed of issuing Government securities to the banks at an average interest rate of about 1% and paying such interest out of general Government revenues has been more equitable for the Canadian public than the alternative of forcing adjustments in deposit interest rates, service charges or other items," he said.

CHAPTER IV

FOREIGN EXCHANGE CONTROL

One of the most important contributions to the war effort made by the chartered banks has been the administration of the foreign exchange control regulations prescribed by the Foreign Exchange Control Board. It will be necessary at this point to review the background of the Canadian exchange position before the war with the object of ascertaining why it was necessary to introduce foreign exchange control in Canada and why the co-operation of the chartered banks was considered indispensable to the implementation of such a policy.

During the first Great War, it may be argued, the elaborate mechanism of foreign exchange control was not deemed essential. The facts of the situation are these, however. In 1914 both the Canadian dollar and the pound sterling were cut loose from the Gold Standard and promptly fell to a discount in terms of the American dollar. In order to prevent a greater disparity, the Canadian-American dollar rate was pegged or stabilized by a series of measures which resulted in a form of foreign exchange control. The measures adopted were threefold. First, United States securities held in Great Britain were sold to Americans to provide United States funds with which to bolster both the

pound sterling and the Canadian dollar. Second, Canada resorted to borrowing in the United States for the same purpose. Finally, after the United States entered the war, the exchange rate was stabilized by special arrangement with the United States Government.

While the measures resorted to succeeded in preventing a substantial decline in the Canadian-American dollar rate, they did not affect to any extent the daily operations of foreign exchange traders, importers or exporters. There were no restrictions on the purchase or sale of foreign exchange for any purpose whatsoever. Canada was not then the important world trader which she is today, however, nor were her relations with the rest of the world as complex as they were in 1939.

As an indication of what might have happened to the Canadian dollar during the first Great War without Government intervention, it is significant to recall that towards the end of 1920, when the peg was removed from the Canadian-American dollar rate, the Canadian dollar fell to 82 cents in New York. During the two succeeding years, however, it recovered and parity was virtually restored. Canada formally returned to the Gold Standard in 1926 which ensured a normal relationship with other Gold Standard countries, notably the United States and Great Britain, for the next few years.

The economic depression of the 'thirties set up disturbances which shook all currencies which had returned to gold as well as those which had not. The Canadian dollar, in sympathy with the pound sterling, declined in New York following the abandonment of the Gold Standard by Great Britain in 1933. It fluctuated widely until the American dollar was divorced from gold two years later.

During the inter-war period, no formal exchange control was introduced to narrow the disparity between the Canadian dollar on the one hand, and the pound sterling and the American dollar on the other. While the depreciation of the Canadian dollar brought some temporary advantages to Canadian exporters, it brought uncertainties which, in the long run, were not helpful in establishing enduring trading and investment relations with Canada's two best customers, the United States and Great Britain. The exigencies of the present war made it imperative that such uncertainties be removed, at least for the duration of hostilities.

For Canada, foreign exchange control has one principal object, viz., to conserve foreign exchange assets, principally American dollars, so that they may be utilized for the purchase of essential war equipment and supplies and not be dissipated on non-essential materials or services. To accomplish this end it is necessary to prohibit the export

of capital, except in unusual circumstances, and to regulate the flow of exchange purchased for the importation of civilian goods.

In the years prior to 1939, it is estimated that the British Empire as a whole was in all probability buying more goods and services from the United States than it was selling to them. After the outbreak of war the need for American dollars became even more important. The "cash and carry" policy of the United States intensified this problem by making it impossible for belligerents to obtain credit. As a measure of relief, Great Britain resorted to the liquidation of United States assets and reduced her holdings from \$4,483 million at the end of 1939 to \$2,167 million within fifteen months.

Clearly, then, there was an urgent need to conserve American dollar assets in the British Empire as a whole. The Canadian position, however, was much more favourable when considered by itself. In the years immediately preceding the war there was a surplus of foreign exchange from Canadian international transactions on current account which was available for export as capital. This averaged \$200 million per year which was used partly to add to Canadian holdings of foreign securities but principally to

reduce Canada's foreign debt. The bulk of the surplus was derived from trade with Great Britain and to some extent from trade with countries other than the United States. A small deficit usually resulted from Canadian-American trading relations.

The early war years made a drastic change in the over-all financial picture. The disappearance of European markets in 1940, together with a sharp contraction in exports to the Far East, resulted in the disappearance of the large export surplus to countries outside the British Empire, other than the United States. By the end of 1940 it had declined to \$2 million and in the succeeding year was converted into a small deficit. This situation by itself was serious enough. Added to it, however, was the difficulty of converting the surplus realized in the sterling area into American dollars. In the pre-war period, this problem had never arisen. Surplus sterling exchange had always been readily convertible into any other currency. As far as Canada was concerned this meant that it was utilized to purchase American dollars to pay for surplus imports from the United States and to retire American-held debt.

The introduction of exchange control in Great Britain following the outbreak of war made such a simple balancing of international accounts no longer possible. The

free use of surplus sterling exchange was abolished in order to conserve British dollar assets and to provide much-needed American dollars for essential war purchases. This action placed a considerable strain on the ability of Canada to buy American dollar exchange at a time when it was necessary to make heavy purchases of supplies and equipment in the United States to carry out her vast war industrial program. It was apparent, therefore, that control was indispensable in order to ensure that such foreign exchange as was available, principally American dollars, would be utilized for the purchase of essential war materials and other vital supplies and for the purpose of servicing Canada's foreign-held debt. Canadian holdings of American securities and other dollar assets were not large enough to stand any severe drain. Nor was it possible for Canada, a belligerent country, to borrow in the United States in view of the neutrality legislation which had been placed on the statute books.

Several other factors also made it imperative that exchange control should be introduced in Canada at the earliest possible moment. There was the possibility of a large scale export of foreign-owned capital, a serious threat to the stability of the Canadian dollar. Foreign investments in Canada just before the war aggregated approximately \$7 billion of which about \$4 billion was owned by residents of the United

States. In addition, Canadian dollar balances of non-residents in Canadian banks were substantial. The possibility of a liquidation of some, at least, of these investments and an attempt to convert the proceeds and bank balances into American dollars was a real one.

Not only would an export of capital have interfered with the mobilization of foreign exchange required for war purposes, but it would also have hampered the gigantic task of raising sufficient funds within Canada to finance the commitments undertaken. A flight of capital, bringing with it lack of confidence in the Canadian dollar, would undoubtedly have had a very depressing effect on the ability of the Government to market war loan bonds. Further, the employment of domestic funds for the purpose of purchasing foreign-held assets in Canada would have reduced the amount of cash available to the Government since these funds would, presumably, have come from accumulated savings. Finally, any large scale attempt by non-residents to dispose of their holdings in Canada would have impaired the capital value of many sound securities, to the detriment of Canadian and non-resident investors alike. Such a reaction might easily have had a permanent effect on foreign investment in Canada for years to come.

For these three reasons -- to conserve American

dollar assets for war purchases, to facilitate Canada's war financing program, and to protect the investments of non-residents -- foreign exchange control and the imposition of restrictions on the export of capital became a necessary part of Canada's wartime economic machinery.

One or two other reasons also made such a step desirable. All belligerent countries introduced foreign exchange control. Without it Canada would have suffered from the disadvantage of trying to maintain the stability of the Canadian dollar without adequate means of doing so. Trade essential to the prosecution of the war would have been severely handicapped. Further, the conservation and proper disposition of foreign exchange would have been extremely difficult and Government finance at home uncertain. Financial arrangements with other Empire countries, chiefly foreign exchange dealings, would have been unnecessarily complicated by the absence of proper centralized machinery.

Foreign exchange control in Canada was established on September 15, 1939, five days after the Dominion had declared war on Germany. The order-in-council prescribing the regulations and setting up the Foreign Exchange Control Board was passed under the authority of the War Measures Act. The general principles of control laid down were as follows:

Foreign exchange received by residents of Canada from any source whatsoever must be sold to the Board through its agents; all imports and exports of goods, merchandise, currency, securities and other movable property must be licensed by the Board or its agents; securities may be sold in Canada by or on behalf of non-residents only under permit issued by the Board or its agents.

The transition from an exchange system free from all regulation to one under rigid exchange control proved much simpler than was thought possible. In point of fact, Canada presents unusual difficulties. International transactions play such a large part in the economic life of the Dominion that normally any interference with the free flow of exchange would create problems of considerable magnitude. In 1939 Canada was the fifth largest trading country in the world and receipts from abroad formed a very substantial percentage of the national income. Exchange control was bound to affect most of the population in one way or another. It also impinged on the intimate relations existing between branch plants or subsidiary companies and their parent organizations in the United States. Funds had always moved both ways across the border without any restriction whatever, regardless of whether or not they represented the shipment of goods or the payment of dividends.

Finally, Canadians had never given thought before to the necessity of restricting their requirements of foreign exchange. They had been used to travelling and making purchases in the United States and it was a novel experience to find that they could not obtain American dollars as easily or use Canadian currency as freely as in the past. It was necessary, therefore, to educate them to a new point of view.

Preparations for the introduction of exchange control had been made months before the actual outbreak of war. Forms designed as licences and permits and sets of instructions had been printed and were ready for immediate distribution. The early success of the control measures was due to two factors: the thoroughness of these preparations and the active co-operation of the financial institutions which acted as agents of the Foreign Exchange Control Board.

The principal agents of the Board are the chartered banks who act as authorized dealers in buying and selling foreign exchange, issuing export and import licences, travel permits, etc. Settlement must be made with the Board at regular intervals and details of all transactions reported fully. Transfers of Canadian dollars from residents to non-residents are subject to close scrutiny as well as all foreign exchange dealings; in this way the Board retains complete control over all factors

influencing the stability of the Canadian dollar and appropriate action can be taken when necessary to correct any threatening situation.

In all transactions involving foreign exchange, a major responsibility falls on the chartered banks themselves. As agents of the Foreign Exchange Control Board they are the intermediaries between the Board and the public. It is their duty to apply the regulations in such a way that there will be a minimum of inconvenience to importers and exporters in the case of legitimate transactions.

But it is equally important that they carry out the spirit as well as the letter of the law in dealing with their customers. The Board has delegated to the banks certain discretionary powers which make it unnecessary for them to refer cases within prescribed limits. In this way they administer many routine matters which would be completely beyond the capacity of the Board to handle unless branch offices were established throughout Canada. The cost of setting up such a system of control offices and providing the necessary personnel would have been a burden on the country's finances not altogether in proportion to the benefits to be derived.

The banks with their network of branches and trained staffs were the logical choice as agents and the task

of exercising control on behalf of the Board, though onerous, has been carried out in an efficient and praiseworthy manner. The public have had to be educated to the use of the forms and permits necessary for their respective operations. Individual problems have had to be solved with or without reference to the Board, depending on their nature and the amount of currency involved.

Much of this work brings little or no remuneration to the banks. While they are allowed a percentage of the amount of exchange bought or sold, in many instances the net return is small. This is particularly true in the case of travel or export permits for nominal amounts of currency. Forms have to be completed in detail, requiring the time of one or more clerks and possibly a reference to the senior accountant or the manager for an interpretation of the regulations. Permission frequently has to be obtained from the Board which necessitates correspondence and often telephone calls as well.

While the exchange restrictions on travel were relaxed about the middle of 1944 there was no sudden lessening of work done by the banks. On the contrary, many thousands of persons decided that they wished to holiday in the United States or visit friends or relatives. All had to consult their banks in order to obtain a permit to take American or

Canadian dollars out of Canada.

It is true, however, that as time passed the public became more familiar with exchange restrictions and with their co-operation the work of the banks became less onerous.

Foreign exchange is provided by the Board for all imports not prohibited by law and for all services rendered to residents by non-residents of Canada. As examples, exchange is made available for the payment of life insurance premiums, freight, advertising and other services. Canadian debtors having to service bonds or debentures in American dollars are permitted to purchase foreign exchange as are non-resident holders of income-bearing securities payable in Canadian dollars. Dividends may similarly be remitted in American dollars. Capital obligations expressed in foreign currencies which come due may be retired in the currency in which they were contracted.

Since the inception of foreign exchange control the Board, through its agents, has purchased American dollars at a premium of 10% and has sold them at a premium of 11%. These official rates did not often represent the true relationship between the American and the Canadian dollar, particularly in the early years of the war.

American dollar assets of the Board have been strengthened from time to time by various additional measures. In April, 1940 the Foreign Exchange Acquisition Order was passed, compelling all residents of Canada to sell to the Board their holdings of foreign exchange in the form of bank notes, bank deposits, cheques, etc. Canadian insurance companies and other commercial organizations operating outside Canada were granted certain exemptions from the order. In June of the same year a War Exchange Tax was imposed on all imports originating outside the sterling area with the object of further discouraging imports from the United States. Travel south of the border, except on business or for reasons of health, was restricted in July, 1940. In December the War Exchange Conservation Act was brought into force, prohibiting a long list of goods from countries outside the sterling area, unless imported under special licence.

Several orders-in-council, issued under the War Measures Act, supplemented these restrictions by placing controls on the production of passenger automobiles and on the installation of machinery and equipment for non-war purposes, many parts of which had to be imported from the United States. While foreign exchange conservation was not the principal object of these measures, they served to cut down the volume of imports for non-essential purposes.

The most important step taken to make more American dollars available for war purchases was embodied in the Hyde Park Declaration of April, 1941 in which Canada and the United States agreed to co-ordinate their production programs. In effect, this meant that the United States undertook first, to make substantial additional purchases of essential raw materials and supplies produced in Canada and second, to ship to Great Britain under Lease-Lend such materials and parts as Canada might acquire for inclusion in war equipment and supplies produced for Great Britain. In the first part of the program American dollars came to Canada in greater quantities than ever before; in the second, a very large saving in American dollars required to finance imports resulted.

The Hyde Park Declaration was not designed to make up the whole of the threatened deficit of American dollars but during its currency it did make it possible for Canada to build up her war industries without resort to Lease-Lend. Canada has paid cash for all imports, whether or not they were destined to be used for war purposes. Having served a useful purpose in an extremely difficult period, the Hyde Park Declaration was allowed to lapse in 1944 following a substantial improvement in Canada's holdings of American dollars. This was mostly due to the whole-hearted implemen-

tation of the terms of the Declaration by the United States and partly also to an unprecedented volume of net capital imports from the United States in 1943. Several reasons have been advanced for this movement. First, it was suggested that American operators considered the Canadian dollar to be undervalued in terms of United States currency; second, that the higher yield on Canadian dollar securities was proving to be attractive to American capital; third, that the threat of inflation in the United States was encouraging a moderate flight of capital.

The following table, published by the Bank of Canada, illustrates concisely the improvement which has taken place in Canada's foreign exchange position during the war years, exclusive of capital movements.

Canada's Balance of International Payments						
(Estimated Net Current Account Balances)						
	1938	1939	1940	1941	1942	1943
(millions of dollars)						
Great Britain	127	137	343	734	1,223	1,149
Other Empire countries	44	39	76	71	46	67
United States	-149	-116	-292	-318	-180	-19
Other non-Empire countries	78	66	22	4	12	9
All Countries	100	126	149	491	1,101	1,200

While the improvement on current account alone is enormous, there is little hope that Foreign Exchange Control will be relaxed in the near future. On the contrary, it is more than likely that it will be retained for several years at least after the war, possibly in a modified form only. So many factors enter into the post war picture than an accurate forecast of the probable turn of events is impossible. The liberated countries of Europe will require substantial help in the form of food, equipment and supplies to enable them to restore their economic machinery to working order. Such assistance may have to be continued for more than two or three years. It will, of course, have to come from the United Nations, chiefly the United States and Canada whose economies will be in the best position to meet the immediate demands of the post war period. Great Britain will be fully occupied for a number of years in rebuilding her own industrial fabric although she will undoubtedly endeavour to play as large a part as possible in the rehabilitation of Europe with the object of reviving the markets which she lost during the war.

The program of relief and rehabilitation which the UNRRA organization has undertaken will itself involve the transfer of huge quantities of food and supplies. Such movements of goods will virtually amount to free gifts by the

countries concerned since all the United Nations are called on to make financial contributions to the common cause. Each will expect to have most, if not all, of its subscription expended within its own borders, although this will not always be possible. For most of them, then, the exports which go to occupied territories will not bring much, if any, foreign exchange into their treasuries. It will be necessary for each of the United Nations, with the possible exception of the United States, to conserve what exchange it can obtain from the sale of goods in the world market in order to finance the purchase of essential materials and goods which have to be imported.

Canada will undoubtedly be called on to make large shipments of wheat and livestock products to Europe as well as certain types of manufactured goods. Great Britain has already completed long-term contracts with Canada for the purchase of beef and bacon on a substantial scale until the end of 1946. It is not yet clear how Canadian dollars will be found to meet these commitments unless British industry is able to effect a quick conversion to the production of civilian goods immediately after the war.

Problems such as those outlined above make it certain that foreign exchange control will be continued for

sometime after the cessation of hostilities. In this way only can the abnormal movement of goods be facilitated and the economies of liberated countries revived.

A further problem lies in the uncertainty of the post war tariff policies to be followed by the leading trading nations of the world. Canada is vitally interested in seeing that a solution adequate to her own needs is found. The Dominion is now the third largest trading nation in the world instead of the fifth as in pre-war days. If her customers, present and potential, plan to restrict the movement of goods and services by high import duties, quotas, etc., her domestic economy will suffer seriously. It may well be necessary for Canada to retain exchange control until it is apparent that she will be able to export on a scale adequate to support essential imports.

As the United States is the principal source of imports into the Dominion the course of American tariff policy will be watched more closely than ever in the post war years. There is evidence, however, that the present favourable trading relations between the two countries may be extended after the war, possibly on less advantageous terms, but on a basis more acceptable than that which existed before 1939.

One or two other factors, important to Canada, enter into the exchange picture. In pre-war days, tourists from the United States brought into Canada as much as \$149 million per year, if 1937 is taken as an example. This figure must be adjusted, however, to allow for the expenditures of Canadians in the United States which amounted to \$65 million in the same year. The net of \$84 million is not an insignificant figure in the balance of international payments.

