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# RECENT CHANGES IN THE MONETARY STRUCTURE OF CANADA

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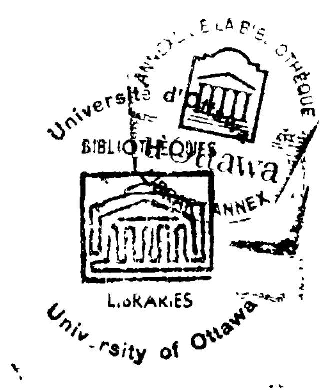
Thesis presented to the Faculty of Social, Political and Economic Sciences of the University of Ottawa as partial fulfillment of the requirements for the degree of Master of Arts.




Kingston, Canada, 1955

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# INTRODUCTION

The Canadian economic system is a child of change, and in a youthful, vigorous and growing nation, therein lies its strength. Canada has recognized the challenge that these vacillating times represent and has keynoted her defence with the policy of "flexible adaptability".

The recent years have seen the effectiveness of this pliable ability, as the Canadian economic system attempted to overcome some of the deficiencies in its structure.

The years 1953, 1954 and 1955 have seen some very significant changes in our monetary structure. "Structural changes", to quote Wagemann[1], "are organic, constitutional transformations of the economic system". Thus the establishment of a new central banking system, such as the Federal Reserve System in the U.S.A., or the great increase in the size of the U.K. public debt occasioned by the war, could be classified as a structural change. Therefore, the recent creation of a short-term money market and certain amendments to the Bank Act qualify as important revisions to the monetary structure of Canada.

The year 1953 saw the Bank of Canada exert its strong influence in broadening the short-term securities market. The Co-operative Movement applied for and received a Federal Charter in order to extend its scope of operations from coast to coast.

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[1] Wagemann, Ernest, Economic Rhythm, New York, McGraw-Hill Book Co., Inc., 1930, p.26.

For Canada's chartered banks, 1954 was a momentous year. That year witnessed the decennial process of revising the Bank Act. The Bank of Canada Act also was amended. Some of the amendments to the Bank Act radically altered the power and scope of chartered banking operations. The most important of these changes were associated with bank loan regulations. A new regulation allowed banks to take chattel mortgages for the first time; famous section 88 was extended once again; a new section 82 outlined the conditions under which the banks could lend money on the security of oil and gas in the ground; and most significant of all was the inclusion of the banks as lenders in the mortgage field. There was also a number of administrational amendments to simplify the internal mechanism of chartered banks. The most influential revision in the Bank of Canada Act, and one of direct significance to the chartered banks, was the establishment of variable legal cash reserves. This amendment greatly increased the monetary control of the Central Bank.

The creation of a short-term money market in June 1954 filled one of the last remaining gaps in the financial system of Canada.

In 1955 the actual operations of most of these changes were in full swing and facts and figures became available as a measure to determine the value of their contributions.

Thus it is quite apparent that the major changes resulting from the Bank Act, the Bank of Canada Act, and the creation of a short-term money market were striking alterations in our monetary system.

As these changes are relatively recent, little research has been done as yet to present them in a comprehensive and correlated form. While it is true that most of these changes have been discussed by competent bankers and economists in varying degrees in periodicals and newspaper articles, there has not, to the best of my knowledge, emerged as yet, one single book, article or thesis, published which has treated all of these changes fully.[2] But three periodical articles stand out as the most comprehensive presentation of their subject to date, they are:

Macintosh, R.M. "Broadening the Money Market", _The Canadian Banker_, Autumn 1954, p. 63-73.

McLaughlin, W.E. "Mortgage Lending by Canadian Banks", _The Canadian Banker_, Spring 1955, p. 54-64.

Rogers, R.W., "The Bank Act 1954 Edition", _The Canadian Banker_, Autumn 1954, p. 24-37.

As no one unified text existed dealing with these important structural amendments, it was deemed fitting and timely

[2] A.B. Jamieson is writing a supplement to his "Chartered Banking in Canada", which proposes to deal with the recent monetary changes. Ryerson Press, Toronto, will publish it later this year.

that a research project be undertaken to perform this task, using these three topics and articles as a guide.

Therefore, it is the intention of this thesis to present as complete an exposition of each of these structural changes with all their ramifications, insofar as it is possible within the limits of this paper, and to correlate the available information into one comprehensive project. The secondary purpose, and it flows from the first, is to estimate the impact that these innovations will exert upon the future economic structure of Canada.

Chapter I presents a background to the Bank Act and an outline of the procedure followed in amending the Act. The main body of this chapter deals with the actual revisions to the new Bank Act and their comparison, if any, to the superceeded legislation. The amendments to the Bank of Canada Act completethis chapter.

Chapter II deals rather extensively with the monetary power given to the Central Bank by the establishment of variable legal cash reserves.

Chapter III outlines the extension and modifications of bank loan regulations under the new Bank Act. Special treatment is given to the clauses authorizing chattel mortgages and mortgage lending under the N.H.A. Section 83 and 82 also receive individual attention.

Chapter IV gives a comprehensive presentation of the creation of a Canadian money market. Special attention is also given to the section dealing with the Broadening of the Short-Term Securities Market and the Rediscount Rate.

A brief conclusion outlining the effectiveness of these changes completes the thesis.

# CHAPTER I

## THE BANK ACT AND THE BANK OF CANADA ACT--OLD AND NEW

The Canadian banking system is a product of evolution, which contains within itself the seed of its own regeneration. This virile capacity of self-propagation is the Decennial Review. By this is meant that every ten years the Bank Act is subjected to a process of searching scrutiny and careful revision. The flexibility of this action allows the banks to discard useless and outmoded regulations and supplant them with statutes, in keeping with the latest developments of an energized economy. While the Bank of Canada Act is perpetual, it too is subject to amendment whenever the occasion demands it.

The purpose of this chapter is to outline the amendments that were made in the 1954 revision. These revision proceedings were broad in scope and resulted in a number of basic changes in banking law. As a way of introducing these changes, we have supplied a little background to the Bank Act itself, and the method used in selecting the actual amendments.

There are 161 sections of this new revised Bank Act and it outlines the complete sphere of regulations governing the banking business and contains the basic structural and procedural features that have made the Canadian banking system one of the strongest and soundest in the world.

While banking had its beginning in Canada over 133 years ago with the granting of a charter to the Bank of New Brunswick, it was not until the birth of the Dominion of Canada in 1867 that it became subject to federal authority. The then operating banks were allowed to continue in business under a temporary federal act. In 1871 the Government of Canada passed its first single Bank Act which embodied the powers and responsibilities of the banks.

Last year marked the eighth time that the Bank Act has been subject to revision. It is worthy to note at this time that it was on the initiative of the banks themselves, that the duration of their charter extend for ten years only, making them unique among all the banks of the world. Mr. Jamieson says, "In no other country is a similar practice followed".[1] He states that in 1900 the Government offered to make the bank charters perpetual, but the banking system, after due deliberation, decided to retain the decennial revision because they felt it would give them greater flexibility and adaptability to meet the changing, ever-expanding needs of a dynamic economy. The gradual evolution of the Bank Act, brought about by valuable changes and amendments since that time, has adequately proved the wisdom of that prophetic decision.

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[1] Jamieson, A.B., Chartered Banking in Canada, Ryerson Press, Toronto, copyright 1953, p.22.