To what extent an influx of American tourist dollars can be relied on in the post war period will not be evident until after the conclusion of hostilities. It seems reasonable to suppose that Canada will once more become the playground of thousands of American visitors but they may be deterred from crossing the border if exchange rates are unfavourable or are subject to violent fluctuation. There is no reason to presume that such will be the case, however, unless the inflationary movement which has already gained much ground in the United States continues to make headway. This may well prove to be a further argument in favour of the retention of exchange control in Canada.

Finally, it must be said that much will depend on the volume of capital imports into Canada. It is more than

likely that many American companies owning branch plants in Canada will wish to expand their Canadian operations and that additional capital will be required to enable them to do so. There will also be many newcomers in the field. Exchange stability will be a factor in decisions of this nature for profit margins can soon be wiped out by unfavourable exchange rates. Profits which are not re-invested in Canada are, as a rule, withdrawn. To induce more American capital to come to Canada and participate in the post-war boom it may be necessary to retain a measure of exchange control.

Canada's chartered banks will be charged with the responsibility of continuing the operation of exchange control should it be considered indispensable. They will also be well prepared to assist in the expansion of Canadian overseas trade. Five of the banks operate branches in London and in the United States; four have offices in Newfoundland while three are widely represented in South America and the West Indies. In 1943, 135 branches and agencies were in operation outside Canada.

CHAPTER V
RATION COUPON BANKING

Early in the war years it became apparent to the Government that the distribution of certain essential foods and supplies would have to be regulated if stocks were to be divided equitably and overseas deliveries effected as promised. A broad policy was formed by the War-time Prices and Trade Board in October, 1942 which was supplemented by various restrictive measures from time to time. Rationing was introduced for commodities in short supply which were essential to all or certain groups of consumers, or when it became necessary to ensure that distribution was made on an equitable basis.

Two types of rationing schemes were set up, one of which was by coupon and the other by permit. In the case of the former, only articles which were in general use and which were purchased at regular intervals in approximately equal quantities by all consumers were included. Other commodities, particularly those of a durable nature and which were not considered indispensable to all consumers, such as electric stoves, tires and tubes, farm

machinery and typewriters were rationed by permit.

Sugar, tea, coffee, butter, meat, evaporated milk, canned fruit, marmalade, jam, maple syrup and gasoline have all been rationed by coupon at one time or another since 1942. It is with these commodities that this discussion will be concerned. Sugar was first rationed in January, 1942 by an "honour" system which required consumers to restrict their purchases to $\frac{3}{4}$ pound per week per person, then to $\frac{1}{2}$ pound per week in May, but it became necessary to introduce coupon rationing on July 1st of the same year. The ration has been maintained at $\frac{1}{2}$ pound per week per person since that date, except for a slight cut in 1945, with extra allotments for canning and preserving purposes.

Tea and coffee were also rationed by the "honour" or voluntary rationing system in 1942 but coupon rationing followed on August 3rd when a weekly allotment of one ounce of tea or four ounces of coffee per person was provided. This ration was increased substantially in September of the following year and again in May, 1944. Rationing was discontinued a few months later with the announcement that the shipping situation had improved sufficiently to ensure adequate stocks for all ordinary purposes.

Butter was first rationed by coupon on December

21st, 1942 when a weekly allotment of $\frac{1}{2}$ pound per person was authorized. Fluctuations in butter stocks made it necessary to reduce this amount temporarily in 1943 and 1944 and for an indefinite period in 1945. Meat rationing, which went into effect on May 27th, 1943, was suspended indefinitely in February, 1944 with the announcement that large surpluses had been accumulated. During the past twelve months there have been several semi-official statements to the effect that it will not likely be necessary to re-introduce the rationing of meat.

Marmalade, jam, maple syrup, canned fruits, honey and other sweeteners were grouped for rationing purposes on September 2nd, 1943. Since that date the value of these "preserve" coupons has been adjusted several times in keeping with available supplies; each has an alternative value of $\frac{1}{2}$ pound of sugar. Evaporated milk has been rationed by coupon since October 4th, 1943 in order to ensure that adequate supplies would be available for children, invalids and other essential users.

The enormous demand for gasoline created by the war forced the Government to introduce coupon rationing on April 1st, 1942. All vehicle owners were required to register their cars with the regional offices of the Oil Controller and

to obtain a gasoline licence and ration book. The original value of the coupon or unit was five gallons but this was subsequently reduced to three gallons. The number of coupons or units allocated to users varies with their individual requirements, due consideration being given to commercial and vocational needs.

An effective rationing system involves the control of supplies through the various stages of distribution from the manufacturer or producer to the final consumer. To implement this control it has been necessary to require that retailers and wholesalers produce coupons obtained from their customers or equivalent documents when replenishing their stocks of rationed commodities. The actual handling of coupons on such a large scale originally involved a tremendous amount of work, not only by the retailer in collecting coupons from his customers, but also by his suppliers. The procedure was greatly simplified by the introduction of ration coupon banking in March, 1943. This was an entirely new development in Canadian banking practice. Originally, it applied only to rationed foods, but in April, 1944 it was extended to include gasoline rationing as well.

Consultations between bank representatives and the Administrator of Consumer Rationing were begun late in 1942 with a view to enlisting the services of the chartered banks.

A close study of bank facilities followed with a subsequent request to undertake this special work, commencing March 1st, 1943.

Much preliminary work had to be done before ration coupon banking could become a reality. The president of the Canadian Bankers' Association appointed a special committee of bank officers to collaborate with the Wartime Prices and Trade Board representatives in devising routine and preparing instructions for all bank branches. The procedure to be followed was based on the theory that the greatest economy of time and effort could be achieved by arranging that, as far as practicable, coupons and other documents used by consumers to obtain rationed goods should be deposited to ration coupon accounts or exchanged for bank transfer vouchers by the dealers supplying the consumers.

Under existing arrangements ration coupon accounts operated by the banks are of two types, dealers' accounts and quota users' accounts. The following persons or firms who deal in rationed commodities are required to conduct ration coupon bank accounts and for this purpose are designated as "dealers": jobbers and brokers, wholesalers, creameries producing butter, importers of rationed preserves, manufacturers of evaporated milk, primary producers

of commodities included in the "preserves" rationing scheme whose annual production amounts to 2,000 pounds or more (except producers of rationed maple products and honey), beekeepers whose annual production of honey amounts to 4,000 pounds or more, retailers whose normal monthly gross sales in food, exclusive of meals, amount to \$2,500 or more.

Separate accounts are kept for each rationed commodity or group of commodities. Each is operated in the same way as an ordinary bank account except that entries and balances represent a number of coupons instead of dollars and cents. A dealer who operates a ration coupon bank account may replenish his stock of a rationed commodity by forwarding to his supplier a cheque drawn on his account for the number of coupons which his order represents. The supplier then deposits the cheque to the credit of his own ration coupon bank account for the same commodity. He draws on his own account in a similar manner when he makes purchases from manufacturers or producers. The simplicity of the bank account system eliminates the cumbersome transfer of thousands of coupons and other documents from retailer to wholesaler and from wholesaler to supplier, etc.

Small retailers and others who are not required to operate ration coupon accounts must still surrender coupons or documents to their suppliers. In order to cut down the volume of coupons changing hands and at the same time to eliminate the necessity of operating accounts for such retailers, it has been provided that a bank transfer voucher may be obtained in exchange for coupons or ration coupon documents. The only restriction placed on this type of transfer is that the voucher must not be issued for less than 250 coupons. Bank transfer vouchers may also be used by travelling representatives of dealers who are required to conduct ration coupon accounts and, under certain conditions, by branches of dealers required to keep such accounts.

Retailers attach coupons which are surrendered by their customers to gummed sheets provided by the Ration Administration. The sheets are designed to accommodate the number of coupons necessary for what is usually a minimum wholesale order for each commodity. Only completed sheets may be deposited in ration coupon bank accounts. When a bank transfer voucher is requested, however, a retailer may present an incomplete sheet if the amount of coupons affixed to it corresponds with the amount of an order which he is placing with his supplier.

Hotels, restaurants, hospitals and other institutions serving meals which include rationed goods are required to conduct quota users' ration coupon accounts. Each operates on a quota set periodically by the Ration Administration. The quota authorizations indicate in terms of coupons the quantity of goods to which the quota users are entitled for a certain period of time. The authorizations issued by the Ration Administration are taken to the banks by the quota users where they are converted to credits in the various commodity accounts operated by them. As they purchase rationed goods they draw covering ration cheques against their respective accounts in favour of their suppliers.

Inasmuch as the ration coupon transactions handled by the banks are of an accounting nature only and do not affect their assets or liabilities, no settlements are required between branches or banks. When ration coupon cheques or bank vouchers drawn on other branches or banks are deposited they are forwarded to the branches or banks concerned along with other items. Special purchase permits, quota authorizations or other documents are forwarded to the Ration Administration. Coupons received over the counter are destroyed by the banks after being properly checked and recorded. The banks are reimbursed by the Government for

their work to the extent necessary to cover their expenses as determined by a cost analysis. The arrangements are contained in an order-in-council dated August 17th, 1943 as amended.

The resemblance of ration coupon banking to ordinary banking transactions is limited by certain requirements of the Ration Administration. A bank may not open a ration coupon account for a dealer required to operate such an account unless his application to do so has been approved by the district branch of the Administration. The bank may then complete the necessary formalities and supply the dealer with special ration cheques and deposit slips. Quota users must also apply for permission to operate ration coupon accounts.

Authority to sign ration cheques may be delegated by the persons authorized to sign withdrawals from the individual's or company's ordinary bank accounts. Specimen signatures are obtained by the banks as in the case of ordinary accounts. If necessary, the banks may have 48 hours in which to check and accept or refuse deposits to ration coupon accounts. Definite rules are laid down as to the conditions under which coupons may be received. Ration cheques and bank transfer vouchers must be endorsed in the usual way when deposited, both by the transferee and by the negotiating bank.

Coupons remain valid in the hand of dealers for an additional two weeks after the expiry date notified to the public. During that period they may only be deposited to the credit of ration coupon accounts or exchanged for bank transfer vouchers. Ration cheques are debited to dealers' accounts even though an overdraft may be created. The dealer is notified immediately as well as the district branch of the Ration Administration. Prompt cover is expected. While there is no provision for the certification of ration cheques, they are returned to dealers at regular intervals as in the case of current account vouchers. Quota users, however, may not have their ration cheques returned to them.

When a ration cheque is lost a dealer may furnish a stop order form, authorising the bank to refuse to honour the item. Contrary to the practice followed when ordinary cheques are lost, a bank must honour an original ration cheque, even if a duplicate has already been presented and debited to the dealer's account. Both the dealer and the Ration Administration have to be notified of such action. Bank inspectors as well as inspectors of the Administration examine coupon banking records and the procedure followed in bank branches from time to time. It is their duty to ensure that the destruction of coupons and coupon accounting are carried out in

accordance with the Ration Administration's instructions.

Reports of the number of consumer coupons deposited to ration coupon accounts or exchanged for bank transfer vouchers during the period must be forwarded every month by all branch banks to their head offices. In addition, a report containing the names of dealers and quota users whose accounts have been inactive during the preceding six months' period must be forwarded to the Ration Administration semi-annually. As is the case in all bank records, information concerning ration coupon accounts is kept strictly confidential, only depositors and representatives of the Wartime Prices and Trade Board being entitled to request particulars.

Since the inception of ration coupon banking, the chartered banks, as agents of the Wartime Prices and Trade Board, have opened more than 209,000 accounts and handled hundreds of millions of coupons which would otherwise have required an enormous addition to the personnel of the Ration Administration and its district branches. Ration coupon banking has become a major wartime service of the banks. By using their facilities the Government has been able to make a substantial saving in both manpower and money. It is estimated that in 1943 more than 50 million coupons entered into circulation every week of the year. In 1944 there were more than 138,000 ration coupon accounts in operation.

The saving of many hours of work on the part of dealers is an accomplished fact. Undoubtedly the simplified banking routine set up has resulted in an economy of time of no little consequence. Instead of making returns to the Ration Administration, a dealer is able to complete all his ration transactions when he calls at his local bank in connection with his usual financial operations. Alternatively, he may draw a ration cheque on his account when placing an order with his supplier, a device far simpler than the complicated business of transferring to him thousands of consumer coupons which he has acquired from his customers, or submitting them to a district office of the Ration Administration in order to secure permission to replenish his depleted stocks of rationed commodities.

It is conceivable that, if the exigencies of the war make the rationing of more consumers' goods necessary, the banks will be called on to enlarge this new sphere of operations. The experience gained during the past two years has resulted in a smoothly-functioning system which has served the country efficiently and at a minimum cost to the Government. It may well be continued for a few years in the post war period.

CHAPTER VI

WAR FINANCE AND THE BANKS

As agents of the Bank of Canada, the chartered banks have performed a valuable service to the Government in facilitating the sale and distribution of Victory Loan Bonds and War Savings Certificates. This is quite apart from the assistance rendered by direct participation in the financing of the war effort through the purchase of Government securities such as Treasury Bills, Deposit Certificates, etc. Two War Loan and seven Victory Loan bond issues have been offered to the public since September, 1939. The figures of each are worth noting.

Public Bond Issues in Canada Since 1939

Item	Date	Objective (millions of dollars)	Subscriptions (excluding conversions) (millions of dollars)	Subscribers
1st War Loan	Jan. 1940	200	320	178,363
2nd War Loan	Sept. 1940	300	342	150,890
1st Victory Loan	June 1941	600	730	968,259
2nd Victory Loan	Feb. - Mar. 1942	600	843	1,681,267
3rd Victory Loan	Oct. - Nov. 1942	750	991	2,032,154
4th Victory Loan	Apr. - May 1943	1,100	1,309	2,668,420

Item	Date	Objective (millions of dollars)	Subscriptions (excluding conversions)	Subscribers
h Victory Loan	Oct. - Nov. 1943	1,200	1,375	3,033,051
h Victory Loan	Apr. - May 1944	1,200	1,408	3,077,123
h Victory Loan	Oct. - Nov. 1944	1,300	1,517	3,300,735

It will be observed that, with two exceptions, the objective of each campaign has been for a greater amount than the one which it followed. Despite the determination of the Government to raise as much revenue as possible by taxation, the ever increasing demands of the war have made it necessary to borrow vast sums from the accumulated savings and current income of local government bodies, corporations and individuals alike. Their response to each successive appeal has resulted in every campaign being over-subscribed by a substantial margin. Subscribers have increased from over 178,000 in 1940 to more than 3,300,000 in the drive conducted in the autumn of 1944.

For this very favourable development there are several explanations. First, there is the patriotic motive which has prompted a number of people to invest whatever they could spare, and sometimes more, in Government war bonds.

Propaganda disseminated by the National War Finance Committee through the medium of the press, radio and moving picture theatres has roused many persons to think more of the welfare of their country than they ordinarily would. Second, there is the profit motive which has induced both corporations and individuals to put their accumulated savings to work earning interest. Opportunities for the employment of surplus funds have become fewer owing to :-

- (1) the Government's policy of financing the construction and operations of many war plants;
- (2) the shortage of consumer goods; and
- (3) Government restrictions on credit purchases.

Investment in Government securities has, therefore, become more and more attractive. This movement has taken place despite the fact that the interest rate on all war issues, except the First War Loan, has not exceeded 3%. Lastly, there is little doubt that the efficient organization developed by the National War Finance Committee on behalf of the Bank of Canada has tapped most, if not all, available sources of subscriptions. The Committee was formed in January, 1942 by the

Minister of Finance just before the opening of the Second Victory Loan Campaign. It succeeded the War Savings and Victory Loan Committees which were appointed for earlier drives, the former in May, 1940 and the latter in June, 1941.

The Minister, in a speech in the House of Commons in June, 1943, summed up the objectives of the National War Finance Committee as follows: "Future operations of the ..

..... Committee contemplate:-

- (a) a continuous program of public education in the national and personal need for, and advantages of, voluntary savings during the war years,
- (b) the continuous sales promotion of War Savings Certificates and Stamps,
- (c) the sale of two Victory Loans in each year, one in the Spring months and another in the Fall, and
- (d) the development of a better public understanding of the advantages, both national and personal, to be realized through retention, at least for the duration of the war, of securities purchased during the war years."

The Committee consists of a national executive committee of representatives of all major industries, agriculture, labour, commerce, finance, women's organisations, etc., and provincial committees organised on a similar basis. In addition, there are over 450 local units. The permanent full-time staff of the National War Finance Committee is made up of less than 400 persons; it is supplemented by approximately 125,000 voluntary workers attached to the local units. There are, in addition, about 17,000 workers engaged on a temporary basis as well as hundreds of salesmen working for a commission. About 1,850 investment dealers and brokers act for the Committee during the various campaigns.

Five divisions execute the Committee's plans. The first of these, the Special Names Division, canvasses corporations, financial houses, government agencies, and individuals believed to be capable of subscribing \$25,000 or more in a single campaign. Personnel of this division are recruited chiefly from officers of investment and brokerage houses. Investors on the Special Names lists have accounted for about 60% of all Victory Loan subscriptions.

The second, the Payroll Savings Division, covers the members of the armed forces and employees of companies

who have a payroll of at least 25 names whose annual incomes do not exceed \$3,000. Commissions are not paid on canvasses conducted by the personnel of these divisions. In the case of the third, the General Sales Division, individual salesmen are paid at rates varying from 1/8 of 1% to 5/8 of 1%, depending on whether or not the issue sold is of a medium or long-term type. Dealers and brokers are remunerated for their efforts according to the service rendered.

The General Sales Division extends its operations to all potential investors not covered by the Special Names and Payroll Savings Divisions. Two other divisions of somewhat lesser importance complete the organization of the National War Savings Committee. The first, the Public Relations Division, handles advertising by means of the radio, press, public performances, outdoor advertising, etc. The Administrative Division, comprising permanent personnel, supervises the organization as a whole and takes care of all administrative details.

Contrary to popular belief, the cost of marketing Victory Loan bond issues has been very moderate. With the exception of the First Victory Loan, every issue has cost the Government less than 1%; in the case of the Fifth, the

cost was only .76%. The effectiveness of the organization set up to market Victory Loan Bonds and the low cost at which it is able to operate owe much to the chartered banks and their network of branches in all communities of any size throughout Canada.