The process of decennial review of the Bank Act involves a great amount of advanced labor on the part of the Government and the banks alike. In fact, study usually begins about two years before the year of amendments. Special committees of experts evaluate all the suggested amendments and in collaboration with the Minister, the Inspector General of Banks and representatives of the banks, prepare a first-stage draft bill. This draft is made available to the banks for study and suggested recommendations. After all the preliminary changes have been incorporated into the draft, it is introduced as a bill in the House of Commons. While the bill is subject to the same legislative stages as other enactments, its most drawn out and rigorous examination occurs in the House of Commons Banking and Commerce Committee. The make-up of this Committee, which numbers 50, is determined approximately in proportion to the numerical strength of the various political parties represented in the House of Commons. During the course of its many meetings, representatives of the chartered banks are required to present themselves before the Committee and to answer questions in regard to the Bank Act and general banking policy. This year (1954), the President of the Canadian Bankers Association, Mr. T.H. Atkinson, was the principle banking representative called. Other organizations and interested parties may also give evidence and suggestions.

The combination of these overall contributions by the Committee, the Government, the public, and the banks is instrumental in giving the Bank Act and the Bank of Canada Act a most complete and exhaustive review with the aim of improving and strengthening it, and bringing it into line with the latest economic conditions.

After twenty-nine sittings by the Committee, the revised Bank Act of 1954 was presented to the House for ratification and became law on July 1, 1954.

The remainder of this chapter will be devoted to an enumeration of the majority of changes that were incorporated into the revised Bank Act and the Bank of Canada Act.

## CASH RESERVES

The major change in the Bank of Canada Act, and one which was of direct significance to the chartered banks, was an extension of the Bank of Canada's power to perform the fundamental function of regulating the supply of cash available to the chartered banking system. Hitherto, the Bank of Canada Act provided that each chartered bank must at all times maintain a cash reserve, in the form of deposits with the Bank of Canada and/or Bank of Canada notes, equivalent to five per cent of the bank's deposit liabilities in Canadian currency. This was embodied in section 59 of the old Bank Act. The new procedure as incorporated in the Bank of Canada Act, (section 18(o)) and the Bank Act, (section 71), provides

that the chartered banks must maintain an average minimum cash ratio which may be varied by the Bank of Canada between eight per cent and twelve per cent. The Bank of Canada may not, however, increase the reserve requirement in any one month by more than one percentage point and must give a minimum of one month's notice before making the change.

This power was created to add a new and more flexible monetary instrument to those available to the Bank of Canada, such as the rediscount rate and open market operations, to allow it to perform its statutory duty "to regulate credit and currency in the best interest of the economic life of the nation"[a]. Another of the changes in this section was the new method of determining the amount of cash reserve required to be maintained by a bank during any month. The old method called for not less than five per cent of their deposit liabilities calculated upon the daily average of these deposit liabilities. Under this new revision, a bank's deposits in the Bank of Canada continue to be based on the daily average, but its Bank of Canada notes and its Canadian dollar deposits liabilities are now the averages of the four consecutive Wednesdays, ending with the last Wednesday but one in the preceding month. The use of this method over the daily averages simplifies the work involved in assembling the figures from branches.

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[a] Preamble to Bank of Canada Act.

BUSINESS AND POWER

Section 75 contains a description of the fields in which the banks may and may not operate. Part 1 of this section underwent some phraseology revision which was expected to qualify and clarify the existing regulations. Formerly this section merely authorized the opening of branches, as "branch" is now defined to include an agency and office, words specifically included before.

The former clauses (b) and (c) have been amalgamated. The old (b) which allowed a bank to "engage in and carry on business as a dealer in gold and silver coin and bullion"[a] is out, because it embodied no specific and evident authority to lend on the security of gold and silver. The latest change clearly authorizes dealing in and lending against these valuable metals.

Clause (d) authorizing a bank to lend without security is new. Collateral was formerly required before, although in actual practice, banks did make unsecured loans to customers whose ability and integrity was sound.

Subsection (2) of section 75 deals with the prohibited business of banks and it is here that one of the most significant changes occur. Since the first Bank Act in 1871, there has been a general prohibition against mortgage lending.

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[a] Bank Act 1944, p.26.

The reason for this being the realistic assumption that the essential lack of liquidity of conventional mortgages renders them an unsuitable investment for Canada's chartered banks, which must stand ever prepared to meet their deposit liabilities on demand. This feeling may have been prompted by the disastrous experiences of U.S. banks in 1733 which resulted from their acceptance of real property as security.

The first deviation from this long established position was in 1944 when the Farm Improvement Loans Act allowed mortgage security to be taken in respect of farm improvement loans for more than $2,000, repayable during a period longer than five years. A similar enactment was added to the Veterans' Business and Professional Loans Act in 1945, where mortgage security was allowed to be used in situations where the regulations required it.

But in 1954 the major change occured when the Government of Canada decided to include banks as authorized lenders on residential mortgages and amended the National Housing Act accordingly.

According to the Bank Act of 1944 which read:

> "Except as authorized by this Act the bank shall not either directly or indirectly (c) lend money or make advances upon the security, mortgage or hypothecation of any lands, tenements or immovable property..."

Although the Farm Act and the Veterans' Act were exempt from this clause, it was decided to amend this section. Therefore

the Bank Act was amended in the opening words of section 75(2) to state that the National Housing Act 1954, the Farm Improvement Loans Act and the Veterans' Business and Professional Loans Act, were exempt from the prohibitions of the subsection.

A new prohibition in subsection (2) is the termination of the note-issuing privileges of banks. This privilege had been progressively reduced since the Bank of Canada was set up in 1934.

New section 72 makes provision for transfer to the appropriate governmental authority in other countries of the issuing bank's liability for its outstanding local issue upon payment of the amount involved.

Paragraph (g) is also new and it was initiated to protect the pension fund of the employees. It prohibits a bank from investing the pension funds in bank stock without Treasury Board approval.

Another marked diversion from tradition was the new addition of subsection (5) of section 75. This recommendation by the Banking Committee, and acceptance of it by the House of Commons, empowers the bank to make loans to individuals on the security of chattel mortgage or its equivalent, on household property and motor vehicles. This new departure arose from the evident desire of the Committee to provide a security medium which would enable banks to expand their activities in the small personal loan field.

## SECTION 38

The banks were happy to learn that the number of this section would not be changed. This section enjoys the distinction of being the only one, broadly speaking, whose number and substance are widely known to many outside the banking fraternity. This is probably due to the fact that it provides for the pledging, by a borrower, of security that remains in his possession and under his control.

There was little change in this section other than certain minor revisions which were used to broaden its scope. Some examples are:

(1) Enabling a farmer to borrow for the purchase of seed potatoes on the security of the potatoes and resultant crop.

(2) The definition of livestock was broadened to include poultry.

(3) The term fisherman was redefined to clarify the eligibility of corporations and partnerships.

(4) The term "products of the sea, lakes and rivers" now encompasses, in addition to fish of all kinds, "any substances extracted or derived from any water".

(5) Subsection (4) of section 38, which deals with registration procedure on Notice of Intention where security upon property has been given to the bank, has been slightly altered in order to simplify the transaction for the Bank of Canada.

These forementioned changes were the results of banking authorities' desire to increase and improve the worthy structure of this section.

## CAPITAL AND SHARES

For the first time since 1890 a change was made in the capital requirements for a new bank. Under section 13, the minimum subscribed capital was increased from $500,000 to $1,000,000 and the minimum paid up capital from $250,000 to $500,000. The Act was also amended to allow banks greater flexibility in offering new stock to shareholders and making it easier for them to obtain new capital. It gave them additional scope to overcome legal obstacles that may exist in other countries to an offer under conditions acceptable to Canadian shareholders, the exact procedure available to them is embodied in section 36(d).

Section 48 marked another deviation which allowed banks to make its shares more easily transferable than the present book stock, a step made possible by the removal of the double liability of holders of bank stock that was in operation when banks had note-issuing rights. The banks were now given their choice of issuing their stock in the form of negotiable certificates instead of the current method of book stock. Although bank directors possess these new options, they are subject to certain statutory limitations which are

outlined under section 50, subsection (3) and (4).

## SECTION 82

One of the most important innovations in this new Act is the addition of this whole new section which provides an improved and more flexible mode whereby the banks may lend money on the security of oil and natural gas in the ground, and of rights of ownership thereto. The term hydrocarbons used in the Act is generally defined as "oil bearing shale, tar sands, crude oil, petroleum and natural gas".

The administration of this type of loan by the Bank is outlined in additional subsections and paragraphs. The form used, the rights and powers of the Bank, the provision for registration under land registry and provisions for additional security, are all clearly and explicitly set down. The addition of this section had been contemplated for quite some time and is the result of long and extensive studies by proficient veterans in the oil business and the monetary field. Great expectations are anticipated from the enactment.

## ADMINISTRATIONAL AMENDMENTS

The revision of the Bank Act brought about a considerable number of changes in the internal administration of banks and banking procedure and therefore warrants the attention of those savants who wish to delve deeply into the refinements of

the changes. Treating these changes in numerical order, we start with section 19(1). This section dealing with the establishment of employee pension funds was formerly section 13(3), and it required that this fund be invested only in trustee securities. This is now omitted and the only restriction is that which forbids investment of these funds in bank stock.

Section 21, subsection (2) now requires that a majority of directors to be Her Majesty's subjects "ordinarily resident in Canada".[4] The old terminology "domiciled"[5] only contained an intention to live here permanently. Subsection (3) is new and it renders void the election of a director if the new combination of directors alters the Canadian majority required by subsection (2). This requirement is strengthened by subsection (2) of section 23 and 25.

Another amendment suggested by the Banking and Commerce Committee provides that a person is ineligible to be elected or appointed a director of a bank after July 1, 1959, if he has reached his seventy-fifth year. This clause is now subsection (4) of section 21.

Section 30 has been revised to present an enlarged outline of the general powers of directors to make by-laws and administer the affairs of the Bank.

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[4] Bank Act 1954, p.11.

[5] Bank Act 1944, p.7.

Under a revision in section 61[?], shareholders have a wider choice in selecting their auditors. Formerly they had to choose from a list published by the Minister in the Canada Gazette, but the new procedure allows them to appoint anyone having the necessary qualifications.

The section dealing with the destruction of old records has also been modified. Section 74 replaces the old section 92(6) and the regulation governing the retention of old records has been changed from 30 years to 20 years.

The annual statement of a bank also underwent a number of alterations to keep it in step with the latest accounting procedures. Subsection (1) of section 53[?] requests the directors to submit a statement that shall "present fairly the financial position of the bank for the financial year ...", the older terminology called for a "full and clear statement of the affairs of the bank". The accounting fraternity had also requested a uniform acceptance and use of the term "contingency reserves" instead of certain other equivalent but non-standard terms. The actual form of the annual statement also underwent a streamlining revision. Assets are shown first instead of liabilities. The number of asset classifications was reduced from 29 to 16[?], and the liabilities were pared down from 14 to 11. Two of the new asset classifications are: Item 5, "cheques and other items in transit, net", Item 9 "mortgages and hypothecs insured under the National Housing Act, 1954, less provision for estimated loss".

The monthly return of a bank's financial position contained in section 103, also underwent a condensation. The assets were reduced from 32 to 26 items while the liabilities were reduced from 16 to 14.

A clause in the Bank of Canada Act, which formerly called for a monthly statement of the cash reserve from each bank, has now been incorporated into the Bank Act under section 104. The authenticity of this report is to be verified by the Inspector General of Banks as laid down in section 53(2).

The form required for the reporting of assets, cash reserves and liabilities that are valued or payable in foreign currency, was formerly dealt with in section 59, but has been changed to section 104.

Section 109 and 110 require that all unclaimed deposits inactive for nine years and every cheque, draft, or bill of exchange, (including an instrument drawn by one branch of the bank upon another branch of the bank) that has been issued, certified, or accepted by the bank at a branch of the bank in Canada, and unpaid for nine years, must be reported to the Minister. The former inactive period was five years.

The Bank of Canada Act also was amended to include the administration of sums under $10.00 which have been dormant or unpaid for 30 years. The new regulations specify that if these amounts are not claimed within 20 years after receipt in the Bank of Canada that they will be placed in the

Consolidated Revenue Fund.

Section 113 now requires that all branch managers prepare written declarations stating that neither interest or discount rates charged during the year exceeded the statutory limitation prescribed in section 91. Formerly section 91 contained this demand.

Former section 78(2) has been changed to section 114. This section now deals with only real property that the management have decided is no longer needed by the Bank. These decisions are influenced by the regulations contained in section 81(2).

This completes the list of revisions of both Acts and the general consensus of opinion has been that it is an excellent piece of legislation. It was evident during all the Committee meetings that everyone recognized the basic premise that the Canadian banks exist to serve the public. The Bank of Montreal called it "an excellent example of the workings of an enlightened democratic process".[8]

While all of these changes are important in their own right, a certain number of them have significantly influenced and even altered the monetary structure of Canada. These changes require additional treatment and explanation before we can appreciate their true import and future impact upon our economy, to this end chapters two and three are dedicated.

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[8] Bank of Montreal Business Review, "Old Charters for New", July 22, 1954, p.4.

## CHAPTER II

## INTRODUCTION OF NEW LEGAL RESERVES INCREASES CENTRAL BANK CONTROL

It has always been one of the chief functions of a central bank to regulate credit and currency in such a way as to promote the interest of the general public. In order to regulate the quantity of money, the Central Bank is given a special group of powers among which are the rediscount rate, open market operations, and moral suasion (informal agreements). But now an additional method of control over the supply of credit has been initiated with the introduction of the principle of variable cash reserves and the new method of determining them. These new powers given to the Bank of Canada are regarded by the orthodox financial experts as one of the most vital means of influencing the economic climate.

These new controls give the Bank of Canada direct authority to regulate from time to time the level of bank credit and the amount of cash available to the business community and general public.

Up until now Canada was almost the only country with a central banking system where the central bank did not have the authority over the cash ratio.

When the Bank of Canada was created in 1934, credit control was not an immediate problem. It seemed then inappro-

priate and futile to try to fix a range for the banks' cash ratios. But the principle of central control was incorporated in the Bank of Canada Act. It took the form of a clause requiring the banks to keep 5 per cent of their deposit liabilities as deposits in the Bank of Canada. Neither then nor since has any bank considered 5 per cent anything like adequate.

The original purpose of legal reserve requirements against deposits was to provide banks with cash in some proportion to their deposit liabilities. These reserves were designed to assure depositors of convertibility of their deposits into cash. This concept of the function of legal reserve requirements has been progressively modified. Experience indicated that a small ratio of reserves is not adequate protection to ensure the conversion of deposits into cash. Moreover, with the advent of a central bank which made all sound assets of a bank convertible into cash, there was less need for the commercial banks to make provision for liquid funds to meet depositors' demands for cash.

The view is now widely held that legal reserve requirements are not designed to provide liquidity to the banks but are designed to provide the Central Bank with an instrument for controlling the stock of money by altering bank reserves and thereby encouraging or restricting bank loans and investments.

This new concept of reserves is why official thought here supported the idea of the flexible cash requirement (monthly averages) and flexible control over ratios.