The banks provide the main facilities for distributing bonds purchased in each campaign, whether for cash, on the instalment plan or by the payroll deduction plan. In the case of cash subscriptions, a purchaser may place his order with any authorized salesman, bond dealer or other agent, including his own bank. In the application form which he signs he names a particular branch bank or trust company at which he wishes to take delivery of his bonds. If he prefers to make his purchase on the instalment plan, he has the choice of spreading the payments over a six months' period according to a schedule prescribed in the application form, or he may make his own arrangements with his branch bank. In any event he must name a bank or trust company where he will complete his purchase.

If a purchaser is employed by a large organization, he may elect to buy his bonds on the payroll deduction plan

which most employers have adopted in each campaign, often with the advice and assistance of their local branch bank manager. Under this arrangement the purchaser contracts to have his employer make regular deductions from his salary or wages which deductions are remitted to the bank to be credited to the individual purchaser's account. Settlement may be made with the bank by the employer every week, fortnight or month according to the arrangement which best suits his circumstances.

As a general rule the employer undertakes to purchase Victory Loan Bonds on behalf of his employees, borrowing the necessary funds from the bank. Many companies make the initial payment themselves or undertake to pay their employees a bonus for every bond which they buy. In any event, the usual procedure is to have the bank do the necessary financing of the unpaid instalments in preference to utilizing company funds for this purpose. The employees are virtually borrowing from the bank, but on a collective basis. In some cases where companies are not prepared to obligate themselves for their employees, the banks acquire the necessary bonds and carry them in their investment accounts; the amounts owing thereon are reduced by monthly

deductions made from employees' pay cheques which are remitted to the banks by the companies.

The payroll deduction plan necessitates a considerable amount of bookkeeping both on the part of the banks and their customers. At the height of a campaign, the extra work involved forces the banks to divert a number of their staff from other duties and to require them to work many hours overtime. However, the time and effort consumed are written off as a further contribution to the war effort.

A unique feature introduced in the Third Victory Loan campaign was the Agricultural Sales Program under which farmers were urged to purchase bonds from the sale of farm produce. The farmer was required to execute a "Victory Ticket", authorizing the buyer of his produce to remit to the National War Finance Committee the proceeds of the sale. The chartered banks made special arrangements to expedite deliveries under this scheme.

To sum up, the part played by the banks in facilitating the marketing of each Victory Loan issue is threefold in nature: over-the-counter sales, the financing of purchases, and the making of deliveries to new as well as old customers. For services rendered they receive a

commission on the volume of deliveries effected. (More than 10,750,000 bonds had been delivered by the end of October, 1944.) The commission amounts to $\frac{3}{8}$ of 1% on short-term issues and $\frac{1}{4}$ of 1% on long-term issues.

In the case of the earlier Loans, the basis of remuneration was quite different. In the first two War Loan drives individual canvassers were paid a commission of $\frac{3}{4}$ of 1%. The banks as a whole were allotted a fixed proportion of total commissions payable which was then allocated to individual banks on a pro rata basis. In the First Victory Loan campaign salesmen were paid $\frac{1}{4}$ of 1% on short-term issues and $\frac{1}{2}$ of 1% on long-term issues. When the Second Victory Loan drive was inaugurated the rates of commission were increased $\frac{3}{8}$ of 1% on both types of bonds, but no commissions were paid on the proportion of subscriptions which represented conversions from maturing issues.

In the case of both the First and Second Victory Loans, the chartered banks were allotted commissions of $\frac{1}{4}$ of 1% on all bonds handled. At no time, then, has the Government offered high or unwarranted rates of commission to facilitate the sale and delivery of Victory Bonds. Criticism has come from some directions that the banks have been compensated more generously than was necessary. The fact of the matter is, however, that no system of distribution could have been set

up on as economical a basis as that provided by the branch banking system. Certainly it would not have been considered expedient to organize a temporary network of agencies for the sole purpose of making deliveries of bonds twice a year. There must also be taken into consideration the year-round service which the banks provide in effecting registrations and transfers for the investing public and in maintaining the cost-free service of selling and distributing War Savings Certificates and stamps.

Staffs of branch banks bear a heavy responsibility in their dealings with the public. Many purchasers of bonds are owners of securities for the first time. Whether or not they will again subscribe to Victory Loan issues at a later date frequently depends on the manner in which they are treated when they enter their local bank. Many cases are on record where an over-worked bank clerk has paid scanty attention to the purchaser of a \$50 bond when the next customer in line is known to be a subscriber of substantial means. There is, of course, no excuse for discrimination and it would not be fair to say that it is practised at all widely. In any event, it is important from the national point of view, if from none other, that every individual subscription to Victory Bonds be cheerfully accepted. For it is the multitude of small investors whose savings assure the success of every campaign.

What has been written above about Victory Loan Bonds applies equally in the case of War Savings Certificates. These are issued in denominations of \$5, \$10, etc., and are now sold over the counter in much the same way as bank drafts or money orders. In the early years of the war the banks merely accepted orders accompanied by cash or war savings stamps. They were then forwarded to Ottawa where special staffs of the Department of Finance filled out certificates and mailed them to the purchasers or the individuals named in the orders. The amount of work involved in following this procedure resulted in delays of many weeks between the time that orders were placed and the time that certificates were delivered.

In July, 1943 over-the-counter sales began in all chartered banks by special arrangement with the Department of Finance. This change in procedure meant that the public could now exchange cash or stamps for certificates in one operation. Undoubtedly the service which has been provided since the inauguration of spot sales has stimulated the sale of certificates. It has, of course, added to the work of the banks. First, the teller or accountant must be interviewed and the order placed. Then the cash or

stamps have to be checked, or if a cheque is presented, its worth must be verified or appraised. The application form must be completed carefully by the purchaser as the particulars which it contains are transcribed to the certificate itself. This work is done on a typewriter by one of the stenographers, as a rule, in order to ensure neatness and accuracy. A duplicate of the certificate is later forwarded to Ottawa to complete the records of the Department of Finance.

For all this work the banks receive no compensation whatsoever. It may be true to say that some new business is acquired as a result of contacts made with the public which did not exist before. But it is questionable whether any great value can be attached to accounts secured in this way. There is no doubt, however, that a certain amount of goodwill can be built up by a branch bank if it offers courteous and prompt attention to the requirements of purchasers of War Savings Certificates, regardless of the size of the transactions involved.

War Savings Stamps are also handled on an over-the-counter basis. Sales, however, require considerably less time than the completion of orders for War Savings Cer-

tificates. All tellers carry stamps in their cash and sell them as they do excise stamps. Often a customer can be induced to accept some of his change in the form of stamps. It is evident, then, that the banks are in an advantageous position to stimulate the sale of both certificates and stamps and in this way to contribute materially to the diversion of savings into the Government treasury.

There is one noteworthy social aspect to the systematic saving program forced on the public by the National War Finance Committee, acting on behalf of the Government, and by the chartered banks, acting as propaganda agents for the Committee. By the end of the war, thousands of individuals who had never saved money before will have accumulated a substantial reserve in the form of Victory Loan Bonds and War Savings Certificates. Whether or not they proceed to realize on these securities and spend the proceeds is not the point under consideration at the moment. The important thing is that they have become conditioned to the habit of saving.

Many will soon lose this habit, of course. But thousands of others will have developed a new standard of values, the consequences of which may have far-reaching

effects. They will have learned that in time of prosperity one should prepare for adversity. The advantages of saving have been stressed many times through the various propaganda media employed by the Committee, with carefully drawn conclusions as to the benefits to be derived in the post war era.

The banks have always recognized that the saving habit, once acquired and cultivated, can bring good to themselves as well as to the public. Bank advertising has taken up the war saving theme and has emphasized the virtue of buying Victory Loan Bonds and War Savings Certificates now to provide for the future. Holders of bonds will in due course become holders of cash when their securities mature or are sold and they will make good bank customers. Further, persons who are accustomed to saving during the war years and who continue to save after the war also make desirable clients. They are valuable as depositors because they know how to hold on to money and as borrowers because they have a better sense of the value of money than those who do not save.

It is not unreasonable to suppose that if enough people are influenced by the saving habit post war booms and depressions might be lessened in severity. Many economists have written at great length on the virtues of controlling the saving and spending of the community to accomplish

this end. Voluntary saving, if on a large enough scale, might reduce the volume of spending in time of prosperity and create unsatisfied wants sufficient to induce an outflow of accumulated savings in time of depression. The social consequences of such an action, if a concerted one, might well be the mitigation of fluctuations in the volume of unemployment in the country.

The principle of saving in good times and spending in bad is put into practice by the Government of Sweden in normal years, an example that might well be imitated by all other countries. Taxation is retained at a reasonably high level in periods of prosperity when the proceeds are laid aside and earmarked to be spent in periods of depression. Vast public work projects are then brought into being, financed by this accumulation. Taxes are not expected to yield as much in bad years and are often substantially lower in order to lighten the burden of taxpayers.

Such an over-all long-range budget of saving and spending might well be the model for individual planning. If a sufficient number of people were to adopt it, the voluntary control of spending referred to above might become a reality and a forceful influence in the country.

CHAPTER VII

MISCELLANEOUS BANK SERVICES

In addition to the expansion of normal banking services to meet wartime requirements and the creation of special facilities to carry out Government business, the chartered banks have provided several less conspicuous services which pass almost unnoticed in a review of bank operations. None of them brings in any revenue commensurate with the responsibilities undertaken or with the facilities made available to the public and the Government.

The first of these wartime services is provided for the benefit of the Custodian of Enemy Property. On September 5th, 1939 --- five days before Canada declared war on Germany -- the "Regulations Respecting Trading with the Enemy" were brought into force by an order-in-council passed under the War Measures Act. These Regulations were subsequently amended, being replaced by the "Consolidated Regulations Respecting Trading with the Enemy (1939)" which in turn have been altered on two occasions. In brief, they prescribe the conditions governing the disposition of enemy property located in Canada on the outbreak of war and deal also with related subjects.

All enemy and enemy-occupied territory was brought within the scope of the Regulations from time to time. Principal offences are:-

- (1) trading, attempting to trade, and proposals or agreements to trade with the enemy;
- (2) dealing in the property of the enemy for the purpose of enabling him to obtain money or credit thereon;
- (3) aiding or abetting any person, whether resident in Canada or not, to so deal in enemy property;
- (4) knowingly discharging any enemy debt, promissory note or bill of exchange, or purchasing enemy currency.

Penalties for committing any of these offences are severe.

The Secretary of State is the Custodian of Enemy Property and his department is responsible for the enforcement of the ban on trading with enemy aliens and the necessary sequestration of enemy property in Canada. Such property, regardless of whether or not it has been disclosed, is vested in him under the Regulations; he acquires all the rights that the enemy himself had in the property, including the

form of dealing with such property in any manner that he sees fit.

Included in enemy property are such items as bank accounts, dividends and interest, insurance and bequests payable to enemy aliens. It will now be apparent why the close co-operation of the chartered banks was necessary to ensure that the Regulations were enforced strictly and that all available data concerning suspected accounts were passed to the Custodian for such action as he considered necessary. Since few financial transactions take place in Canada without some reference to a chartered bank at one point or another such valuable information has been reported by bank clerks while performing their routine duties. There are many instances on record where it was known to branch staffs that certain names on the books of the bank were fictitious and intended to mask questionable financial operations. Prompt action by the Custodian following receipt of such advice often frustrated attempts to violate the enemy trading regulations. Accounts conducted by citizens of countries threatened by Germany were watched closely and appropriate action taken when the invasion of these territories became a reality.

Prior to the outbreak of war, and even in the

first year of hostilities, many European banks sent securities and cash to Canadian banks for safekeeping. Sealed instructions often accompanied such transfers; these were to be acted upon in the event that Germany invaded the country of origin.

All these operations involved close liaison with the Custodian of Enemy Property once hostilities had actually commenced. Reports had to be submitted by the chartered banks and investigations conducted. The thoroughness in which the banks discharged their obligations resulted in the Government being able to draw a tight net around all enemy or suspected enemy financial or trading operations which might otherwise have hampered Canada's war effort.

Early in the war years, the chartered banks made it known that, as a contribution to the war effort and to the welfare of those serving in the armed forces, they would not collect the usual exchange charges on funds transferred from one city or town to another. The Bank Act provides that the banks may exact a charge of $\frac{1}{8}$ of 1%, minimum 15 cents, on all cheques or other items negotiated which are drawn on points where they have branch offices; in the case of points where they have no direct representation, they may exact a charge of $\frac{1}{4}$ of 1%, minimum 25 cents. To servicemen who are moved about the country, sometimes at frequent in-

tervals, this concession resulted in a real convenience and a substantial saving of money. It meant that they could leave their principal account at the branch in their hometown where they had always done business and transfer funds from time to time to temporary accounts elsewhere without charge. This convenience has been utilized quite extensively. Most servicemen have some financial commitments in their hometown. To be able to draw cheques on a local account when making various payments which come due has facilitated the personal business of thousands of sailors, soldiers and airmen. Normally, they would have been obliged to purchase post office money orders or bank drafts to make such remittances with the added cost of exchange charges.

The banks have gone even further to make it easy for servicemen to carry on their personal affairs. All accounts, whether current or savings, have been operated without cost to the depositors. Under ordinary circumstances these accounts would bring in an appreciable amount of revenue to the banks since most of them are made up of small balances; withdrawals are numerous and, to place them on a profitable basis, the banks would normally collect a monthly service charge. By waiving this charge, the banks are saving servicemen many dollars each month. It is reasonable to suppose,

however, that these concessions to the men and women of the armed forces will, in the long run, pay dividends to the banks in the form of goodwill and, at a later date, bring them business of a more profitable nature.

Both servicemen and their dependents call on the banks to cash their monthly or semi-monthly pay and allowance cheques. To the average person this may seem to be all in the day's work for a branch bank, but it must not be forgotten that the volume of these cheques has increased by scores of thousands since the first year of the war. The banks virtually act as paymasters for many thousands of service personnel who are not paid in cash. Their dependents are paid by cheque only, requiring a visit to their local branch once a month. Workers in war factories who are paid by cheque have also contributed substantially to the volume of items handled each month by the banks. As pointed out in Chapter IX, this additional burden has been carried with staffs considerably less experienced than in peacetime.

Many branch banks have been opened since the outbreak of war at military camps and air force establishments with the sole object of providing banking facilities at isolated points which would not otherwise exist. Branches

of this type have little, if any chance, of operating at a profit. Examples are The Royal Bank of Canada's branches at Goose Bay, Labrador and Gander, Newfoundland.

Considerable assistance has been rendered the Canadian Red Cross Society, the Canadian Legion War Services, Incorporated, the Over-Seas League (Canada) Tobacco and Hamper Fund, the Greek War Relief Campaign and similar wartime benefit organisations in collecting funds and transferring them to local branches or to regional offices, together with lists of subscribers. All branch banks receive and transfer subscriptions without charge. They have contributed to the success of these campaigns also by making substantial donations from head office funds and by displaying posters prominently in branches in order to stimulate public interest.

In order to encourage the public to keep their Victory Loan Bonds and War Savings Certificates and not to convert them into cash the banks have advertised special low rates for safekeeping service. For a very nominal amount they undertake to place in their vaults all bonds and certificates deposited with them. Coupons are clipped from the bonds as they come due and the proceeds are deposited to the customers' deposit accounts. Safekeeping service had to be expanded further when a shortage of individual safety deposit boxes developed in most cities and towns. Advantage could have been

taken of the increased demand by collecting the full rates for this service had it not been for the decision which the banks made to co-operate closely with the Government in all fields related to the war effort.

The Government depends upon the banks for much of its information concerning personal incomes. When coupons aggregating \$3 or more, clipped from Dominion of Canada bonds, are cashed at a branch the owner or his agent must sign one of the Government's income declaration/^{forms} on which he must disclose the true ownership of the bond or bonds. These forms are collected by the branches and forwarded to the appropriate Government authorities at regular intervals. In this way a check is made of personal income which might not be revealed on the annual income tax returns. The importance of this source of information has increased greatly since 1939 with the huge expansion of Government bonds in the hands of the public. This development has likewise given the banks much additional work, thousands of declaration forms being collected by some branches in an average month.

One of the measures adopted by the Wartime Prices and Trade Board to keep the cost of living from rising has been the introduction of subsidies paid to producers of certain essential commodities which enter into the cost of living. Subsidies have been paid, as a rule, where it no longer appeared

possible to meet the problem of rising costs by further economies in the cost of production and distribution. They have also been used to stimulate production while preventing an increase in wholesale and retail prices. Examples of subsidies of this type are those paid on various dairy products, notably milk.

Towards the close of 1942 it became apparent to the Board that the cost of living was moving upward again. In order to prevent a further rise it was decided to reduce the price of certain widely used foodstuffs by the payment of subsidies, viz., milk, oranges, tea and coffee. In the case of milk a subsidy of two cents per quart was authorized. By agreement with the Commodity Prices Stabilization Corporation Limited the chartered banks undertook on January 1st, 1943 to make payment of the subsidy through their branches. This procedure provided the Government with a simple and effective method of distributing the subsidy at a very small cost. Vouchers are issued to milk producers who present them to their local bank for redemption. The bank in turn is reimbursed by the Commodity Prices Stabilization Corporation Limited.

Finally, the banks have made a major contribution to the war effort by lending trained personnel to the various

Government wartime agencies such as the Foreign Exchange Control Board, the Wartime Prices and Trade Board, etc. The acquisition of experienced bank officers has expedited much of the Government's wartime business.

CHAPTER VIII

BANK PROFITS

The profits earned by the chartered banks have often been the target of much criticism. Sometimes the allegations made have been well founded; other times they have been fantastic; most times they have been made with an incomplete knowledge of all the facts. The criticism of recent years has been based, in part, on the dividend policies of the banks during the late 'twenties and early 'thirties and the fact that no substantial reductions appeared to be necessary in the depression years.

It is true that as late as 1931 the Bank of Nova Scotia, for example, made a distribution at the rate of 16% per annum while two other banks continued to pay dividends of 12% plus a bonus of 2%. This situation was drawn to the attention of the members of the Royal Commission on Banking and Currency in 1933. Figures were submitted by the Canadian Bankers' Association which summarized the trend of divided and undivided profits during the previous ten years, as follows:-

Bank Profits and Dividends

1923 - 1932

(millions of dollars)

Average Paid Up Capital	123.6
Average Reserve Fund	137.4
Average Undivided Profits	7.1
 Average Shareholders' Investment	 <u>268.1</u>
 Average Net Annual Profit Available for Dividends	 17.1
Average Net Annual Profit Distributed as Dividends	15.9

In the first place, it must be pointed out that the reserve funds which have been accumulated during the years are considered part of the shareholders' investment; they are made up of both surplus profits and of cash received from shareholders as premiums on new issues of capital stock. In the case of the above figure, 42% of the accumulation was derived from premiums while only 34% came from surplus profits. The balance, 24%, was acquired through the purchase of assets of other banks.

The average net annual profit distributed as dividends in the period under review was only 5.9% per annum of the average shareholders' investment. To the public, however, this appeared as 12.8% of the average paid up capital which is

misleading and confusing to those not in possession of the actual facts. Bank dividends, following the usual practice, are declared as a percentage of the paid up capital. The Royal Commission did not commit itself as to whether or not the banks had earned reasonable profits during the previous decade but it did point out that at that time shareholders were subject to the double liability clause in the Bank Act in the event of a failure to meet note and deposit obligations. Presumably this entitled them to a higher return on their investment, but for all practical purposes the risk has been negligible since the collapse of the Home Bank in 1923.

The decline in bank earnings which featured the 'thirties was attributable to two factors. First of these was the reduction in loans, part of a general decline in assets, already described in Chapter III. Second, and equally important, was the progressive reduction in interest rates stimulated by the Government's easy money policy. To counteract this development as far as possible the banks cut their dividend rates, closed a number of unprofitable branches and reduced the rate of interest paid on deposits. Finally, operating charges on deposit accounts were increased and a number of services which had previously been performed without charge were now placed on a regular tariff basis.

The war years have brought certain changes in bank profits as indicated in the following table, based on figures published in the Canada Year Book.

Bank Profits and Dividends

Year	Net Profits (millions of dollars)	Average Dividend Rate
1938	16.0	8.9%
1939	16.5	8.9%
1940	16.4	8.9%
1941	16.4	8.9%
1942	15.7	8.0%
1943	15.3	7.2%
1944	14.7 [†]	7.2%

[†] estimated

First there is noted the improvement in net profits in the early years of the war consequent on the rapid expansion in business activity. Taxes had not then increased at a rate sufficient to absorb all surplus profits and operating expenses were only moderately greater. During this period dividend distributions were maintained at an average rate of 8.9%. By 1942, however, despite the growth in total assets, the size of the banks' holdings of Government securities together with higher taxes resulted in a reduction of net profits which was accompanied by a cut in dividend rates. As was illustrated in Chapter III, the war has brought an increase in the proportion of bank assets on

which earnings are lowest --- Government securities -- and a reduction in the proportion on which earnings are highest --- loans. While this serves to improve the liquid position of the banks it has the effect of reducing their earning power, despite an over-all increase in the total of assets held.

The interest rate on all Government borrowings averages only 2.6% today compared with 5.1% at the end of the first Great War. In discussing the low return on the bank's portfolio, Mr. G. W. Spinney, president of the Bank of Montreal, told the 1943 annual meeting of the shareholders that it yielded only slightly more than $1\frac{1}{2}\%$, without making any allowance for operating expenses, taxes, etc. The reason for this statement is clear when it is realized that the average yield of treasury bills in that year was 1.5% and that of deposit certificates only $\frac{3}{4}$ of 1%. For every dollar of Dominion and provincial taxes which the Bank of Montreal paid in 1930, it had to remit \$4 in 1943. The same comparison is true in the case of the other chartered banks.

The combined taxes, Dominion and municipal, of all the banks reached the sum of \$15 million in that year, a substantial contribution to the war chest of the country and to the welfare of the municipalities served by the banks.

This large amount was collected in part as a result of the sharp increase in the Excess Profits Tax which went into effect in 1942. Under the terms of the tax as revised many of the banks were compelled to reduce their dividend rates; a ceiling was placed on the amount of profits which could be distributed to shareholders.

With reference to the taxation of banks, the Canadian Bankers' Association appeared before the Royal Commission on Dominion - Provincial Relations in 1938 with several concrete suggestions which are worthy of passing attention. First, the Association argued, if there is to be a redistribution of revenue between the Dominion Government and the governments of the provinces, the taxation of the chartered banks should be centralized in the Dominion since their operations extend throughout the length and breadth of the country. Meanwhile, the Association recommended that there should be a uniform method of imposing municipal taxes. It was pointed out that different municipalities in the same province often have different powers to tax banks. A tax on assessed values was suggested as the most desirable basis for municipal taxation. Finally, it was pointed out that the most logical tax of all on banks would be one on the volume of business transacted.

Taxes formed only one of the large items making

up bank expenses in 1943. Payrolls aggregated \$41 million and interest paid on deposits \$22 million. These figures, added to taxes of \$15 million, meant that \$78 million had to be paid out before any dividends could be distributed to shareholders. At present rates, these dividends aggregate about \$9.6 million per year, an average rate of 7.2% on the par value of the paid up capital of the banks. However, in terms of the shareholders' investment --- paid up capital plus reserve funds plus undivided profits --- the average yield of these dividends is only 3.3%. On the basis of the above figures, the shareholders of the banks received only \$1 for every \$8.12 which was distributed in salaries, wages, taxes and interest. There are, of course, other charges which must also be met. These include overhead expenses such as stationery, printing, light, heat, water, fuel and rent; contributions to pension funds and to group insurance policies; contributions to unemployment insurance premiums, appropriations for depreciation of property; provision for bad and doubtful debts.

While taxes have absorbed much of the banks' increase in gross profits during the war years, operating costs generally have been higher. Wartime regulations compelled the banks, in common with other business organizations, to pay cost of living bonuses which subsequently were merged with

salaries. Many banks have paid allowances to personnel on active service and have kept their pension fund contributions and group insurance premiums up to date for them. Staff engaged to take their places have had to be paid, often at rates higher than would normally be the case. As pointed out in Chapter IX, the banks have had to employ many hundreds of clerks in excess of their normal peacetime requirements. Unemployment insurance, which came into force on July 1st, 1941, introduced a new item of expense. For actuarial reasons, a number of the banks have bolstered their pension funds by increasing the annual appropriations. A recent amendment to the Income Tax Act made this possible.

It is not improbable that after the war many holders of Government bonds may wish to convert them into cash in order to make long-delayed purchases. If the sale of these securities should reach large proportions the chartered banks might be obliged to join the Bank of Canada in supporting the market by purchasing all bonds offered. Such a policy, if extended over any great period of time, might have the effect of further increasing the proportion of bank assets invested in Government bonds. A decline in the ratio of earnings to total assets would inevitably follow.

If, added to this development, operating costs should continue to rise, the banks might be forced to bolster their income by lowering the rate of interest paid on time deposits, or by increasing service charges. The alternative would be to reduce salaries and dividends, a step which would be taken with great reluctance and not without considerable opposition. Bank personnel have, on the whole, bettered themselves financially during the war years, the shortage of manpower having compelled the chartered banks to offer more attractive rates of remuneration. Shareholders are of the opinion that they have not benefited in any way from the growth in earnings brought on by the war. The return on their investment has been cut several times since 1941 and they would undoubtedly resist any movement to reduce it further.

The future of bank profits, then, is not as clearly defined as would appear on the surface. It is true, of course, that with the gradual disappearance of the chartered bank note issue the double liability of the shareholders becomes of no importance whatsoever. This might be used as an argument in favour of lower dividend rates. However, when it is realized that they have dropped from a range of 9% - 16% in 1930 to a range of 5% - 10% in 1944 it must be admitted that bank dividends have been adjusted fairly well to the changed conditions of recent years.

It has never been customary for the Minister of Finance to make public detailed information of the profits of the chartered banks. However, in response to pressure from members of Parliament in the 1944 session the Minister tabled for inclusion in Hansard a summary of the average current operating earnings and expenses during the fourteen-year period 1929-1943 and also for the year 1943. These figures, which are reproduced below, are noteworthy in several respects.

Statement of Current Operating Earnings and Expenses

All Ten Chartered Banks	Average of Financial Years 1929 - 1943	Financial Year 1943
(millions of dollars)		
<u>Current Operating Earnings:</u>		
Interest and discount on loans	77.5	60.6
Interest, dividends and trading profits on securities	35.0	48.7
Exchange, commissions, service charges, etc.	26.2	35.2
	<hr/>	<hr/>
Total Current Operating Earnings	138.7	144.5
<u>Current Operating Expenses:</u>		
Interest on deposits	36.0	24.5
Remuneration to employees	42.5	49.7
Provision for taxes	10.5	15.9
Contributions to pension funds	1.5	2.1
Depreciation for bank premises	1.8	2.3
Other operating expenses	20.0	20.4
	<hr/>	<hr/>
Total Current Operating Expenses	112.3	114.9

The first point worthy of mention is the extent to which the character of bank earnings has changed during the last few years. This becomes evident if the 1943 figures are taken as a sample and are contrasted with the average for 1929 - 1943. In the latter period, earnings from loans made up well over half of aggregate earnings compared with substantially less than half of the total in 1943. On the other hand, earnings from securities assumed a much more important relative position in that year than formerly. This new relationship reflects clearly the fundamental change which has taken place in the character of bank assets. The extent to which the banks have had to augment income from assets by various commissions, service charges, etc., is clearly shown in the figures of the table.

Expenses have likewise undergone a modification in character. The substantial decline in interest paid on deposits reflects the progressive fall in rates which commenced in 1933. Prior to that year, all the chartered banks allowed interest at the rate of 3% per annum on time deposits, calculated on the minimum monthly balance of the customer. On May 1st, 1933 the rate was cut to 2½% and on November 1st, 1934 from 2½% to 2%. Following the opening of the Bank of Canada in March, 1935 and the intensification of the Government's easy money policy, the chartered banks lowered the rate

of interest paid on commercial deposits on June 1st of that year from 2% to 1% ($1\frac{1}{2}\%$ if left with the banks in the form of deposit receipts for periods exceeding 90 days). The rate of 2% was maintained in the case of deposits of individuals and religious and charitable institutions.

On January 1st, 1936 the rate was reduced to $\frac{1}{2}$ of 1% in the case of commercial deposits while the rate applicable to individuals and religious and charitable institutions was cut to $1\frac{1}{2}\%$. There has been no further decline but a slight modification in the method of calculating interest was made on March 1st, 1939. After that date the minimum quarterly balance became the basis instead of the minimum monthly balance, the effect of which was to reduce moderately the amount of interest paid to depositors.

The Montreal City and District Savings Bank as well as the Caisse d'Economie de Notre Dame de Quebec followed the same procedure, but the maximum rate which they paid on deposits did not fall below 2%. The Post Office Savings Bank took a similar course in handling the interest problem.

Returning to the profits of the chartered banks it is not surprising to find that the 1943 salary bill was substantially over the 1929-1943 average for reasons dis-

cussed elsewhere in the Chapter. The expanded appropriation for taxes also needs no further comment.

Some of the members of the House of Commons Standing Committee on Banking and Commerce, in examining the provisions of the 1944 Bank Act, took exception to the fact that the chartered banks are able to transfer substantial amounts of profits to contingency reserves without disclosing the sums involved. The practice of setting up such reserves is very old; they are intended to constitute a second line of defence in the event that the banks are called upon to meet unforeseen losses of considerable size. The first line is, of course, the ordinary reserves which are accumulated out of profits, the amounts of which are revealed in published statements.

The president of the Bank of Montreal, Mr. G. W. Spinney, summed up the attitude of the chartered banks on this subject when he spoke to the annual meeting of shareholders on December 4th, 1944. "The custom of adding to the inner or contingent reserves of a bank during the years when it is possible to do so is one which the test of experience in all countries has proven to be the only safe policy to protect the interests of depositors No bank can maintain a proper continuity of service to the public without making losses, nor can a bank be operated

prudently without reserves to meet such lossesReserves are the principal means by which the banks provide for unforeseen losses and average their losses over good and bad years. The Bank of Montreal has followed the practice of setting up such reserves and it is doubtful if we could have weathered all the storms of the past 127 years, and continued throughout to play our part in serving the community, if the management in good times had not prudently set aside reasonable sums to meet the inevitable changes in business conditions and the effect of such changes upon the value of the Bank's assets."

The criticisms of the House of Commons Committee were in fact threefold. First, it was claimed that the banks, being public corporations, should disclose all profits and their true financial position in the annual published statements. Second, the charge was made that by transferring surplus profits to inner or contingent reserves the banks were able to avoid the payment of income and excess profits taxes on their total net earnings. Finally, the opinion was expressed that these surplus profits could be distributed as dividends in later years when the actual net earnings of the banks would not justify such a distribution.

It is a well known and generally accepted view that the foundation of the banking system is public confidence. This confidence, however, can easily be impaired if a sudden contract-

ion in either the reported net profits or the published reserve positions of the chartered banks should take place. It is, therefore, deemed advisable in the interests of depositors and shareholders as well as the general public not to disclose the amounts transferred to inner reserves or the actual aggregate of such reserves. By so doing, the banks are free to stabilize their reported net profits and draw on inner reserves when necessary.

Further, since provision for anticipated losses must be considered as ^a legitimate expense of carrying on business, the banks are entitled to deduct such amounts from their taxable income. The question arises, however, as to what may be considered reasonable anticipated losses. The Minister of Finance, discussing the question before the House Committee on June 6th, 1944, declared that in his judgment and the judgment of his advisers, the appropriations made to the reserves of two, or possibly three banks at the end of the year 1943 may have represented an undue degree of conservatism. However, the Minister pointed out that "our view of what is reasonable is only a matter of judgment as no rule of thumb can be applied to determine the value of bank assets which vary greatly in character and diversification" He added that after a further examination to determine

the exact amount of the excess in each case he would be obliged to advise the Minister of National Revenue of the addition which in his opinion should be made to the net income of the banks concerned for the purpose of taxation.

While it cannot be denied that inner reserves do provide a convenient repository for surplus profits which might otherwise be subject to income and excess profits taxes, the fact must be recalled that the chartered banks went through a difficult period in the early 'thirties which was characterized by a sharp curtailment in earnings and by a growing volume of actual and potential losses in loans. The severe contraction in production and employment and consequent decline in corporation and personal incomes had serious repercussions on the ability of the public to repay bank advances. Reserve funds, both published and hidden, were drawn on heavily in those years. Many of the banks are now having their first opportunity to replenish these depleted funds. Others are anxious to make all possible provision for any post war depression in business activity which may arise.

In retrospect, it must be admitted that the Canadian banking system has stood the trials of the inter-war

period without undue strain while south of the international border thousands of banks were forced to close their doors at the first sign of panic in the Great Depression.

With the object of presenting detailed information to the Minister of Finance so that he may assess more readily the amount of taxable profits of the chartered banks, Section 53 of the Bank Act was amended in 1944. It now provides that all banks must submit a statement to the Minister each year, giving full particulars of current operating earnings and expenses together with other supplementary information. This amendment will undoubtedly have the effect of making the banks more cautious in estimating their probable future losses and in planning transfers to inner reserves. A summary of the figures called for is required to be published in the Canada Gazette and to be tabled in Parliament.

As to the future course of bank earnings and net profits it is reasonable to surmise that they will reflect the degree of business activity in the post war years. If the plans of the Government are successful in maintaining a volume of employment adequate to sustain the national income at a high level the banks will share in the accompanying prosperity.

Earnings will rise as commercial borrowings are stimulated by the restoration of peace-time production and by the termination of Government financing of industry. Net profits of the banks will also be greater with the lightening of the tax burden.

Bank stocks reflect the prospect of an early improvement in net earnings. Early in 1945, prices had moved up from two to seven points above the lowest figures reached in 1944. At current dividend rates and market prices, bank stocks yield between 3.3% and 4.2%.

Bank shareholders number over 51,190 of whom about two thirds comprise women, retired people and executors or trustees of estates. Practically every occupation is represented, about 260 being definitely ascertained. Contrary to popular belief, the average holding of bank stock is not large, averaging only 28 shares. Over 70% of all shareholders reside in Canada. With the splitting of shares on the basis of ten for one, introduced in the 1944 revision of the Bank Act, bank stock will undoubtedly be more widely distributed than ever before. Shares will permeate to the lowliest member of the community who has saved a few dollars and seeks to invest them in a sound dividend-paying stock.

This socialization of bank stock, a new development, may have a widespread effect on public opinion if at some

future date a socialist government should be elected. Sufficient opposition might develop to negative all attempts to nationalise the banking system, one of the avowed objectives of socialist parties. The extent to which this would benefit or hinder Canada's economic progress is considered in Chapter XII.

CHAPTER IX

PERSONNEL PROBLEMS

Earlier in this book it was pointed out that at the outbreak of war the chartered banks were operating over 3,300 branches in Canada, two-thirds of which were located in the provinces of Quebec and Ontario. The following table, extracted from the Canada Year Book, gives the distribution in 1938 compared with that in 1943.

Branches of Chartered Banks in Canada

Province	1938	1943
Prince Edward Island	27	23
Nova Scotia	134	126
New Brunswick	98	93
Quebec	1,078	1,041
Ontario	1,210	1,092
Manitoba	164	148
Saskatchewan	246	213
Alberta	180	163
British Columbia	190	180
Yukon and N.W.T.	5	5
Total	<u>3,332</u>	<u>3,084</u>

The contraction in the number of branches commenced in the early 'thirties when the general decline in business activity began to interfere seriously with the volume of bank profits. Normally, branches are operated on a self-accounting

basis. Some had always been run at a loss but had not been closed in order to maintain the goodwill of the community or to furnish banking services which would not otherwise exist. Others which had formerly reported a small annual profit became unprofitable with the decline in aggregate loans and deposits. In 1930 there were 4,063 branches in Canada but by 1938 over 700 of these had been closed. This movement took place at a time when employment opportunities in all fields were limited. A job in a chartered bank had become as difficult to obtain as an appointment on the Board of Directors. However, very few employees were retired and the level of bank employment was fairly well stabilized.

The closing of branches during this period was not carried out on an arbitrary basis. The needs of the communities affected were considered and where it was expedient and possible to do so two or more banks exchanged businesses by closing offices at competitive points. In this way many small towns which had been served by two or three branches, none of which was on a paying basis, continued to enjoy full banking facilities provided now by one or two offices, instead of two or three. The consolidation of businesses usually resulted in the branches of the banks

entering such an arrangement being placed on a profitable basis instead of both being operated at a loss.