In the past, the Central Bank's influence on the credit supply was exercised only indirectly through two major instruments; open market operations and informal agreements. The compactness of the Canadian banking system has lent itself readily to informal agreements between the banks and the monetary authorities for the implementation of bank lending and investment policies aimed at maintaining financial stability. Examples of this sort include the agreement in March 1946 which in effect prevented undue switching from short-term to long-term government securities in bank portfolios; the February 1948 agreement to limit bank financing of business capital needs; and the agreement of February 1951 to check the further expansion of total bank credit and to curb bank lending for less essential purposes. It was not until May 1952, when the worst inflationary pressures had passed, that the Bank of Canada again suggested that the credit restraints could be suspended. The official terminology used to end this period was "The Bank of Canada feels that normal central bank action to influence the level of total bank credit no longer needs to be supplemented by the special arrangements with the banks".[1]

[1] Financial Post, "How Ottawa Tightening Money and Credit Control", Michael Barkway, Feb. 30, 1954, p.3.

Open market operations by the Bank of Canada have been the principal instrument of quantitative monetary control since the founding of the Bank. In the late thirties they were used to foster economic recovery, and during and immediately after World War II to implement a "stable rate" policy; after the outbreak of the Korean hostilities, open market operations were carried on in such a manner as to restrain monetary expansion.

The effectiveness of open market operations seems to have been hindered by the fact that the customary 10 per cent reserve ratio of the chartered banks was far above the 5 per cent minimum legally required until last year. The absence of a well developed money market also made effective open market policy more difficult. Scope for open market operations should, however, be enhanced by the recent progress in the money market and the enlarged authority to deal in longer term securities.

In contrast to these methods of anonymous market influences and "gentlemanly agreement" with the banks, direct control over cash ratios would have two advantages:

(1) It would be clear and definite, and it would apply equally to all banks. There could be no complaints, as there are apt to be with informal agreements that one bank is interpreting it less strictly than another. Moral suasion suffers from the disadvantage of swaying

the conscientious and not affecting those who are uncooperative.

(2) It would be a public signal. A raising or lowering of the cash ratio would be a sign to commerce in general that credit should be curtailed or that restraints could be eased. This would enlarge the scope of influence of the central bank.

The overall reasoning behind the adoption of this new policy is the fact that the authority to change reserve requirements is a powerful instrument of monetary control, because changes in reserve requirements affect the volume of excess reserves as well as the deposit-creation multiplier for the banking system.

As we mentioned previously, changes in the reserve requirements apply equally to all banks and even though there may be a large volume of excess reserves in the aggregate, some banks may have little or none. An increase in reserve requirements,therefore, will impose hardships on the banks with no excess reserves, this increase will cause these banks to reduce loans and investments or to borrow from the Central Bank.

Because of their powerful and blunt effects, most central banks have utilized changes in reserve requirements only at times when the total of excess reserves were so large

that the number of deficiencies in reserves that resulted in individual cases would be very small. Because of the disturbing effects of changes in reserve requirements, they have not been used to adapt the monetary system to day-to-day changes in underlying monetary conditions. Rather, they have been generally employed to adjust the banking system to large changes in the supply of bank reserves. This has been the policy of the Federal Reserve System in the U.S.A. and other similar central banks, but the point of interest to us is how does the Bank of Canada intend to use this new authority. In April 1954, Graham F. Towers, governor of the Central Bank, in his evidence before the Banking and Commerce Committee indicated that the Bank of Canada intends to use its new powers with a good deal of restraint. In practice, Mr. Towers indicated the Bank would seek to keep the minimum at the statutory bottom proposed in the new Act-- 8 per cent. This would allow the banks the greatest amount of freedom in the use of their funds. They could even let it fall for short periods below the minimum because the banks only need to work towards a satisfactory average at the end of the month, whereas formerly this was a daily requirement, and also the fact that they no longer need to supply figures of daily averages will save them much inconvenience. This new change gives the banks greater flexibility in conforming to the legal requirement.

Mr. Towers further clarified the Bank's policy when he said:[a]

> If the Central Bank had occasion to use the power to increase the minimum cash reserve ratio to try to help deal for the time being with a sudden inflationary push, I would hope that as soon as they possibly could they would return to the 8 per cent level, because I think that is a reasonable level and that the power to go up to 12 per cent should be used in the main when there are inflationary pressures.
>
> I think that on that side the action of the Central Bank would not only have its effect on the commercial banks, but it would also be serving notice on the public that moderation in borrowing was desirable and would reinforce the attitude of the banks towards their customers in explaining the situation to them. I do not think it works so much on the way down and I would prefer in that case to see the Central Bank get to the 8 per cent level, if it were not there already and then rely on the powers that it has at present so as to produce a situation of distinct ease in the money market.

This very sage and realistic policy for the reserve ratios certainly augurs well their effective use as a monetary instrument.

Another highlight that should be considered is whether the Canadian banks are dropping their cash ratios relative to the requirements of the new minimum reserve legislation.

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[a] Banking and Commerce Meeting, March 25, 1954 on Bill 297.

The tradition of maintaining a 10 per cent reserve requirement is one of long standing, but most observers think that the chartered banks have been quick to adopt this new idea. In fact, there was much evidence to support this soon after the Bank Act amendment, as chartered banks holdings of treasury bills increased by $40 millions between July 7 and July 21, 1954. One bank, it is said, now has as much as 4 per cent of its deposits in Canada treasury bills. In such a position there is no need for a 10 per cent holding of cash against deposits.

Another explanation given for the reduced cash ratios is the increase in day-to-day loans to the discount market.

These were the signs that suggested that the banks would soon fall into line with the new regulations and by December 31, 1954, the average for the banks as a group was 8.7 per cent with several banks keeping close to the 8 per cent minimum.

A very revealing insight into monetary policy occured when the legal reserve was changed.

Had the Bank of Canada wished to stabilize the total volume of bank credit at the existing level on July 1 when the new cash reserve ratio was introduced, it would have taken measures to reduce the cash reserves of the banks by anything up to $200 millions, depending upon its estimate of how closely

the banks would be guided by the new minimum. But in late 1954, the Bank of Canada had embarked on an easier monetary policy and therefore when the reserve ratio was changed it took care that its actions should not detract from the easy money situation. In the next few months the Central Bank absorbed something less than half the extra cash made available by the adoption of the new legal reserve ratios, thus leaving the banks with cash reserves well in excess of the legal requirements. Indeed these reserves were sufficient to provide the cash backing for over $500 millions of security purchases by the banks in the latter part of 1954 and still leave their average cash ratio above 8-1/2 per cent. This example shows the very important role of the reserve ratio, the monetary consequences that could result from altering it, and it gives us a fuller appreciation of the Bank of Canada's new power.

By way of comparison, I would like to present a few general facts on the established procedure used in the U.S.A. and the U.K. governing their reserve ratios.

The U.S. system does not count notes in the till as part of the cash reserve. The ratio is set as a ratio between bank deposits at the Federal Reserve Banks and the total deposits held by the banks. Also a distinction is made between the bank's liability on demand deposits and on notice deposits.

The U.S. cash requirement (in terms of deposits with the Federal Reserve) is only 6 per cent on notice deposits. This is the maximum limit of the statutory range. On demand deposits it is 22 per cent for banks classified as "Central Reserve City" banks, 19 per cent for Reserve City banks and 13 per cent for country banks. These prevailing rates compare with statutory top limits of 26 per cent, 20 per cent and 14 per cent. The method used in determining the amount of cash held in relation to deposits is figured on a weekly average.

In the United Kingdom, the cash ratio is established conventionally, not legally, and is currently 8 per cent. The Bank of England has power to suggest to the joint stock banks what it should be: if the banks do not accept the suggestion--- which has never happened --- the Chancellor of the Exchequer has the authority to fix it.