During the war years the same movement was carried on but the motive which inspired it had now changed. In the 'thirties it was a question only of dollars and cents whether or not a branch should remain open. After 1939 the deciding factor was one of manpower, although some offices were closed because they had become unprofitable as the result of war conditions. It was found to be impossible to find adequate personnel for all branches in the face of enlistments in the armed forces and retirements to war industries offering greater monetary reward. Further, the Wartime Prices and Trade Board encouraged the consolidation of branches and National Selective Service declined to grant the chartered banks any priority in securing staff replacements. In fact, during the first four years of the war, the banks were, as a general rule, not even granted any exemptions or deferments from military service.

By the end of 1944 more than 8,700 bank employees, including over 500 women, had left to serve in the armed forces at home and abroad. To fill their places many new employees, chiefly of the female sex, had to be trained at a time when the volume of day to day transactions had grown to

unusual proportions. To begin with, the number of cheques and deposits handled each day had reached record figures. Members of the armed forces, their dependents, factory workers and the general public were operating more bank accounts, cashing more cheques and making more deposits than ever before. The number of Government cheques paid and cleared daily forced many branches to divert a large number of clerks to the exclusive task of handling these items.

As each new Victory Loan added to the public's holdings of Government bonds the volume of coupons presented for payment increased enormously. (Coupons are payable at all branches of the chartered banks on and after their due dates.) Bank tellers had never been called on before to negotiate so many of these items. Each Victory Loan campaign further increased the strain, the sale and delivery of bonds adding many hours to the day's work.

Most important of the wartime duties assigned to the chartered banks was the administration of the Government's Foreign Exchange Control Regulations. Employees, both new and old, had to learn the underlying principles of exchange control in order to be able to explain their operation to the public. The amount of routine involved in completing forms and making returns to the Foreign Exchange Control Board absorbed many additional

man-hours. The introduction of ration coupon banking in 1943 accentuated the difficulty of finding adequate personnel to handle the increased volume of work brought on by wartime conditions.

Not only were senior bank officers fully engaged in coping with this increase but they were also expected to take a close interest in supervising the training of all new clerks. This responsibility was made more onerous by a high rate of turnover among recently engaged personnel. To alleviate the pressure as much as possible, many bank officers who had reached the age of retirement were retained in their posts and others who had already retired on pension were invited to return to the banks for the duration of the war.

The outstanding change which has taken place during the war years in the personnel situation is the preponderance of women in positions formerly held by men. More than 60% of the staffs of the banks is now made up of women compared with less than 22% before the war. Many of them have had to fill positions, after a very brief apprenticeship, which in normal times would require five or more years of training and seniority. In most cases they have been engaged on a temporary basis with the understanding that they may be called on to retire after the war.

Many women who have displayed unusual ability or initiative will be retained, but the banks have declared their intention of offering all employees who return from active service positions similar to or better than they filled at the time of their enlistment. The implementation of this policy will necessitate discontinuing the services of several thousands of women, a number of whom were married before the war. Presumably most of the latter will return to the domestic duties which they relinquished on entering the banks as will a number of others who were married during the war years.

If the first Great War set a precedent, it can be assumed that a large number of bank employees will not choose to return to their former jobs. In the present war, in particular, many men have been given technical and other training which will fit them for employment in fields remote from banking. Others will wish to remain in the permanent armed forces of Canada which, according to present Government policy, will be maintained on a greater scale than before the war. Finally, there will be a number of young men who will wish to launch out on their own initiative, either with or without adequate financial backing.

The Government offers some encouragement to those

with these ambitions. In the last days of the 1944 session Parliament passed the War Service Grants Act. This Act, besides providing a generous retirement gratuity to personnel of the armed forces who have served voluntarily, authorizes the payment of a re-establishment credit of a similar amount. The latter may be used for a number of purposes, including working capital for a business or profession, or for the purchase of tools, instruments or equipment for a trade, business or profession. Other rehabilitation schemes of the Government provide for free vocational training or university education with maintenance grants based on the number of dependents of the applicant. These features of the Government's scheme will undoubtedly induce some young men who might otherwise return to the employ of the banks to go into business for themselves or to take advantage of the opportunity to complete their education.

It is not easy to forecast the employment situation of the banks after the war. One thing is certain, however. Of the 18,700 women who were numbered among the 31,000 bank employees in 1944 a large percentage will retire voluntarily or will be requested to terminate their employment. The aggregate number of positions available will decline sharply following the withdrawal of wartime restrictions, such as ration coupon banking and foreign exchange control, and with

the replacement of women by men. On the other hand, a post war boom in industry and commerce might offset this decline to a certain extent.

The young men who do return to their former posts will be attracted by the special features which bank employment offers, viz., security, annual holidays with pay, sick leave with pay, retirement pensions on a generous scale, group insurance at reasonable premium rates providing life, accident and sickness protection, and an excellent general business training.

The security factor in bank employment will become increasingly important in the post war period when the world will be much more security conscious than at present. Unemployment insurance, which came into effect in Canada on July 1st, 1941, is only part of a comprehensive social security system planned for the future. The movement is world wide. Great Britain and the United States are already making plans to enlarge their schemes which today are more comprehensive than anything Canada can offer. However perfect these measures may appear to be some anomalies arise from time to time bringing injustice to certain classes of people. One of these is the rigid application of the Unemployment Insurance Act to bank employees who earn the sum of \$2,400 or less per year.

Bank employment undoubtedly removes three great fears which face the average worker, unemployment when business is slack, unemployment as a result of illness or some other physical disability, and unemployment in old age. Unemployment insurance and old age pensions relieve these fears in part only. Bank employees are discharged only when there is ample evidence of dishonesty, inefficiency or gross negligence; they need never worry that they will lose their jobs merely because bank loans have fallen off or the volume of deposits has declined.

There is no such thing as a pool of unemployed bankers and hence no need for unemployment insurance. This fact was demonstrated clearly in a brief submitted to a special committee of the House of Commons on Unemployment Insurance by the President of the Canadian Banker's Association in July, 1940. Figures were cited to show that the number of persons released from bank employment in 1937 was only 0.84% of the number to whom the Unemployment Insurance Act would apply; in 1938 it was 1.65% and in 1939 only 1.33%. The general policy followed by the banks has been to retain at all times staffs adequate to take care of peak demands including the vacation season. The number of men actually released from employment in an average year is remarkably small.

There are several reasons for this condition. In the first place, a careful selection is made of all applicants for bank positions. Educational qualifications are important and initiative, good appearance and intelligence are characteristics sought after. Every young man who enters the services of a bank receives a careful training over a period of three or four years which virtually amounts to an apprenticeship. During that time the bank endeavours to ascertain whether he has the qualities and necessary enthusiasm to make a success of a banking career. If not, he is told that he will likely be more successful in another field. Usually he has a few weeks or months in which to find some other employment during which time he continues to receive his bank salary. Or he may be granted a gratuity to tide him over the interval between one job and another. In 1939, for example, the banks released only 270 of a total of 20,156 employees. All received substantially more from the banks than they would have been paid under the provisions of the Unemployment Insurance Act if it had been in force in that year.

As mentioned above, the banks provide an intensive training which makes it comparatively easy for a young man to secure employment in a variety of businesses if he does not make the grade in banking. A branch manager cannot be hired

in the ordinary labour market; he must be carefully trained from his earliest years in the bank. At the age of 60 (65 in a few cases) a banker can look forward to retiring on a pension which will provide him with a comfortable income for the rest of his days. (In 1945 the average pension being paid was \$2,189.) His dependents are protected also, whether or not he lives to the retirement age. This is a feature of bank pension schemes which is not often given due consideration.

Pensions granted to dependent wives and children make it unnecessary to carry heavy life insurance in the case of the average employee. This is a saving which is difficult to reckon in dollars and cents but which is substantial nevertheless. If an employee takes ill or suffers some physical injury his salary will be continued in full for many months, and in part for many more months until he is able to return to his post. In addition, he has the protection of group accident and sickness insurance, in the case of some banks, and group life insurance at exceptionally low rates, in the case of most of them. The premiums on these policies are subsidized generously by the banks in order to make them available to everyone on their staff.

An annual vacation of at least two weeks with

full pay (three weeks after a certain number of years' service) helps to keep all employees in good health and fit them for their tasks which have become considerably more arduous since 1939. Loans are provided at special rates of interest to assist employees to discharge some unforeseen obligation such as an illness, a concession which is not always fully appreciated.

All told, the banks offer the utmost in stability of employment and assurance of a steady income during the lifetime of their employees and their families. It remains to be seen, then, why the Government thought it advisable to include this group of workers in the general unemployment insurance scheme. The Canadian Bankers' Association pointed out that such a plan would place a burden on bank employees out of all proportion to the benefits which might accrue to them under the most adverse circumstances. Attention was drawn to the position of British bankers who are covered by a special insurance scheme forming part of the general unemployment insurance program; under this arrangement they are considered to be in a preferred category and pay lower premiums. The Association's submission to the House of Commons committee concluded by recommending that bankers be excepted from any general plan, or if this was not found possible, that they

be included in a special plan as in England, or that some fair and reasonable limit be placed on contributions of both the banks and their employees in keeping with the benefits to be derived.

While it was admitted in official circles that the claim of the banks was well founded and that the security of employment which they provided fully justified the stand which they had taken it was, nevertheless, decided to proceed with the original plan. The argument was advanced that one exception to the general rule would invite another and that those who were in a position to contribute to the welfare of the less fortunate would have to do so.

One post war problem in particular will be prominent in the minds of bank employees on active service and head office officials engaged in personnel work. This is the question of salaries. Bankers in the Navy, Army or Air Force will have, in very many cases, been remunerated on a higher scale than they were in the bank which they left. Their standard of living will have risen considerably; they will also have acquired domestic responsibilities and other obligations which will make it difficult for them to accept any very substantial reduction in income.

Bank salaries have never been considered to be too generous, particularly when due consideration is given to the many responsibilities devolving upon the average clerk. In order to compete with industry and secure adequate replacement staff, the banks were forced to offer higher commencing salaries to both clerks and stenographers early in the war years. In many cases these salaries had to be supplemented by living allowances in cities and towns where the cost of living had taken a sharp rise. It is reasonable to suppose that in the post war period it may be necessary to retain this higher scale of remuneration in order to induce suitable young men to make banking their career. If this is not done the banks will undoubtedly bring some criticism upon themselves.

Banking requires the utmost in integrity, initiative and intelligence and these qualities are not to be found in such abundance that their price should be below that applying in many other trades and professions. Lack of recognition of this important fact will only serve to provide extremists and other critics of the banking system with material to support their claim that bank clerks are grossly underpaid. While it is true that net earnings of the banks have never fully recovered since the boom days

of the late 'twenties it is nevertheless clear that a larger proportion of gross income will have to be diverted to the payment of higher salaries if one of the major criticisms of the chartered banks is to be answered effectively.

All banks have granted leave of absence to employees who enlisted in one of the fighting services and have undertaken to see that they are restored to suitable positions on their return. Some have paid allowances to both single and married men to supplement their military pay. Others granted a bonus of one month's salary at the time their employees joined up. Most have continued the pension fund payments formerly contributed by their employees as well as their group insurance premiums.

These concessions have been generous and indicate the interest taken by the management in the welfare of the average employee. It is to be hoped that they will be extended further after the war by the setting up of a scale of salaries commensurate with the responsibilities involved. The suggestion is made that after ten years of service an employee should receive a salary of not less than \$1,800 per annum, regardless of his capabilities. If a bank sees fit to retain him in its employ for that length of time

it must have some good reason for doing so. That reason is sufficient justification for paying him a salary that will at least allow him to marry and bring up a family. The employee's prospects for advancement may be virtually non-existent and he may have to be content with that salary for the remainder of his banking career. Nevertheless, if he is to be retained in the bank's service he should be entitled to a minimum such as that suggested above so that he can marry while still in his early years.

The impression must not be gained, however, that all bank salaries are on a low scale. On the contrary, many bright young men in the more aggressive chartered banks receive fast promotion and substantial increases in salary. There are many attractive posts, from the monetary point of view, in all the banks. The remarks in the preceding paragraph were made in the interest of the slow, plodding, honest and loyal employee who will never display any outstanding talent but whose faithful execution of daily routine is indispensable to the smooth running of the great financial organization of which he is a part. It may be that wartime conditions will serve to give him greater recognition in the future than he has had in the past.

Many bank officers, some of whom occupied senior positions, have been lent to various Government departments and agencies for the duration of the war. Because of their specialized training they provided a pool from which the Government has drawn liberally to fill its requirements. The majority of these transfers were for full time employment but some officers have been able to continue their ordinary duties and give only part of their time to the Government. The British Supply Council in North America, the National War Finance Committee, the Foreign Exchange Control Board, the Wartime Prices and Trade Board and the Commodity Prices Stabilization Corporation are but a few of the agencies of the Government to whom the banks have lent many of their key personnel. This loss, though only temporary in some cases, added to the difficulties created by the enlistment in the armed forces of 50% of the pre-war male staff of the banks.

The assistance given to the war effort in manpower has been both generous and productive. Many decorations have been won in combat with the enemy and hundreds of former bank employees have already given their lives in the cause of freedom.

A former banker heads the Wartime Prices and Trade Board, another the new Industrial Development Bank, and it is common knowledge that the governor of the Bank of Canada since 1935 is himself a former executive of the largest chartered bank.

Many problems will arise in the readjustment period after the war. It will require intelligent leadership on the part of the banks to solve them and make it worth while for the most desirable type of young man to return to their employ. The chartered banks are fully capable of providing this leadership and demonstrating to the rest of the financial and industrial organization of Canada that banking is one of the leading and most exacting professions, that it is one of the most indispensable and valuable, and that it can offer the most in monetary reward and security of employment for the ambitious young man of today.

CHAPTER X

1944 REVISION OF THE BANK ACT

Unlike most corporations, both public and private, the chartered banks are given a life of only ten years at a time under the Bank Act. The Act itself comes up for revision decennially at which time the whole field of banking operations in Canada is reviewed. Amendments are then proposed and, if acceptable to Parliament, incorporated in the new Bank Act. At the same time it is customary to renew the charters of the banks for another ten years.

The first general Bank Act for the Dominion of Canada was passed in 1871. Since that year there have been seven revisions, including that of 1944. On four occasions it was necessary to extend the charters of the banks temporarily owing to the fact that the decennial revision of the Bank Act had not been completed by the expiry date. This took place in 1911, 1912 and again in 1933 and 1944. Each revision has contributed something to the code of banking law and practice now consolidated in the Act.

An outstanding feature of the Act of 1871 was the introduction of the "double indemnity clause". This provision was borrowed from a clause appearing in the charter granted to the Bank of Nova Scotia in 1832 and which was inserted in the Act renewing the charter of the Bank of Montreal in 1841. The double indemnity clause requires that a shareholder of a chartered bank be liable, in addition to the extent to which his shares are not paid up, for an amount equal to the par value of the shares held by him in the event of the insolvency of the bank. This represents a potential reserve fund of substantial proportions; it may be utilized if a bank should be unable to meet the demands of its note-holders or depositors for legal tender, or pay any of its other obligations. It has been necessary on several occasions to call on shareholders in this way to meet deficiencies.

The Act of 1871 provided for the issuance of bank notes by the chartered banks but there were no reserve requirements; however, all banks were obligated to keep at least one-third of such cash reserves as were considered necessary in the form of notes of the Dominion of Canada. The banks were prohibited from lending against the security of their own stock or of real estate and from paying dividends

out of capital---provisions which have been carried forward in each revision as fundamental. Many other less important principles were written into the original Act.

The first general revision of the Bank Act took place in 1880. A number of banks had failed in the depression of the 'seventies with losses, particularly to the note-holders. In the new Act there was inserted a provision that bank notes should henceforth have a prior lien on the general assets of the issuing bank. At least 40% of cash reserves now had to be kept in the form of Dominion of Canada notes. The title "bank" was restricted to apply only to chartered banks.

Between Confederation and 1889 ten banks failed and nine others withdrew from business, involving heavy losses to shareholders, depositors and noteholders. The Bank Act of 1890, therefore, brought in several new features designed to protect investors as well as creditors of the banks. One of these was the introduction of the Bank Circulation Redemption Fund provision which required that all banks deposit with the Minister of Finance 5% of their average yearly note circulation. Further assessments could be made by the Minister, if considered necessary, to maintain the fund at a satisfactory level. The proceeds were to be used to redeem

the notes of a bank which had failed if other suitable arrangements were not made by the liquidators of the bank. Unclaimed balances standing in the name of a bank which had failed were to be acquired by the Government without prejudice to future claims.

This provision in the Bank Act was designed to protect noteholders from incurring any loss as a result of notes circulating at a discount. To protect the public further, paid up subscriptions of \$250,000 were to be required in future before a bank could be incorporated and commence business. Subscribed capital was left unchanged at a minimum of \$500,000. Sections of the act dealing with loans against the security of warehouse receipts and bills of lading were revised and supplemented by new provisions which enabled banks to make advances to manufacturers upon the general security of goods manufactured or procured for manufacture, and to wholesale purchasers and shippers of natural products on the security of such products. Noteholders were still given a prior lien on all assets, but the Crown was established as a prior creditor over all other creditors.

Before the ensuing revision of the Bank Act, the Canadian Bankers' Association was formed as a voluntary organization devoted to serving member banks and their staffs.

In 1900 Parliament incorporated the Association and empowered it to "promote generally the interests and efficiency of banks and bank officers and the education and training of those contemplating employment in banks." It was also given power to set up and regulate clearing houses which were to be organized on a voluntary basis. In the revision of the Bank Act which took place in the same year, the Canadian Bankers' Association was assigned certain important functions. It was given control over suspended banks through a curator who was to act until a liquidator was appointed. Supervision of the issue and destruction of bank notes were among other responsibilities delegated to the Association.

The Act of 1900 introduced several other amendments, one of which was to enable amalgamations of banks to take place without the specific approval of Parliament. Real estate acquired as additional security, as provided by earlier statutes, could be held for a period of twelve years only, following which the Crown could legally seize the property after giving six months' notice.

Two or three minor amendments to the Bank Act were made in the early years of the twentieth century in

keeping with the economic expansion of Canada. None was of sufficient importance to merit comment. It became increasingly noticeable, however, that the note circulation of the banks was gradually approaching the limit of paid-up capital prescribed by the Act. The elasticity of the note issue had always been considered adequate for all requirements. However, the rapid development of agriculture and the heavy demands which it created for currency during the crop-moving period pointed to the fact that some modification in the existing limit on bank note circulation was necessary. The Bank Act was, therefore, amended in 1906 to permit a bank to issue notes in excess of its paid up capital to the amount of 15% of its rest fund and unimpaired paid up capital combined. This privilege could be exploited, however, only during the months of October, November, December and January. In order to discourage excessive use of the privilege, the banks were required to pay a special tax of not more than 5% per annum on the excess issue in circulation.

The next decennial revision of the Bank Act was postponed until 1913 at which time the note issue privilege was again the subject of further amendment. The period of the year during which an excess issue was permitted was extended by two months. Further, the banks might now issue

additional notes against an equal amount of gold or Dominion of Canada notes which they were required to deposit in the newly established central gold reserves. This was a worthwhile concession in that it enabled the banks to retain the gold and Dominion of Canada notes as part of their cash reserves while they were able to build up their own note circulation. (The value of the note circulation to the chartered banks will be dealt with later.) The Act of 1913 was amended in one other important respect. A shareholders' audit on the basis outlined in the English Joint Stock Companies Act was made mandatory. Two further amendments were passed by Parliament in 1915 and 1916, respecting loans against the security of cattle and for the purchase of seed grain.

Much criticism was levelled at the banks by ordinary creditors of manufacturers, wholesalers and shippers who had pledged their goods, wares and merchandise as security. At that time there was no obligation on the part of borrowers to disclose that the banks had acquired a prior lien on their products or produce. Following many proven examples of unwarranted injustice a provision was inserted in the 1923 revision of the Bank Act requiring that notice of intention to borrow under Section 88 of the Act (the section

referred to above) must be registered at the office of the Assistant Receiver General in the province in which the borrower resided. In this way the extent to which the assets of a borrower were encumbered could be determined by consulting the official record and errors of judgment regarding the credit worthiness of a client avoided.

The Act was also amended by the strengthening of the provisions dealing with the shareholders' audit. Annual and monthly returns were henceforth to contain more detailed information, including statements of controlled companies in the names of which any part of a bank's operations were carried on. The sections dealing with loans were modified and advances to an officer or clerk of a bank could not at any time be in excess of \$10,000. Guarantee and pension funds, representing contributions of both the banks and their employees, must henceforth be invested in trustee securities only.

Despite all the protective measures embodied in the Bank Act from time to time, the Home Bank failed in 1923 with considerable loss to shareholders and depositors. A special amendment to the Bank Act was, therefore, passed in the following year. It provided for an annual inspection of every bank by the Inspector-General of Banks, an official of

the Department of Finance. This inspection was to be in addition to the annual audit made by the auditors appointed by the shareholders at their annual meeting and to the annual inspection made of every branch by specially trained bank inspectors who report directly or through supervisors to their head office.

In July, 1933 the Government appointed a Royal Commission under the chairmanship of the eminent British financier, Lord Macmillan, to conduct a complete and detailed examination of the Bank Act, including "a study of the entire monetary system of Canada," and to consider "whether and in what respects the banking institutions and the monetary system of Canada may be modified, extended or developed for the purpose of facilitating co-operation in public policies designed to promote the revival of domestic and foreign trade and enterprise" This action was prompted by the depression in business activity which had already created an unwieldy volume of unemployment and by the fact that the Bank Act was due for revision in that year.

There was a strong feeling on the part of many Canadians that the establishment of a central bank in Canada would solve a number of the economic problems which then confronted the country. The commissioners were, therefore,

charged especially with the responsibility of determining whether or not it would be advisable for Canada to take such action. If they recommended that a central bank should be set up, they must also indicate in their report what its relation to the existing chartered banks should be and what should be its proper authority and function.

The Commission held sessions in Ottawa where the representatives of the chartered banks and the Government presented briefs. These were followed by public hearings in the leading cities of the country from coast to coast at which representatives of provincial and local governments appeared as well as delegates from boards of trade, farmers' organisations, etc. In less than two months the Commission completed its sessions and submitted its report to the Government. Most important finding was that which recommended the immediate establishment of a central bank. (The Bank of Canada was incorporated in the following year and commenced operations on March 11, 1935.)

With regard to the existing commercial banking system the Commission made several recommendations, not all of which were included in the 1934 revision of the Bank Act. One of these was that the maximum rate of interest prescribed in the Act, 7%, should be abolished as being an undesirable inter-

ference with freedom of contract. A Canadian member of the Commission, the Honourable J. E. Brownlee, dissented and it is significant to note that this provision in the Bank Act was not altered.

Since the establishment of a central bank received more consideration than any other proposal it is not surprising to find that the Bank Act of 1934 made few changes in the code prescribed for the chartered banks. After that date, however, they were required to maintain a cash reserve of not less than 5% of their deposit liabilities payable in Canadian dollars, in the form of deposits with and notes of the Bank of Canada. In practice, however, the chartered banks have usually held cash reserves averaging 10% of their Canadian dollar deposit liabilities. This provision, therefore, placed no new burden on them. (Bank of Canada notes replaced Dominion of Canada notes following the opening of the Bank.)

Certain other changes were introduced consequent upon the establishment of the Bank of Canada. All chartered bank reserves of gold were to be surrendered to the Bank in exchange for Bank of Canada notes or deposits and the note issue privilege was to be gradually withdrawn. Circulation was to be reduced to 25% of paid up capital by January 1st, 1945.

By the time the next decennial revision was due, Canada had passed from the depth of an economic depression to the height of a wartime boom. Many problems still remained unsolved, however, and the amendments brought forward bore the unmistakable mark of anticipating post war difficulties. The Minister of Finance introduced the revised Bank Bill into the House of Commons on May 1st, 1944. Subsequently it was referred to the Standing Committee on Banking and Commerce which promptly entered into a prolonged discussion of various aspects of banking. The Act, when finally passed, made several important changes in the banking code, each of which will be considered in turn.

The first modification affected the note issue privilege which the chartered banks had enjoyed since their earliest days. As was indicated above, the note circulation was to be drastically reduced by the beginning of 1945. The new Act reaffirmed that after January 1st the outstanding note issue of the chartered banks should not exceed 25% of paid up capital but provided also that no notes should be issued or re-issued after that date. It was further laid down that all chartered bank notes should be retired by January 1st,

1950 by each bank paying out of its balance with the Bank of Canada a sum equal to its outstanding note issue in Canada. This sum will be transferred to the Bank of Canada which will become responsible for redeeming all chartered bank notes which have not already been retired. Banks which circulate their notes outside Canada will be permitted to continue doing so provided that such issues do not exceed 10% of their unimpaired paid up capital. In effect this means that the Bank of Canada will become the exclusive note issuing authority in Canada. As chartered bank notes are paid into the banks they will be withdrawn from circulation and Bank of Canada notes will take their place, completing a transformation in Canadian bank note currency which began in 1936.

One effect of the withdrawal of the note issue privilege will be the gradual disappearance of the double indemnity clause as the outstanding circulation decreases. After the Bank of Canada has assumed liability for all issues in 1950 the clause will become non-operative and bank shares will bear no additional risk to investors. In practice the clause has been no handicap to the sale of bank stock in recent years. The financial stability of all the chartered banks has overcome any hesitation on the part of the public to accept any additional responsibility attached to bank shares.

The policy pursued since the inception of the Bank of Canada of eliminating chartered bank note circulation and substituting monopoly control by the Bank of Canada is a logical step in the development of an efficient banking system built around a central bank. In the Report of the Royal Commission referred to above it was recommended that the proposed central bank for Canada "should have the sole right of note issue; the commercial banks' issue should be redeemed over a specified period of years." Giving as their reasons, the commissioners added, "A central bank is responsible for the control of the volume of credit and the maintenance of the stability of the currency. This responsibility connotes that the bank should be granted the sole right of issuing currency (other than coin) for it would be intolerable that a central bank's policy should be hampered by the action of other issuing authorities in a country."

At one of the hearings of the Commission in 1933 the Canadian Bankers' Association submitted a brief showing that the note issue privilege yielded a net profit of about 1.6% of the average circulation of a typical bank. In terms of dollars and cents, the loss to such a bank of the privilege and the added cost of substituting legal tender currency was substantial, representing about one-third of the amount distributed to shareholders. However, the Report of the Commission concluded by

stating, "The experience of other countries has shown conclusively that the right of issue is not indispensable in assuring adequate profits to commercial banks."

This observation has been borne out by the results of the operations of the chartered banks since 1935. In his address at the annual meeting of the Royal Bank of Canada on January 11th, 1945, the president, Mr. M. W. Wilson, remarked that "the circulation privilege has not been of great value in recent years except as an advertising medium, but the privilege did serve a very practical purpose in years gone by. During the early development period in Canada it enabled the banks to establish branches in small rural communities which otherwise would have been denied banking facilities." Since the period of expansion in the number of branches operated by the chartered banks appears to be a matter of history, it is reasonable to conclude that the absence of the note issue privilege will not be noticed very much in the future.

A new sub-section was written into the revised Act of 1944 which requires the chartered banks to transfer to the Bank of Canada all balances unclaimed for ten years, together with accrued interest, if any, and the proceeds of all certified cheques and bank drafts unpaid for ten years. Upon transfer of these sums to the Bank of Canada the chartered banks will cease

to be liable for honouring any claims put forward and the Bank of Canada will assume full responsibility. In other words, if payment is demanded of the chartered banks by a former creditor or by his legal representative, he will be referred to the Bank of Canada who will pay the amount due together with accumulated interest. Interest will not continue to accumulate, however, after 20 years have elapsed unless a claim for the amount due is submitted before the expiration of that period.

This provision in no way limits the right of a depositor to claim what is his rightful property but it does set out the procedure to be followed in the circumstances mentioned above. The Bank of Canada will thus become the repository of all unclaimed balances in perpetuity. At the present time there is a court case pending to decide whether or not unclaimed balances are in effect property within the meaning of section 92 of the British North America Act. The Province of Quebec is contesting the right of the Bank of Montreal to transfer such a balance on the ground that it logically falls within its own jurisdiction.

One of the more important changes made in the Bank Act was the downward revision of the maximum rate of interest or

discount which the chartered banks could legally charge on loans or advances. Prior to 1934 section 91 (1) of the Act provided that the banks might "exact any rate of interest or discount not exceeding seven per cent per annum and may receive and take in advance any such rate, but no higher rate of interest shall be recoverable." While it appears that the intention of Parliament was to make 7% the legal maximum rate, the banks interpreted the provision as enabling them to stipulate for rates of 8% or higher where it was considered that the risk involved justified such action. This practice was followed chiefly in Western Canada on the assumption that if a client agreed to pay a higher rate than 7% and actually did so the transaction was legitimate and the money so paid irrecoverable. Section 91 (1) was, therefore, amended in 1934 by the deletion of the words "and may receive and take in advance any such rate" and by the addition of penalties for any bank officer who violated the provisions of the section. A clause was included to permit the banks to collect a minimum charge of \$1 on loans over \$25 and a minimum charge of \$0.50 on loans of \$25 or less.

Following the general decline in interest rates which took place in the 'thirties there was much agitation for a reduction in the maximum rate of interest in the 1944 revision of the Bank Act, notwithstanding the many arguments

put forward by the Royal Commission in 1933 for the abolition of a ceiling on the cost of borrowing. Section 91 (1) was, therefore, further amended by the substitution of "6%" for "7%", a move which has placed many advances in Western Canada and certain other areas on an unprofitable basis for the banks concerned. Adjustments have taken place in the whole rate structure as a result of this amendment. Banks now lend against the security of Dominion of Canada bonds at rates varying from 3% to 4%; advances against other high grade securities may be had at 4% to 4½% while good commercial loans command rates of 4½% to 5% on an unsecured basis. Other advances, including personal loans, are made at 5% to 6%, depending on the circumstances and the risk involved. In point of fact, a rate of 6% is now relatively uncommon. Generally, interest and discount rates are about ½ of 1% lower than they were in 1943 and 1% to 1½% lower than before the war. The effect of this downward adjustment on bank profits is discussed in Chapter VIII.

In the original Bank Bill of 1944, there was included a new provision designed to encourage the banks to participate more extensively in the instalment loan business, now virtually a monopoly of the small loan companies. Under the Small Loans Act the latter may make advances of \$500 or

less at a cost per loan not exceeding 2½% per annum on the outstanding balance, including all charges. The Household Finance Corporation and other leading companies announced early in 1945 that they would henceforth charge only 1½% per month which figure appears much less formidable than the annual rate of 18%. In the proposed amendment to the Bank Act it was provided that the chartered banks could make instalment loans at a discount rate not exceeding 5% per annum, an effective annual interest rate of 9½%. The reaction of the banks to this proposal was not entirely favourable, the principal criticism resting on the fact that under existing legislation they could extend this type of accommodation on suitable terms and in fact had been doing so for several years. Special personal loan facilities were introduced by the Canadian Bank of Commerce in the middle 'thirties, an example that has since been followed by several of the banks.

The proposed amendment was dropped from the Bank Bill by the House of Commons Standing Committee on Banking and Commerce, much to the satisfaction of the small loan companies. They were not alone in welcoming its exclusion. Most of the companies are good borrowing clients of the chartered banks who prefer to see them take the ad-

ditional risks involved in the instalment loan business. In point of fact, the small loan companies have better facilities for handling borrowers who are not considered good bank risks by present standards. They have developed a technique of effecting collections that it is not possible for the banks to follow for several reasons. Accordingly, their loss ratio has been remarkably low and profits remarkably high. The companies, then, make good borrowing clients of the banks who prefer to deal in large figures anyway.

Several other less important changes were made in the Bank Act in 1944 affecting the loaning business of the banks. In the first place, Section 88 covering advances to wholesalers, primary producers and manufacturers on the security of their products or merchandise was modified to simplify routine procedure. In the past fresh security had to be given the banks every time new materials were acquired, resulting in the completion of a revised set of assignment forms, etc. Henceforth, security given to cover a loan, or a series of loans under a line of credit, will be recognized without the necessity of completing fresh assignment forms on every occasion on which new materials are acquired. This simplified procedure will be of considerable assistance to borrowers who find it necessary at frequent intervals to

turn over goods upon which security has been pledged.

The Bank Act was further modified to provide a form of intermediate credit to farmers; the value of this provision is considered in Chapter XI which deals with intermediate and long-term credit. Another amendment enables the banks to lend on the security of lien notes, conditional sales contracts and other instruments or agreements respecting the sale of goods and merchandise, or moneys payable thereunder. The general trend of the 1944 revision as far as lending is concerned was to enlarge the banks' sphere of operations where it was thought that an unsatisfied demand existed and that such action would not in any way threaten their traditional stability.

One or two other amendments to the 1944 Act remain to be discussed. The statutory par value of all bank stock has in the past been fixed at \$100 per share. Effective September 1st, 1944 the par value was reduced to \$10 per share. The reason for this change was the desirability of making bank stock more accessible to small investors and at the same time increasing the number and diversity of bank stockholders. Shares of the chartered banks have always been considered gilt-edged security owing to the sound and able management which has featured their operations but the

high prices which they have commanded have put them out of the reach of many investors. The larger market which they will now have may, however, tend to raise unit prices slightly owing to the increased demand which has been created.

The number of qualifying shares necessary for a directorate in any of the banks was reduced by 50% in the case of one-quarter of the number of directors in order to make it possible for the shareholders to elect a representative number of persons from the farming and small business groups of the country. Formerly, to qualify for the board of directors, a shareholder must hold a minimum of \$5000 paid up shares; under the revised Act he need not hold more than \$2500 worth of paid up stock. Admittedly this is still an obstacle to a number of influential people in the lower income brackets whose presence on the boards of some of the banks would contribute much to the formation of an intelligent lending policy. On the other hand, the argument may well be advanced that any man who has not accumulated at least \$2500 during his farming or business career does not possess the judgment and initiative necessary to make him a valuable bank director. It is notable that since September, 1944 several of the banks have added to their boards of directors agricultural representatives from Western Canada whose experience and advice might have been unobtainable under the

old requirements.

One other new provision in the Bank Act requires that the Minister of Finance must place before Parliament annually a combined statement of the current operating earnings and expenses of all banks and certain other information. This amendment resulted from a lengthy discussion which took place in the House of Commons Standing Committee on Banking and Commerce on the subject of inner reserves. The subject is dealt with in greater detail in Chapter VIII.

Summing up the changes made in the 1944 revision, Mr. S. M. Wedd, president of the Canadian Bankers' Association, told the representatives of the chartered banks at the annual meeting in November, 1944, that the Act as now constituted provided the banks with "renewed opportunity to serve the Canadian public We all regard it in the light of a responsibility which we shall do our best to discharge for the good of the nation."

CHAPTER XI

INTERMEDIATE AND LONG-TERM CREDIT

Tradition has decreed in the countries of the British Commonwealth that the commercial banks should concentrate their lending activities on short-term loans. By short-term loans, or short-term credit, is meant advances of one, two or three months' duration, although some authorities consider that advances which have a currency of not more than one year should be placed in this category. In general, however, the chartered banks of Canada have made it a practice to lend for periods not exceeding three months. Chief among the exceptions to the rule are personal or instalment loans which are frequently arranged for longer periods.

There are several reasons why it is considered sound banking practice to adhere to a policy of extending short-term credit only. In the first place, the deposit liabilities of the chartered banks are payable on demand and assets must, therefore, be kept in a sufficiently liquid state to meet any requests for cash which may arise. It is true that in theory about half of these liabilities are technically payable after notice. However, in practice no distinction is made between demand and

notice deposits in the case of withdrawals.

In the second place, the banks must be in a position to honour their note liabilities promptly if called on to make payment in legal tender money. This responsibility has become less and less important, however, with the gradual withdrawal of the note issue privilege. Finally, it is important that assets other than loans should be sufficiently liquid to enable the banks to readily convert part of them, at least, into cash in order to meet fresh requests for advances.

To perform their proper function in the economy of the country, then, it is necessary for the chartered banks to remain in a highly liquid position at all times. This precludes them from entering the field of intermediate credit on an extensive scale and prohibits them from providing long-term credit. There is no hard and fast rule for distinguishing between intermediate and long-term credit but it is generally understood that the former covers loans repayable over a period of from one to five years while the latter covers advances extending over a period of more than five years.