# CHAPTER III

## RELAXATION AND EXTENSION OF CHARTERED BANK LOAN REGULATIONS

The inherent strength of the Canadian banking system lies in its ability to keep pace with our dynamic economy. It has remained flexible and adaptable in order to meet the changing, ever expanding needs of a rapidly growing country.

The recent changes in banking policy and structure is additional evidence that these laudable qualities still exist. Thus the banks, mindful of their responsibilities towards the development of the nation have been quick to appreciate and practice the recent government amendments which revised and relaxed the bank loan regulations.

The revision of the Bank Act, the Bank of Canada Act, and the National Housing Act has resulted in a number of changes of major importance.

The banks have been given the authority to make chattel mortgages. This power will allow them to increase the security on small personal loans and will greatly add to the convenience of the borrower.

Once again the scope of section 88 has been enlarged in order to increase its contribution to the natural resources industry. This section has been subject to progressive enlightenment since the inception of Canadian banking.

Section 82 is a new addition to the banking structure and is the result of the chartered banks' desires to increase and simplify their participation in the development of a new Canadian industry.

An amendment to both the Bank Act and the National Housing Act paved the way for the entry of the chartered banks into the mortgage lending field. This legislation was entirely originated by the Government who felt that the existing sources of mortgage funds were insufficient to finance a satisfactory volume of new housing building in the future. The rapid increase in new families has been the most important factor in the demand for new houses, far more important than the accumulated backlog at the end of the war. In fact, Canada's population is growing at the rate of about 3 per cent per annum (vs. about 2 per cent in the U.S.) and about seven of every ten Canadian buyers of new homes are buying their first new house, compared with about one in four in the U.S.[1] The Federal Government felt that this growing problem could be eased with the banking system's aid and therefore included them as approved lenders in the N.H.A. plan.

This brief outline has served to introduce these significant alterations in the regulations determining the lending policies of banks. Now we shall examine these changes in detail.

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[1] Financial Post: New Bank Money, Feature Article, Dec.4,1954.

CHATTEL MORTGAGE

Let us now delve deeper into the amendment that enables banks to take a chattel mortgage or other security on household goods, including motor vehicles, in the case of loans to individuals. This is a new principle of Canadian banking that was recommended by the Banking Committee itself. All banks have been making small personal loans for many years-- the aggregate for all banks was $298,200,000 on September 30, 1953[a] -- but the Committee felt that this new change would allow this lending field to expand and also simplify matters for borrowers.

This new section declares that the prohibitions mentioned in section 75 of the Bank Act do not apply to the lending of money or the making of advances upon the security (whether by way of mortgage, transfer or otherwise) of household property and any personal or movable property, to any individual other than a manufacturer or dealer. This amendment was strongly supported by the Canadian Bank of Commerce but it only went part way towards meeting its requests for broader legal powers in the operation of its personal loan department. The Bank of Commerce is the only bank which has a personal loan department which it operates by charging a discount of 6 per cent on the face value of loans made repayable by installments. Its average return on the amount outstanding on

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[a] Atkinson, T.H., "Canadian Banking Progress", The Canadian Banker, Autumn 1954, Vol. 61, No.3, p.51.

personal loans under the discount method is 10.46 per cent. Now the Bank of Commerce asked for relaxation of the Bank Act's ceiling of 6 per cent on the interest or discount rate on bank loans. The interest rate change sought by this bank would have allowed it to scrap the discount device and charge interest on the amount outstanding at 1 per cent per month. The rate charged by loan companies is 2 per cent per month on the reducing balance. While the bank basis is an annual rate and the loan company is a monthly rate, the net effect is that a loan of $100 repayable in equal monthly installments over one year involves charges of about $3.15 from a chartered bank and about $13.50 from a loan company. The Bank of Commerce maintained that this rate of profit offered little incentive for banks to enter this field but a rise in the interest rate would entice the bankers in, and they could give the public the loans they required at half the cost. Both the banks and the public would benefit at the expense of the loan company. This was a strong argument for altering the interest rates but the Banking Committee felt that the temptation would be very great for bank managers to use the higher rate even when loans were financially sound to the detriment of good investment, and therefore refused this request.

A method of banking procedure also produced a controversial discussion when Mr. T.H. Atkinson, General Manager of the

Royal Bank and President of the Canadian Bankers Association, questioned the legality of the discount procedure used by some banks on their personal loans. Mr. Clayton F. Elderkin, Inspector General of Banks, supported the stand taken by the Bank of Commerce when he interpreted the Bank Act as a firm authority to discount personal loans. Although much discussion ensued, the point was not definitely established. My interpretation of section 91 does not coincide with Mr. Elderkin as I fail to see the equality between a rate of interest of 6 per cent and a discount of 6 per cent which in reality produces a rate of interest of 10.46 per cent. It appears that the legal framers had equality in mind when this section was established and if my assumption is wrong, then I feel that the method used to establish this loophole was too elaborate. If a variable rate of interest between 6 per cent and 10 per cent was intended, then the law should clearly state it. Parliamentary legislation should be above such dishonest subtlety, or is this view naïve?

Mr. Atkinson also expressed the view that the other banks were not interested in the personal loan field and would not have asked for the chattel mortgage privilege, but as it is a fact they would undoubtedly make use of it.

One of the reasons advanced for the reluctance of most chartered banks to enter this field is the confusion over the

method of computing interest. But the Bank of Commerce says that irrespective of whether it is discounted or not, the profit on their loans of this type over 18 years of operating a personal loan department has been .77 per cent - less than 1 per cent.

Although profits are low and risk is high, most banks enter the small loan field because this service is expected by the banks' customers. Rather than lose good will and incur strained public relations, the bankers must be prepared to talk business on all levels. But the right to accept chattel mortgages has improved the banks' position as a lender. Banks can use this right to increase the amount of security available from borderline applicants for conventional bank loans at the 6 per cent rate. It will also increase the number of demands from worthy borrowers who no longer need an endorser to secure their loan, they can pledge a piece of personal property as security and attain privacy in their business affairs.

Now that lending conditions have improved for banks in this field, they will probably scrutinize its profit possibilities more closely. A few pertinent facts can throw a great deal of light onto this subject. In 1953 the four firms licensed in this small loan field, Canadian Acceptance Corporation, Community Finance, Household Finance Corporation

and Personal Finance Corporation, loaned $154.8 millions and their net profit after taxes was $3,341,693.[s]

This is a substantial amount of money and certainly worth the efforts necessary to obtain a portion of it. There is no question about the banks' ability to command this field if they want to. Their much smaller rate of interest is the greatest incentive they can offer the public. The respectibility and integrity that surrounds our banks puts them in a class vastly superior to most other personal loan organizations. Another feature is the efficient and time tested administrational organization they have at their disposal. These are but a few of the advantages that the banks can offer the public if they want to. The big question is --- to what extent will the banks go into the personal loan field?

The Montreal Financial Times said on June 25, 1954, shortly after the chattel privilege was established, that the personal loan business will continue to have little appeal for most of the Canadian banks because of the banks' failure to have interest rates increased. On the other hand, the Bank of Commerce has definitely stated that they intend to increase their activities in this field and most other banks are feeling out their new power also.

It is really too early to say what effect this right has exerted on the personal loan policies of banks, but the

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[s] Financial Times, Montreal, "Chattel Mortgages", Feature Article, June 25, 1954, p. 12.

1954 Annual Bank of Canada Report shows that personal loans for all chartered banks are definitely on the increase.

But as yet we cannot say with any certainty just how much of this increase is due to the new banking provision. If it can increase the amount of sound loans for worthy purposes, then it will have vindicated the judgment of the Banking Committee and can take its place as another supporting pillar in the structure of Canadian banking.