While the chartered banks provide excellent facilities for the extension of short-term credit, the intermediate

credit field has been sadly neglected for a number of years. In the case of long-term accommodation, the Canadian Farm Loan Board and the various loan and mortgage companies have been reasonably active in supplying the needs of borrowers. Until the Royal Commission on Banking and Currency investigated the whole banking field there had been only one attempt to supply intermediate credit on other than a very small scale. In 1931 the railway companies, banks, loan companies and insurance companies subscribed \$3 million to form the Dominion Agricultural Credit Company, Limited. Only 10% of this amount was paid up by 1933 and this appeared to be more than adequate to meet all requirements at that time. Loans were granted for periods not exceeding three years at an interest rate of 6% plus certain inspection fees. The company failed to play a large part in satisfying the needs of farmers and its operations were later brought to a close.

During their sessions the Royal Commission heard complaints from various farmer organizations that not only was it not easy to secure intermediate credit but it was proving increasingly difficult to obtain short-term credit from the chartered banks. It will be recalled that these complaints were lodged at a time when agricultural prices were falling rapidly and drought conditions prevailed through-

out Western Canada. With declining revenues the burden of maintaining and operating farms became unbearable for thousands of farmers. Many found, as a result, that it was impossible for them to secure credit to commence the next season's operations.

Representatives of the banks confirmed this situation before the Commission. The Canadian Bankers' Association reported, "Assuming that the need for credit in this form is clearly a matter of sufficient national importance to warrant some action being taken by the authorities, consideration should be given to the creation of an institution financed on the public credit and to the placing upon it of the responsibility for meeting all legitimate demands." The Commission went on record as stating that the need was a real one and recommended that the problem of rural credit be investigated by the Dominion Government with the co-operation of the provincial governments with a view to the setting up of an "adequate and comprehensive scheme."

Little was accomplished, however, until in its 1944 session Parliament passed the Government's Farm Improvement Loans Act. In the words of the preamble the Act was designed "to encourage the provision of intermediate-term and short-term credit to farmers for the improvement and

development of farms, and for the improvement of living conditions thereon". Under the special provisions of the Act, the Government will guarantee 10% of the aggregate of all loans made by the chartered banks. The rate of interest on these advances must not exceed 5% simple interest. Eligible borrowers are farmers who own their farms, or who are purchasers under agreements for sale, or who are tenants. Loans are to be granted for the purpose of providing funds to purchase implements, upon the security of such implements, for the purchase or installation of equipment or of farm electric systems or for permanent improvements generally, upon the security of such equipment or improvements. Section 88 of The Bank Act was amended during the 1944 Revision to make it possible for the banks to finance these improvements and to accept them as security for loans granted.

Certain minor restrictions were placed on borrowings under this scheme. Aggregate advances for farm improvements must not exceed the sum of \$3000 per individual at any one time. Loans are to be repaid in full within a period of ten years. The Minister of Finance is empowered under The Farm Improvement Loans Act to terminate the guarantee provisions after notice to the banks. The guarantee will then become inoperative but only in respect of fresh loans granted

after the date of its expiration. The 10% guarantee of the Government is to apply on the first \$250 million of loans made under the scheme. Those in excess of this amount will not qualify, nor will advances made more than three years after the coming into force of the Act --- March, 1945.

A unique feature of The Farm Improvement Loans Act is the special powers conferred on the chartered banks, notwithstanding the restrictions placed on them by the Bank Act. If a bank makes a farm improvement loan, the principal amount of which exceeds \$2000, and the period of repayment is longer than five years, it is empowered to take as security at the time the loan is made a mortgage on the farm under improvement or an assignment of the rights and interest of a purchaser of the farm under an agreement for sale. This is the first time in the history of Canadian banking that real property has been designated as eligible security for a loan. The Bank Act, however, does authorize the taking of such security where a loan is already current or payment is past due. The framers of the original Bank Act scrupulously avoided giving the banks power to make mortgage loans. Their decision was based on the disastrous results which had befallen many banks in the United States and elsewhere which had been permitted by law to do so.

There is little possibility that the taking of real property as security under The Farm Improvement Loans Act will lead to the making of unsound advances. The Act requires that a loss will be paid by the Government only if "a responsible officer of the bank (has) certified that he scrutinised and checked the application for the loan with the care required of him by the bank in the conduct of its ordinary business." In view of the limit of \$250 million placed on guaranteed advances no serious embarrassment will be felt by the banks if hard times should convert a large number of loans into dead assets. Furthermore, as the Act now reads, the scheme will become inoperative in three years' time. The banks now have ample loanable funds which they can well afford to lend for periods up to ten years without in any way impairing their liquid position. In any event, the permissible aggregate will in all probability never be reached.

The Farm Improvement Loans Act resembles in many ways The Home Improvement Loans Guarantee Act of 1937 under which home-owners were able to borrow from the chartered banks sums up to \$2000 or \$3000 for the improvement of their properties at a rate of discount of $3\frac{1}{2}\%$. The Government undertook to guarantee 15% of all advances made under the Act which were repayable within five years. The Farm Improvement Loans Act is an extension of the same principles. There is a fixed

rate of interest, a maximum amount for each loan, a definite term prescribed for repayment, and a government guarantee against a percentage of losses incurred by the chartered banks. The scheme for home improvement loans was fairly widely availed of and by September 30th, 1940, 119,230 loans had been made, aggregating \$47.5 million. With the coming of war and the shortage of labour and materials the operation of the Act insofar as new loans were concerned was terminated on October 31st of the same year. It is generally considered that the Act was a great success and that it operated to the advantage of both the public and the banks. The loss ratio was extremely low.

The Farm Improvement Loans Act will come into operation at a time when properties are badly in need of repair and improvements, and when the Government is anxious to stimulate employment in the construction and implement manufacturing industries. It is reasonable to suppose that it will become popular and that there will be many eligible borrowers. That the banks are anxious to participate in this new loaning business is borne out by the statement of the general manager of the Bank of Nova Scotia, Mr. H.D. Burns, at the annual meeting in October, 1944. He said, "The legislation covering farm improvement loans ... provides for a new type of credit and will, I hope, develop an important new field of lending not previously open to the banks."

In order to provide intermediate credit for industry as well as agriculture, the Government passed The Industrial Development Bank Act in the closing days of the 1944 session. Originally introduced into Parliament in March, six months before it became law, the bill evoked considerable discussion both in the House of Commons and in the House Standing Committee on Banking and Commerce.

In presenting the views of the Minister of Finance before the Committee, Dr. W. C. Clark, Deputy Minister of Finance, stated that there had always been a gap in the financial structure of Canada and that the Industrial Development Bank Bill was designed to fill that gap. He emphasized that the proposed new bank was intended to supplement and not supplant existing financial institutions. Using as an illustration the case of a small company with a limited amount of capital which required to extend its operations or instal new machinery and tooling, Dr. Clark pointed out that a chartered bank would be quite within its rights in declining to make a loan of this type which could not be repaid within a year or two at the latest. "There is no criticism that can be made of the bank for taking that point of view because that is not the purpose for which chartered banks have been set up."

Dr. Clark went on to say that the investment dealers, whose function is to secure investment funds for capital purposes, would not be interested in marketing new stock of a small company whose name and reputation were practically unknown. Accommodation from a loan or mortgage company or an insurance company would also be difficult to secure unless the company were able to meet all the usual requirements. Similar conditions would prevail in the case of a new company whose sponsors had only limited resources and whose names and reputations were not yet established.

Supplementing his earlier remarks, Dr. Clark told the Committee members that with the new bank "we will be in a much better position to promote an expanding economy after the war with a high level of national income, employment and productivity." Undoubtedly that possibility has been largely influential in compelling the Government to take action in a field which was neglected for so many years. The threat of a post war economic de ression has stimulated much legislative action during the past two years.

It is a fact that in the early years of the war many small industries were converted with or without Government assistance to the production of urgently needed equipment and supplies. Others were created for this purpose.

Intermediate, and in many cases long-term credit, will be required to place these industries on a basis where they can produce civilian goods in the post war period. Further, many new products and techniques will have been developed during the war years which, without adequate financial assistance, will not be fully exploited. The Industrial Development Bank is designed to provide this assistance. According to the preamble of the Act, "It is desirable to establish an industrial development bank to promote the economic welfare of Canada by increasing the effectiveness of monetary action through ensuring the availability of credit to industrial enterprises which may reasonably be expected to prove successful.....by supplementing the activities of other lenders and by providing capital assistance to industry with particular consideration to the financing problems of small enterprises."

The Industrial Development Bank, which opened for business on November 1st, 1944, is organized as a subsidiary of the Bank of Canada, each having the same board of directors. It bears little resemblance to a chartered bank and its operations are specifically excluded from the application of The Bank Act, except in a few specified instances. The Bank may establish branches in any part of Canada though it is unlikely to require direct representation in very many cities or towns.

Its authorized capital is fixed at \$25 million, all of which must be subscribed by the Bank of Canada; \$10 million was required to be paid up at the time that the Bank commenced business. Total resources are estimated at \$100 million inasmuch as the Act provides that the Bank may borrow up to three times the aggregate amount of the paid up capital and reserve fund by way of bonds or debentures. These will not be guaranteed by the Government but will be made an eligible investment of the Bank of Canada.

Assistance to individuals or corporations is to be given in one of three ways if "credit or other financial resources would not otherwise be available on reasonable terms and conditions (and) the amount of capital invested or to be invested is such as to afford the Bank reasonable protection". The Bank may:-

- (1) make or guarantee loans to an individual or corporation, or
- (2) enter into an underwriting agreement in respect of stock, bonds or debentures of a corporation, or
- (3) purchase or otherwise acquire any of the securities of a corporation.

Underwriting agreements or purchases are to be made with a view to reselling the stocks, bonds or debentures subscribed

for or purchased.

It is to be noted that the Bank may guarantee loans as well as make advances direct to worth applicants. In most instances this will mean that where a chartered bank has been approached to provide financial assistance to a worthwhile enterprise but is unwilling to do so the prospective borrower may appeal to the Industrial Development Bank for either a direct loan or for a guarantee of a loan from a chartered bank. There will be many instances of border-line cases which the banks would be willing to handle with the support of such a guarantee.

The Industrial Development Bank will, of course, decide how it will act. It may be assumed, however, that where the application is for short-term accommodation and a chartered bank is willing to make an advance with a guarantee, the Bank will in all probability choose to assist the enterprise in this way. On the other hand, where an application is for medium-term accommodation the Bank will likely elect to make a direct advance, unless assistance would be forthcoming from a loan or mortgage company under a guarantee.

These observations are made in the light of the declaration that the Bank's operations will supplement and not supplant those of existing financial institutions. It

may well be that the management, inspired by Government policy, will go into the lending business on a large scale. This was the criticism raised by many members of Parliament when the Industrial Development Bank Bill was under discussion in the House of Commons.

The argument was advanced that the powers entrusted to the Bank were so broad that it could in effect compete with private enterprise in almost any field it chose. In the first place it might acquire some of the loans of industrial enterprises which would normally be handled by the chartered banks, with or without a guarantee by the Bank. Secondly, it might attempt to control the operations of a business in which "the manufacture, processing or refrigeration of goods, wares and merchandise or the building, alteration or repair of ships or vessels or the generating or distributing of electricity is carried on." That is the type of enterprise which the Bank may assist according to the Act under which it is incorporated. Such control might possibly be used to compete with well-established privately-owned industries in the event that a socialist government were elected to power. It might well be the method used to effect the nationalization of enterprises such as the electric power companies.

Control could be exercised by means of the section of the Act which empowers the Bank to "purchase or otherwise acquire" the securities of any existing or projected corporation, though it would not be within the spirit of the Act. The Bank's influence might also be felt by the provision which enables it to accept or acquire security of any kind as collateral for a loan or guarantee. Such security, consisting of stocks, bonds, debentures, warehouse receipts, bills of lading, goods, wares and merchandise, and mortgages, may be disposed of by the Bank in the event of a default in accordance with certain prescribed procedures. Since there is always present the possibility that the enterprise being assisted may not succeed, the Bank is in the position of being either a potential owner or a potential business broker.

In all fairness to the legislation, however, it must be emphasized that it was not designed to create any uncertainties or to set up a gigantic holding company. Its present general manager, Mr. S. R. Noble, is a veteran of the Royal Bank of Canada where he was senior assistant general manager. With his broad experience and background it is safe to assume that the Industrial Development Bank will play the role for which it was cast. In a public address given in Montreal in February, 1945, Mr. Noble said, "The prime factor

of the Bank is to lend money." To ensure that its activities are concentrated on assisting small industries, Mr. Noble pointed out that the Bank may not legally make advances, investments or guarantees in individual amounts in excess of \$200,000 above an average limit of \$15 million. This has the effect of leaving available \$85 million for loans to enterprises in amounts of \$200,000 and under.

Certain ancillary powers have been assigned the Bank which are worthy of passing comment. It may deal in any securities issued or guaranteed by the Government of Canada; it may accept deposits from debtors and may open deposit accounts with the Bank of Canada or any chartered bank. A reserve fund is to be set up to which all surplus profits will be transferred until the fund is equal to the paid up capital of the Bank. Thereafter, surplus profits may be distributed as dividends at a rate not exceeding 4% per annum, the balance being transferred to the reserve fund.

The Industrial Development Bank Act empowers the Bank of Canada to acquire and hold the capital stock of the Bank and to deal in bonds or debentures which it may issue. However, the amount of securities maturing after 10 years which the Bank of Canada may hold in its own portfolio is limited to twice the paid up capital and rest fund of the Bank of Canada.

The machinery thus set up by the Government fills a long-felt need. It remains to be seen whether or not it will function as smoothly as its sponsors hope. Meanwhile, the leading executives of the chartered banks have given the Bank their blessing and have promised the closest co-operation.

The Bank is not expected to make large profits in view of the magnitude of the risks which will be undertaken. The rate of interest charged in most cases will not exceed 5% which is extremely low for this type of accommodation. The extent to which the Bank will make money and avoid losses will be governed largely by the success or failure of the Government's post war policy to provide a high level of employment and income. It is estimated that over one and a quarter million people will be seeking civilian employment after the war. There is, therefore, great scope for the Industrial Development Bank if private enterprise is encouraged and the small man given an opportunity to exercise his initiative. These conditions can only take place if taxes are lightened and unnecessary restrictions removed at the earliest possible moment.

One or two points raised by members of the House of Commons Standing Committee on Banking and Commerce during their

examination of the Industrial Development Bank Bill merit consideration. It was proposed that the Bank should solicit deposits from the public instead of issuing bonds and debentures on the ground that this would be a cheaper method of financing. Mr. G. F. Towers, Governor of the Bank of Canada and president-designate of the Industrial Development Bank explained carefully that this would not be so. To illustrate his statement he placed on record an estimate of the probable earnings and expenses of the Bank, based on the assumption that its resources of \$100 million were fully employed.

If 5% were the rate of interest charged on loans or collected on investment, earnings on total assets would average about 4.75% since a portion of the Bank's assets must necessarily be kept in the form of cash. If 2.25% were the rate of interest payable on the Bank's bonds and debentures, fixed charges would average 1.75% in relation to total assets. Adding to this figure $\frac{1}{4}$ of 1% for general expenses and $\frac{1}{8}$ % for possible losses, total expenses of 3.75% are arrived at, leaving 1% of total assets for distribution as dividends or transfer to the reserve fund -- a return of 4% on the original paid up capital of \$25 million.

Mr. Towers went on to point out that if the Bank's resources were obtained by way of deposits from the public instead of by the sale of bonds and debentures, it could expect to have to meet interest costs of .6% at least and general operating expenses of 1.5%. The cost of money would, therefore, be about 2.1% which would be increased to 2.35% owing to the necessity of keeping a cash reserve of at least 10% against all public deposits instead of till money averaging about 5%. On this basis the final cost of money would average 2.35% instead of 2.25% and might even be higher. That factor, Mr. Towers remarked, influenced him to recommend that the working funds of the Bank be raised by the sale of bonds and debentures --- apparently the more economical method.

To what extent Mr. Towers was influenced by the feelings of the chartered banks in this matter is not known, but it can be taken for granted that some opposition would have been raised if the Bill had provided for the raising of funds by means of public deposits. The Industrial Development Bank would, in these circumstances, have been competing with the chartered banks in their own field with the added advantage of being in close touch with the affairs of the depositors. Hence it might be their first choice when bank accommodation was required.

Hon. R.B. Hanson brought out an unusual angle. He wanted Mr. Towers to explain what would be the basis on which the Industrial Development Bank would select the type of industries to be assisted. Certain industries and localities could be favoured according to the known wishes of the Government, Mr. Hanson argued. Mr. Towers discreetly avoided answering these queries. Nevertheless, it is conceivable that political pressure might be brought to bear on the Bank to further the project of a cabinet minister. Whether or not the management of the Bank would yield is a matter of conjecture. The record of the Bank of Canada has been very good thus far and its board of directors will have the final say in the affairs of the Industrial Development Bank.

While this Chapter has been concerned principally with intermediate credit, some reference can conveniently be made here to the introduction of long-term credit facilities which the Government brought before Parliament in 1944. To encourage the construction of dwellings by both individuals and municipalities a new National Housing Act was passed which contains more generous terms than its predecessors. Loans may now be obtained under Government guarantee at a rate of interest not exceeding $\frac{4}{2}\%$ per annum. Individuals may borrow up to 90% of the appraised value of \$2000 homes, 85% in the case of \$3000 homes, and 80% in the case of homes costing \$4000 or more.

Repayment may be extended over a period of 20 years, and in some cases 25 years. Special arrangements have been made by the Government with the insurance and mortgage companies to ensure that the scheme functions efficiently. It is anticipated that the National Housing Act, if widely availed of, will do much to encourage post war employment.

Finally, Parliament placed on the statute books in the 1944 session an act to set up the Export Credits Insurance Corporation, an organization designed to guarantee exporters against the risk of loss in approved contracts for the export of Canadian goods. In addition, the Government is empowered to guarantee the obligations of other governments or to lend money to them for the purpose of purchasing Canadian goods.