An interesting sidelight to this provision occurs in the Province of Quebec. Whatever the aspects of the function of the chattel mortgages, it will not have any effect whatever in Quebec. The private law of the Province forbids chattel mortgages, and in the amendment to the Bank Act, pains were taken to avoid passing overriding legislation impinging on Quebec law, even though in theory this would have been permissible. In Quebec, the only means whereby movables or chattels can be made security for a loan is for the article to be in possession of the lender possibly through a lease back arrangement. The same monetary effect can be gained in this fashion, but as a legal device it is inordinately clumsy and not too frequently used by the small loan companies.

## LOAN REGULATIONS ON SECURITY OF OIL AND NATURAL GAS (SECTION 82)

Section 82 is one of the most progressive additions to the new Bank Act. It sets forth the conditions under which the

ten chartered banks can lend money on the security of oil and gas in the ground, or in storage on petroleum, mineral rights and production and storage equipment. The banks had been impeded in financing the rapidly growing oil industry, because production had not reached important dimensions at the time of the 1944 revision, and no provision was made for bank loans against the security of oil and gas. This new clause brings the Bank Act into line with a situation which has been created by the swift development of the industry in Canada. In the ten years between the two revisions, the banks have assisted in the development of the nation's oil resources, but it had to be done by using involved methods of taking security. What the banks have been taking is an assignment of the net profits in production. It is a special document, really an assignment of contract, which a specific company holds for profits from the sale of oil. The loan is based on the banks officers' analysis of the probable earnings during the period of the loan. Suppose it is a loan of $35,000 repayable out of half the net profits from the sale of oil. That might differ each month and be $17,000 one month, $8,000 the next, $13,600 another (about an average of $12,500) and so on until the loan is extinguished. The experience has been remarkably good so far, but this is due to the limited participation by banks in this field. Oil loans are now only

a fraction of the total of wheat loans in the west and no important lending for natural gas production has occured as yet. But as the industry expands and bank participation increases, the value of section 82, which specifies the types of loans which may be made and the security which may be taken, will greatly simplify the procedure of granting loans.

The most important point of immediate consideration is whether or not the banks intend to increase their activities in this loan field now that the restrictions have been removed.

So far as I have been able to gather from the writings of those experienced in this business, these changes are not likely to cause immediately any marked increase in bank loans which are gauged to the demand and assessed security already, but the next ten years should bring about great increases.

Already some of the main banks have developed complete organizations for geological and statistical study of every new oil field and of the operations of companies working in it. They have their own geologists, and a banker on this sort of work soon becomes one of the chief experts. All this organization is to enable the banks, in this booming but speculative business, to decide where loans would be justified because of hopeful operations and for the protection of the money loaned. This field is one of the active lending sectors of U.S. banks, but as they are allowed to deal in mortgages, they have air-tight security. Although Canadian banks cannot

deal in mortgages, section 82 gives them improved methods of taking security which cannot but help stimulate their participation in a lucrative field of lending which saw over $500 millions invested in the past six years. But there is every indication to believe that the best is yet to come and that this new industry may become a vital part of the business of all our banks.

It is now over eight years since the Leduc discovery of February 13, 1947, the turning point in the history of oil and gas in western Canada. Since that short span, oil has become Canada's leading mineral, outranking nickel, copper, and gold; the value of crude oil production was just under $200 millions in 1953 and an approximated $230 millions in 1954. Expenditures on the search for and development of oil and natural gas have risen steadily; in 1953 they amounted to $330 millions in western Canada and approximately $350 millions in 1954. The discovery of the Pembina oil field in 1954, located seventy miles southwest of Edmonton is Canada's largest find to date. This field, together with the Sturgeon Lake discovery, 175 miles northwest of Edmonton, is important on another count, for it indicates the existence of big fields well beyond the Edmonton area where the previous major finds had been concentrated. The very size of the prospective hunting ground —— almost 800,000 square miles

with the producing wells located up to 1,500 miles apart--- the present rate of discovery, the money which is being spent, the exploration activity which is being carried on and the improved techniques being involved, make it almost inconceivable that further oil in very considerable quantities will not be found. The industry has only scratched the surface in exploration and blocks of hundreds of square miles have yet to be tested by drill-bit. On the average to date in western Canada, only one well has been drilled for approximately every 175 square miles, whereas in the U.S.A., one well has been drilled for every 12 square miles of petroliferous territory.

As for natural gas, it is hoped that construction will soon begin on the 2,200 mile trans-Canada pipeline which will allow prairie gas, much of it now awaiting use in capped wells, to be marketed in eastern Canada, at a cost of $300 millions.

Section 82 of the Bank Act makes it obvious that both the law makers and the banks have realized the gigantic potentialities of the forementioned facts. That is why most experts feel that the next decade will see a revolutionary change in the bank lending policies regarding oil and gas.

A striking example of the importance of oil to our economy is the fact that Alberta, with less than 7 per cent of

the population of Canada, accounted for 13 per eent of the capital expenditures.[4] This remarkable record is not entirely due to oil, but the oil and gas discoveries have had a profound effect on the economic climate, attracting investment and people with the promise of a rate of economic progress hardly dreamed of a decade ago. It is safe to say that the discovery of oil at Leduc is one of the landmarks in Canada's economic history.

For a long period, western agriculture and eastern industry have largely provided the bulwarks of the Canadian economy. Now they are joined by the Canadian petroleum industry lending strong support to the further progress of the whole nation. The achievement of this goal to a large measure depends upon a sound but foresighted banking policy. The law is established, it is up to the banks to make adequate use of it.

## LOAN REQUIREMENTS ON SPECIFIC COMMODITIES (SECTION 88)

As outlined earlier in this chapter, section 88 underwent revisions broadening its scope. This section has always been a distinctive feature of Canadian banking and foreshadowed the first Bank Act by an act called an Act

[4] Monthly Review Bank of Nova Scotia, "The Impact of Leduc", Sept. 1954, p.3.

Granting Additional Facilities in Commercial Transactions, passed in 1859, the first step towards the pledge section of the Bank Act.

The section permits loans to specified classes of people on the security of merchandise in their possessions, and a glance at the type of authorized borrowers and the nature of their security is illuminating. Obviously, the aim of the legislation is to facilitate the conversion of natural resources and raw materials into finished goods. In a country like Canada, which has evolved from colonial to national status over a period of a century or so, it is apparent that this great development would not have been achieved without the assistance of bank lending through the provisions of section 88.

The scope of this section has been continuously expanding over the years and has, without fear of contradiction, abundantly justified its creation. It has contributed greatly to the comfort and prosperity of individuals as well as to the speedy and sound development of this country and will no doubt continue to fulfill its vital role.

## BANK LOANS FOR MORTGAGES

E.P. Neufeld writing in the Banker said, "without doubt the major change of the year is the provision that permits the chartered banks to finance residential construction

on security of long term mortgages"[5]. Because of this change two dates have become historical landmarks in the annals of chartered banking -- October 1, 1953, and March 22, 1954. It was on October 1, 1953, that the banks were informed by the Minister of Finance that a proposed amendment to the National Housing Act would shortly make them authorized lenders for mortgage loans.[5a] On March 22, 1954, the National Housing Act 1954 was proclaimed, and the banks, officially declared as approved lenders, made their debut into a foreign field.

Business of this character was almost entirely new to them, for even before the passing of the first general banking statute in 1871--- The Dominion Bank Act--- Canadian banks had been prohibited from taking real and chattel mortgages. Their loans were confined to legitimate banking business, although under section 88 of the Bank Act, they were able to make advances on the hypothecation of natural and manufactured products in the process of production. As mentioned earlier, a slight inroad into this orthodox concept of banking security was made in the decennial revision of 1944, in which certain intermediate loans to farmers, secured by mortgages, were sanctioned by Parliament;and in 1945 this

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[5] Neufeld E.P. "Changes in Canadian Banking", The Banker, Sept. 1954, Vol. CIII, No. 344, p.82.

[5a] See Appendix A for list of approved lenders.

this right was given to loans to veterans. These provisions were not too significant because the loans could not exceed $3,000 or run for longer than ten years. Moreover, an overall limit was established for all banks of $250 millions (later increased) for loans to farmers and of $25 millions for veterans' loans.

The new changes to the National Housing Act and the Bank Act, however, have much greater importance. Naturally such drastic deviations from established banking traditions were prompted by sound reasoning by the Government, but as the banks did not seek this new authority, and in fact were not forewarned of the Government's intention to incorporate it in the banking laws, they were quick to bring before the authorities in Ottawa the ramifications of this big structural change in the financial system and the many difficulties in the way of making it effective. In order for us to appreciate the Government's reasons and the banks' apprehension, a little background to the N.H.A. history would implement our perspective. In order to do this I shall draw on some of the remarks made by Mr. D.B. Mansur, former president of the Central Mortgage and Housing, when he appeared before the Committee on Banking and Commerce.[e] In his capacity as a witness during the N.H.A. amendments, Mr. Mansur gave a detailed history of the housing movement, the highlights of which I shall mention.

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[e] Minutes and Proceedings and Evidence No. 1, Bill 102, Feb. 2, 1954.

Federal housing legislation on a continuing basis was first introduced in Canada in 1935 with the passing of the Dominion Housing Act. This legislation was based on three central ideas:

(1) That it would be possible, through Government assistance to get houses built that would not otherwise have been built and thereby improve the standard of living of the Canadian people.

(2) That the building of additional houses would reduce unemployment that existed at that time.

(3) That with Government participation a set of housing standards could be required as a condition of the mortgage loan, thereby improving the quality of new housing in Canada.

It was in this legal enactment that the principle of joint lending was first inaugurated. Through this arrangement high-ratio loans were made with three-quarters of the mortgage funds coming from the lending institutions and one-quarter from the Federal Government.

In 1937 the Home Improvement Loans Guarantee Act was made law. This legislation provided for guarantees to chartered banks and other approved lending agencies against losses on loans made for the improvement or extension of residential property. This guarantee was limited to loans

in the aggregate of $50 millions.

In 1938 the Dominion Housing Act was repealed and replaced by the National Housing Act 1938. The new legislation benefited from three years of experience and was designed to enlarge the scope of joint mortgage lending. It had that effect.

In 1944 Parliament passed another National Housing Act and in 1945 for its operation created the Central Mortgage and Housing Corporation. This new amended act underwent modernizing revision and continued the principle of joint lending. In the post war years as need arose, Parliament added further provisions to the N.H.A. Two of the major amendments were:

(1) The addition of section 35 which provided for a Federal-Provincial partnership in the field of land assembly and subsidized rental housing; this arrangement provided for a 75 per cent- 25 per cent financial participation between the Federal Government and each of the provinces in respect to both the capital cost and the operating losses of the projects.

(2) The amendment that provided for C.M.H.C. taking over the assets and liabilities of Wartime Housing Limited.

This has been a very brief sketch of the major legislative acts which contributed to the creation of the N.H.A. prior to the 1954 revision.

As Mr. Mansur stated, the Act was both effective and successful but for one major limitation. It was effective because it bridged the gap between conventional mortgage loans and high ratio mortgage loans and it was successful because it relieved part of the accumulated housing shortage of the post war years by approving loans for about 175,000 home ownership and rental units. The limitation which hindered the operation of the Act in 1953 and offered threat of more serious repercussions in future years, was the inability of the present group of lending institutions to provide sufficient funds to meet the demand for joint loans. Consequently the major problem that confronted the new N.H.A. was to find additional sources of lending power which could supply the savings necessary to sustain a high level of housing finance. Therefore, while the Government had a number of reasons for introducing legislation allowing banks to make a restricted type of mortgage loan, the compelling reason was that the current supply of mortgage funds from present lenders was incapable of satisfying the effective demand for new housing.

The question which immediately comes to mind is what caused this shortage of savings? To answer this question

we must appraise the sources of funds which have hitherto supplied the finance for housing construction.

The chief sources have been:[7]

(1) The individual home owners personal money.

(2) The mortgage funds from the lending institutions of which 84 per cent came from life insurance companies and the remaining 16 per cent from loan, trust, fire companies and fraternal organizations.

(3) The Government, through its 25 per cent contributions to National Housing Act loans as well as direct loans.

While Mr. Mansur was addressing the Banking Committee he produced a chart which outlined the actual amounts that each one of the sources contributed to each housing dollar.[8] It was surprising to note that fifty-nine cents of each dollar was supplied by the owners of new homes themselves. Private mortgage lenders such as lending institutions, credit unions etc., made mortgage loans representing twenty-eight cents. Governments provided the remaining thirteen cents, either in the form of direct expenditures on housing or in the form of mortgage loans.

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[7] Financial Post, News Article, Dec. 5, 1953, p. 49.

[8] See Appendix B.

A further breakdown of these figures showed that full owner financing, that is construction financed totally by the owner without mortgage assistance,provided twenty-eight cents of the housing dollar. Mr. Mansur outlined some very logical reasons why this source of lending could not be expected to expand in the immediate future, and therefore answered part of the money shortage problem. Direct Government construction for housing for its own use only accounted for four cents of the housing dollar. The remaining sixty-eight cents is involved in the housing facilitated by mortgage loans of one kind or another. Of this figure the lending institutions are responsible for forty-two cents while the Government investment in the new housing dollar was thirteen cents. The Government contribution, soon to be relegated to a very minor role, is no longer important but what is paramount is the role of the three major groups of lending institutions, the life insurance, loan and trust companies. The question now to be solved is why have the lending institutions who comprised the main bulwark of mortgage financing failed to satisfy the increasing demand for housing funds.

In the early post war years, the success of the joint-loan scheme was mainly based on the capacity of the private mortgage lending institution to take up mortgage loans,

and on measures taken to overcome the influence of increasing building costs upon required down payments. The life insurance companies were able to invest large sums by disposing of government bonds acquired during the war as well as by investing a large proportion of their new money in mortgages. Due to the war there was almost no residential building between 1939 and 1945 and the life insurance companies had no alternative but to invest their surplus funds in government securities. This factor caused the proportion of mortgage loans to life insurance assets to decrease from 19 per cent in 1939 to 12 per cent in 1945. When the war ended the backlog of supressed housing demands surged forward. At this time there was no deficiency of funds because the life companies began a gradual liquidation of government securities and mortgage interest rates were relatively attractive. During the next few years the construction of new homes exceeded all previous records. During the post-Korean inflation there was a conspicuous decline in the amount of housing funds advanced under the joint-loan scheme, but by 1953 with construction costs stablized, the stage was set for a renewal of heavy demand for housing. But now the life companies, which contributed over 80 per cent of all institutional mortgage lending, were approaching what they felt to be a limit on the proportion of their assets earmarked to mortgage loans.

In the space of 8 years that proportion had risen from 12 per cent to 30 per cent, while their government bonds had decreased from 60 per cent to about 20 per cent of assets.[9]

These new percentages were considered to be about the normal proportions between mortgages, assets and government bonds and it became evident that the flow of new mortgage money, caused by a change in life insurance company assets, was likely to decline. In fact official estimates indicated that $50 to $75 millions less might be available in 1954. As a result of this situation, existing lenders were only doing business in the larger centres.