The preamble of the Export Credits Insurance Act states that "it is desirable to promote the revival of trade by establishing a corporation to insure against loss caused by insolvency, delays in collection and transfer difficulties in connection with the export of Canadian-produced goods, and during the period of transition from war to peace by providing for loans or guarantees to governments of other countries or their agencies." The Deputy Minister of Trade and Commerce, the Deputy Minister of Finance and the Governor of the Bank

of Canada constitute the key members of the corporation which is capitalised at \$5 million, divided into 50,000 shares, all of which are to be held by the Minister of Trade and Commerce in trust for the Crown. The corporation is empowered to issue and sell interest-bearing bonds and debentures and to invest moneys in such manner as the board of directors may determine.

The Act permits the corporation "to enter into a contract of insurance with an exporter to insure against the risk of loss involved in a contract for the export of Canadian-produced goods". By "loss" is meant the loss suffered by an exporter due to non-payment of the purchase price of the goods exported by reason of insolvency or delay of the importer or his inability to secure the currency in which the purchase price is to be paid. The liability of the corporation under the contracts of insurance issued and outstanding at any one time is not to exceed ten times the amount of the paid up capital and surplus. Its working capital may be supplemented from time to time by loans from the Consolidated Revenue Fund of Canada authorized by the Governor in Council but they are restricted in amount to five times the paid up capital and surplus.

A unique feature of the Act is Part II which empowers the Governor in Council to authorize the Minister of Finance to guarantee the obligation of a foreign government or government agency to pay the cost of goods produced in Canada. Further, the Minister may make a loan to such government or agency to finance the purchase of Canadian goods. Finally, the Minister may purchase, acquire or guarantee any security issued by such a government or agency to any person in Canada in payment of Canadian-made goods exported abroad.

These undertakings are to be made, however, only if the foreign government concerned requests the Government of Canada to give such guarantees, or make such loans, or acquire or guarantee such securities and if that government undertakes to indemnify the Government of Canada against any loss in connection with such undertakings. The aggregate amount of guarantees outstanding at any one time is not to exceed \$200 million; the aggregate amount of loans outstanding and the value of securities purchased or acquired and held at any one time are not to exceed \$100 million. The Export Credits Insurance Corporation may act as agent of the Minister of Finance in making the above commitments.

The part which the corporation will play in the restoration of Canada's foreign peacetime trade is difficult

to predict. Undoubtedly there will be many potential outlets for Canadian goods in countries which are faced with exchange problems the solution of which may well be found in the new legislation. Exporters will be much more inclined to make commitments with foreign importers or agencies under the protection of the corporation. The possibility of losses will be diminished and the risk to the Canadian Government will be slight if the guarantee of the foreign government concerned is secured in every case.

This new type of intermediate credit may well prove effective in stimulating the export industries of Canada and may make a worthwhile contribution to the maintenance of a high level of employment in the post war period. The chartered banks will enter into the picture by providing the necessary facilities for transferring funds and their assistance in the operation of all undertakings arising under the Act will do much to ensure its success.

CHAPTER XII

BANKING TODAY AND TOMORROW

It is of more than academic interest to inquire what the future holds for Canadian banking. The socialist party, the Co-operative Commonwealth Federation, has on more than one occasion declared that one of the key planks in its political program is to nationalize the banks. This, it has been stated in the original Regina Manifesto and again in a recent publication entitled "Make This Your Canada", will be carried out as soon as possible once the party has been elected to power. It is of prime importance to every customer of the chartered banks that he understands the reasons given for advocating this move and the effects it would have on the financial system of Canada as a whole if it were put into effect.

First, the claim is made that the banks represent a gigantic trust in which is concentrated much of the wealth of the country. Second, it is said that by acting in combination the banks are able to exert a monopolistic influence on the financial life of Canada. Third, it is charged that the present Government subsidizes the banks by financing the war effort in part by the flotation of Victory Loan bonds. Fourth, it is claimed that the banks virtually determine the monetary

policy of the country through their ability to create credit.

Each of these charges must be considered on the basis of the available facts. The ownership of the chartered banks is divided among 51,000 shareholders whose holdings of stock average 28 shares. Over 68% of all shares are held in Canada. The directors of each bank are selected for their intimate knowledge of some particular field of industry and commerce, and latterly of agriculture as well, and for the expert advice which they can provide. It is not customary for a director of one bank to accept a directorship in another bank. Nor is it true that the chartered banks monopolize credit for the benefit of large corporations or trusts. Mr. S. H. Logan, president of the Canadian Bank of Commerce, is the authority for the statement that no bank has any large stock holdings in any trading corporation nor has any "big interest" any important holding in bank stocks. While it may appear that much of the wealth of the country is concentrated in the chartered banks, it must not be forgotten that the prime function of the banks is to act as trustees. As such they have no control over the manner in which their customers choose to dispose of their credit balances. Even in the case of time deposits, which are technically withdrawable after notice, the banks do not exercise the privilege of demanding such notice.

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To imply that banks are a monopoly, acting in concert for their own exclusive ends, is erroneous. There is very genuine competition among the banks both for deposit as well as loaning business. It is true, however, that interest rates are as a rule fairly well uniform. This arrangement is adhered to in order to prevent rate cutting which in the long run would react to the detriment of both depositors and other clients of the banks alike. If interest rates on loans, for example, were progressively decreased to the point where the banks were losing money in order to acquire each other's borrowing accounts, income would have to be bolstered by lowering deposit interest rates and by increasing service charges sharply. Competition, then, is chiefly in providing service although there are hundreds of cases on record in which one bank has been able to offer more favourable borrowing terms than another.

Under the present competitive system, a potential depositor or borrower may "shop around" and decide for himself where he will conduct his banking business. His choice will be influenced by the manner in which he is greeted and the terms offered to him. Each banker will, as a rule, endeavour to sell the services of his bank, spurred by the knowledge that an increase in the business of his branch with a larger net profit at the end of the year will earn for him recognition from his head office.

On the other hand, if banking were nationalised, a potential borrower would find that one branch of the system would offer the same service and terms as another. He would most certainly know that he was dealing with a Government monopoly which left him no alternative source of assistance if his proposition failed to meet the prescribed requirements. He might also find that a friend of his who was in similar circumstances but who happened to be on good terms with an influential Government official might meet with success while he met with failure. As a taxpayer, he would undoubtedly find that the banking system was not being operated as efficiently as it was when in private hands and that its losses were being paid out of the public treasury.

The competition of the ten chartered banks is the best guarantee the public has that the credit balances of depositors will be loaned and invested wisely, that all applications for credit will be considered solely on the basis of their merit, that the affairs of every customer will receive the privacy and attention which are their due, and that industry, commerce and agriculture will receive the assistance and encouragement to which they are entitled.

The claim that the present Government is subsidizing the chartered banks by paying interest on Victory Loan Bonds is based on one or two facts which are being misinterpreted. It is true that about one half of the country's total expenditures for the prosecution of the war and the conduct of the nation's affairs is financed through the sale of Victory Loan Bonds and other securities. This is an enviable record which compares most favourably with that of the other members of the United Nations. As has been pointed out earlier in this book, the easy money policy of the Bank of Canada was designed to provide the chartered banks with sufficient cash reserves to take care of their normal and wartime credit requirements as well as to enable them to buy enough Government securities to stabilize the bond market. This inevitably resulted in a vast expansion of assets consisting for the most part of Government securities of one type or another. As was pointed out in Chapter VIII, increased expenses and taxes have eliminated most of the benefit derived from this increase so that the charge that the banks are being subsidized is false. Furthermore, it is well to note that as trustees the banks are performing a very useful service to the country by mobilising the available savings of their customers and lending them to the Government.

Finally, the charge that the chartered banks determine the monetary policy of the country is contradicted by the facts themselves. They do create credit, however, but only insofar as the Bank of Canada permits them to do so by providing the conditions under which cash reserves are expanded. Control is effectively exercised by the central bank through the medium of open market operations, manipulation of the rediscount rate, alteration of minimum cash reserve requirements, etc. During the war years, the Bank of Canada has pursued its easy money policy by open market operations, that is, by purchasing Government and other high grade securities in the open market. By so doing, more cash is placed in circulation. This cash eventually reaches the chartered banks and, being surplus to their ordinary requirements, becomes the base on which deposits of approximately ten times the amount of cash involved are created. The process is reversed when the Bank of Canada desires to contract credit.

Mr. S. H. Logan, president of the Canadian Bank of Commerce, summed up the relationship of the chartered banks to the Bank of Canada in his annual report to the shareholders on October 30th, 1943, when he said, "The ultimate prerogative of the national monetary policy is already vested in the Dominion

Government's institution, the Bank of Canada. The chartered banks have not the remotest chance of acquiring any of (its) powers, nor have they the slightest desire to seek those powers."

The many and varied services performed by the banks would not be carried out more efficiently if the banking system were nationalized. On the contrary, it would be reasonable to expect that the careful attention now given to all operations would not be continued. Sir Charles Addis, a distinguished member of the Royal Commission on Banking and Currency, remarked in 1933 on conclusion of the presentation made by the banks, "You have been subjected to a searching questionnaire and you have given us a straight reply. You have refuted one by one the many ill-informed and, I may add, in some cases, malicious charges which have been levelled at the banks, and you have done so with a dignity, and with a moderation, and with a frank sincerity which compels conviction. I believe that your document will stand historically as a defence of the Canadian banking system, and if this Commission, in my judgment, has done nothing more than elicit this response it would not altogether have failed in the task allotted to it."

In reply to the suggestion that the British banks be nationalized, Viscount Snowden, socialist Chancellor of the Exchequer in the Labour Government of the late Ramsay MacDonald,

stated, "If banks were nationalized, they would have to be managed as they are now if their solvency is to be maintained." That is a frank admission that the principles followed in capitalist countries by the commercial banks have on the whole worked to the advantage of the communities they served. It follows then, that if no advantage is to accrue, why turn over the administration and control of the banking system to a Government department? It is more than possible that the financial juggernaut thus created would hold the power of life and death over all industry, that it would eventually push its influence into every field of private endeavour and that none would escape its grasp. For few enterprises, large or small, do not require the assistance of the banks at one time or another in carrying out their activities.

If the banks are to maintain the confidence of the public in the post war period, what should be their principal objectives and how may they best serve the interests of the industrial, commercial and agricultural life of the country? They will have an excellent opportunity to play a large part in the recovery program of the Dominion. The accumulation of individual deposits and the potential lending power which they possess are greater than ever before. The productive power of industry is similarly unprecedented. These two conditions are

closely linked together. The money is in the banks, either as potential loans or as deposits, and is ready for spending as soon as goods are available. The machinery of industry is ready to switch to civilian production immediately the war situation warrants such action.

The degree of prosperity in the post war period will be determined, to a very great extent, by the co-operation received from the Government. First, it is important that taxation be reduced on both individual and corporation incomes. In the case of individuals, some relief is justified in order to enable long-delayed purchases and home improvement programs to be put into effect. It must not be forgotten that the personal income tax affects small enterprises; if these are to be encouraged in order to stimulate employment, a further argument for concessions after the war is evident. As far as corporations are concerned, it is quite clear that the excess profits tax should be reduced with a view to its eventual elimination.

In many respects Canada is the highest taxed of all the United Nations. To enable her manufacturers to compete in world markets it is imperative that costs, of which taxes make up a large part, be reduced to a lower level. The excess profits tax is justified in wartime only as a means of placing at the disposal of the country most of the additional profits

made by private enterprise. Admittedly it has a discouraging effect on industry and should, therefore, be withdrawn after the war. "Incentive is necessary to enterprise andenterprise is essential to full employment," in the words of Mr. H. D. Burns, general manager of the Bank of Nova Scotia. It should be added that high taxation which can be borne by well-established industries often becomes prohibitive in the case of new or projected enterprises.

Second, and of equal importance in encouraging the banks and industry to play their full part in post war reconstruction, is the condition that the Government relinquish all non-essential controls as rapidly as possible after the cessation of hostilities. It is of course obvious that many restrictive measures will have to be retained for an indefinite period in order to ensure that materials in short supply are distributed on an equitable basis. But a beginning can be made by the lifting of restrictions on the employment of labour and the types of articles which may or may not be manufactured.

In the case of the banks, restrictions are not and never have been totally absent. In fact the banking system has in many ways been the most regulated of any Canadian industry or enterprise. Licensing and price fixing are commonplace with

banks. As Mr. M. W. Wilson, president of the Royal Bank of Canada, pointed out at the 1942 annual meeting of shareholders, "The much discussed war measures merely bring other commercial concerns into line temporarily with the permanent regulations of the chartered banks." He went on to point out that bank charters come up for renewal at ten-year intervals at which time banking practices are critically examined by the House of Commons Standing Committee on Banking and Commerce. The maximum rate of interest which banks may charge is fixed by the Bank Act as are all their powers.

"As control over banking, money and credit is now ample in Canada," Mr. Beaudry Leman, president of La Banque Canadienne Nationale, told the members of the Sherbrooke Board of Trade on October 26th, 1944, "further curbs on freedom of enterprise might well bring about stagnation and discourage initiative and the incentive to take reasonable risks." The same could be said of all private industry. Mr. Leman might have gone on to say that the early removal of unnecessary controls after the war would tend to produce the very opposite of the situation which he depicted in his address.

Finally, to encourage the banks and industry in the post war period it is desirable that the Government state

in no equivocal terms that it undertakes to promote the welfare of all private enterprise, that no discrimination will be shown against investors who risk their capital in the hope of securing a profit, and that labour will be freed of insecurity by the provision of adequate social insurance measures. Individual initiative is the best hope that Canada has of the enjoyment of a rising standard of living and a post war period of progress and development.

In anticipation of playing a major role in the economic reconstruction of Canada, the banks must do a certain amount of post war planning. Many have already done so but much remains to be accomplished. Being closely associated with industry, agriculture and individuals in every field of endeavour, they have a unique opportunity to influence the saving and spending habits of their customers. Every effort should be exerted to encourage clients to save now with a view to spending in the years following the cessation of hostilities when goods will be available in normal quantities. Saving during wartime has become a national habit and it is not impossible that many individuals will hesitate to dissipate the credit balances which they have accumulated in their deposit accounts. By stimulating saving now with a view to spending later the banks will also benefit by an expansion in consumer loans induced by the unsatisfied wants of customers who have felt the urge to spend.

The disposition of the record volume of savings accumulated during the war will determine the direction and outcome of many post war factors. Much, therefore, depends on the extent to which the banks influence their customers. Savings as such are static and do not become dynamic purchasing power until ^{the} owners are assured of a steady income in the form of a well paid productive job after the war. Spending on durable or non-durable goods will be withheld as long as insecurity of employment exists. There must, therefore, be the fullest possible measure of employment in the post war period. The banks can help to bring this about, first by lending to consumers and producers to provide credit and create jobs, and second by stimulating the translation of savings into purchasing power which, when mobilized for action, will in itself create jobs.

Many banks in the United States have set up machinery to encourage their clients to save for specific post war purchases which will stimulate employment. Special deposit accounts are opened in which customers deposit regularly a certain part of their excess earnings which will provide them with a down payment or the entire purchase price of one or more items of durable goods. One such plan is in operation at the Merchants National Bank and Trust Company in Syracuse, New York. A client who intends to purchase a car or refrigerator, for example, after

the war commences to provide the necessary funds now. The bank determines how much he must save weekly or monthly over a period of one or two years to reach his objective. Special passbooks are used to indicate to him at a glance how much progress he is making. Most depositors of this type will likely become eligible for consumer credit to finance the balance of the cost of their projected purchase.

Other banks in the United States have similar arrangements to encourage customers to save for modernization of their homes or for the construction of new residences. The plan is often extended to retail store owners to encourage them to modernize their shops after the war. Because banks have the necessary machinery for influencing saving and spending they are the best operators of such a scheme.

If all the banks in Canada were to inaugurate a program of "save to spend", and if they were to open special accounts for this purpose, the total potential purchasing power earmarked for spending after the war would reach many millions of dollars. These savings would start the wheels of industry turning without the necessity of selling Victory Loan Bonds to finance the peace. Never before has such an opportunity been presented to the banks. Many of them undoubtedly are aware of this fact but few have published any extensive plans to aid the national recovery effort.

It must be said, however, that the chartered banks have been consistent in giving leadership to the people of Canada through the medium of the annual addresses of the presidents and general managers to the shareholders of their institutions. In recent years much thought has gone into the preparation of speeches covering subjects such as "Taxation After the War", "Canada's Foreign Trade", "Nationalization of Banking", "Post War Employment", etc. Many concrete suggestions have been made which, if adopted, would do much to maintain the volume of employment built up during the war and the accompanying level of national income.

Unfortunately, these addresses are given but once a year and it is doubtful if the publicity given to them at that time is adequate to influence any large body of public opinion. While verbatim reports appear in the leading daily newspapers of the Dominion, many people are of the opinion that such extensive accounts are merely propaganda for the banks and hence are not worth reading. Such is not the case as a careful survey of presidential speeches will reveal. It is suggested that the Canadian Bankers' Association might profitably consolidate the best of the annual addresses and publish them in the form of a review of economic developments in Canada. Distribution should be widespread and should supplement the publication of these addresses in the respective banks' annual statements.

Finally, the chartered banks which are represented in the British Isles, the United States, the West Indies and in South America have a worthwhile opportunity to contribute substantially to the expansion of Canada's foreign trade after the war. Through their representatives abroad they can be of considerable service in placing their foreign and domestic customers in touch with one another and with market conditions at home and abroad. The development of these contacts will in the long run react to the benefit of the country as well as to the banks themselves.

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This survey of banking in wartime has necessarily been confined chiefly to the activities of the ten chartered banks for it is they which form the backbone of the financial structure of Canada. An attempt has been made to show how they have been affected by the economic forces set in motion by the oncoming of a gigantic world struggle, the extent to which they have contributed to the part taken by Canada and the role which they may be expected to play in the post war period.

Canada is fortunate in possessing a banking system established on firm foundations, and one which has on the whole served the country extremely well in time of war as in time of peace. If anyone is doubtful of the validity of this statement

let him glance at the banking history of other nations. He need go no farther than south of the border to recall that in the early years of the Great Depression thousands of small banks closed their doors, never to open them again. The loss to depositors was enormous; in many cases the lifetime savings of clients disappeared overnight. Not one Canadian bank was forced to suspend business during this period of economic upheaval. No banking system was better prepared to respond to the exigencies of war than that of Canada and none is better equipped to serve the country in the post war era. Its contribution to the war effort has been incalculable; its contribution to the peace will be of equal magnitude if its leaders are men of vision and are not hampered in their efforts by the deadening hand of Government regimentation.

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