Mr. Mansur also testified before the Banking Committee that he felt that it would be unrealistic to count on continued liquidation of government bonds by the life companies to provide additional housing funds, and he stressed the fact that there was strong evidence of these companies falling below their 1953 contributions.[10] He also mentioned the contributions of the trust and loan companies who between 1947 and 1953 approved $793 millions of mortgage loans, or 26 per cent of all mortgage loan approvals by lending institutions. Of this amount their mortgage loan approvals for new residential construction totalled $217 millions, representing 13 per cent of the lending institutions total.

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[9] Bank of Nova Scotia, Monthly Review, Oct. 1954, p.4.

[10] Minutes and Proceedings and Evidence No.1,Bill 102,Feb.2,1954.

Mr. Mansur also interjected a note of caution in expecting an increase of new mortgage funds from the loan companies because by the end of 1952, they held 71 per cent of their assets in mortgage form. In order to increase their mortgage accounts, they must sell debentures or increase deposits and while their assets have been increasing it is not comparable to the regular increases that characterize the life companies and therefore cannot be counted on sufficiently to fill the growing gap in mortgage funds.

With the reduction of mortgage funds the lenders reduced their field of operations and the onus of responsibility to provide for the needs of those in the smaller and more isolated areas descended upon the Government. The only recourse open to the Government was to have C.M.H.C. increase its direct loans.

Ever since the enactment of the Dominion Housing Act in 1935, the supplying of the joint-loan facilities for home ownership has been a problem in the smaller and more remote communities. To meet this need the lending institutions decided to administer applications from the smaller cities and outlying areas by each taking a definite geographical area under its responsibility. Even though this improved the situation for a time, it did not fully solve the problem and it continued to grow more acute. Finally in an effort to improve this situation, Parliament, in June of 1947, gave to C.M.H.C. the authority to

make loans under similar terms and conditions as other lending institutions, where it was decided by the Corporation that the facilities for making loans were lacking.

In the beginning, C.M.H.C. operated in communities up to 5,000 population but this was increased to 55,000 when the lending companies withdrew their activities into the larger communities in 1952. This increased role was forced upon C.M.H.C. in order that credit-worthy borrowers throughout the country could benefit from the N.H.A.

But this entailed greater participation by the Government than they originally planned. To provide for the needs of the smaller communities, the Government was obliged to make direct loans to the amount of $50,000,000 each year. This was in addition to the $50,000,000 a year currently being provided by its 25 per cent participation in N.H.A. loans. Ottawa began to find this trend very unsatisfactory because it did not wish to play the role of creditor to so many individual citizens. Finding itself faced on one hand with this undesirable trend and on the other with mounting pressure of public opinion and a severe limitation in the supply of life insurance and loan company money, the Government produced a plan to bring new sources of funds into the housing field. The basis of the proposal was the amendment of the N.H.A. to include the chartered banks as one of the lending institutions. At the same time the Government's 25 per cent contribution and

pool guarantee plan was replaced by a form of residential mortgage insurance.

The underlying intention of the Government's action was to attract a portion of the chartered banks' savings deposits, which represent a major channel for private savings in Canada. In fact at the end of 1953, fully 55 per cent of their deposits consisted of savings deposits.[11]

Although Canadian banking policy had always prohibited mortgage loans, the Government felt there was ample precedent for savings deposits of the banks being utilized as a source of mortgage funds. In the United States the mutual savings banks, saving and loan institutions, and commercial banks provide about 60 per cent of the new money in mortgage financing. In addition, they originate many mortgages which, after processing, are transferred to the life companies.[12] In Australia, banks are the principal source of non-government mortgage funds and have a greater investment in residential mortgages than have the insurance companies.

Therefore the Government felt that merely because savings and commercial operations were combined here, was not sufficient justification to prohibit the chartered banks from investing a portion of their savings deposits in mortgages on residential property. The new safeguard of having C.M.H.C.

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[11] The Banker, Sept. 1954, Vol. CIII, No. 344, p. 154.

[12] Financial Post, News Article, Dec. 5, 1953, p. 49.

insure the loan was an additional feature designed by the Government to enhance the desirability of this new investment medium

One of the main reasons behind the Canadian banks distrust of mortgage lending was the bank failures in the U. S. A. in the 1930's, but the changing times have brought about several practical aspects which tend to offset any arguments that mortgage lending would impair the strength and security of the banking system. The difficulties experienced by the U.S. banks were mainly the result of commercial and industrial mortgages, rather than residential loans. Furthermore, the improved procedure of mortgage loans such as monthly principal repayment plans on a regular amortized basis, combined payment of taxes, and the insurance feature, tend to eliminate the dangers in residential loans which existed during the thirties. Deeper penetration into this situation unearthed additional factors that caused the banks their original concern when informed that they were to be made part of the National Housing Programme.

As previously mentioned this was a surprise move by the Government that took the banks unaware. It was an unsought privilege that tossed them onto an unchartered and foreign shore and involved them in taking over the vast mortgage lending activities of a government organization (C.M.H.C.) with operations amounting to over $50,000,000 per year. But in actuality, this

was not as serious as it first appeared. C.M.H.C. did not withdraw altogether from the mortgage field. While imposing upon the banks the responsibility for financing new home building, it undertook to insure them on their mortgage up to 98 per cent.[1a]

C.M.H.C. also undertook the responsibility of using its field staff to assist the banks in establishing the lending value of a house and lot. While the other lending institutions had their own staff of experts and inspectors to do this task, the banks did not. The elimination of this job greatly eased the administration involved in granting a mortgage loan and simplified the entry of chartered banks into the mortgage field.

One of the greatest difficulties foreseen by the banks was foreclosure proceedings on properties against which they might make mortgage loans. It is a required condition under the N.H.A. that the lenders, in the event of a payment default, must foreclose and dispossess the original tenant before they can submit their claim for insurance coverage to the C.M.H.C. The banks had visions of being cast in a "Simon Legree" role and impairing their good public relations. Another disadvantage envisaged by the banks was in the event of default by mortgagors, such legal proceedings would have to be taken under various provincial laws, necessitating

[1a]There is an important distinction between bank mortgage loans in Canada and those in the United States. In Canada insured loans can be made only on new homes and apartments. This limitation does not apply in the U.S.

lengthy action, particularly in Quebec and Saskatchewan. Foreclosure could drag on for years and so involve the banks in loss. These problems, particularly the first, evoked strong and vociferous arguments by the bankers who wished to transfer this responsibility to C.M.H.C. but the Government was adamant. They explained that the banks were being given an almost full guarantee and that the rate of interest yet to be established would be a commercial rate, and therefore as this was strictly a business proposition the banks would have to assume their share of any related unpleasanties.

As mentioned earlier one of the important changes in the National Housing Act was the establishment of a system of mortgage insurance through C.M.H.C. The principles of this plan are as follows:

The lending institutions will pay an insurance premium to C.M.H.C., the cost of which will be 2 per cent of the loan, and it will be borne by the borrower. In the event of default on a mortgage, title to the property is transferred to C.M.H.C., and the lending institution receives a cash settlement of 98 per cent of the unpaid principal, plus 98 per cent of the interest at the mortgage rate for six months from default, and interest for a further twelve months at a rate of 2 per cent lower than the mortgage rate. A stipulated amount of $125 was allowed to defray the legal costs involved in the foreclosure.

This plan also evoked protests from the lending institutions. But Ottawa countered these claims by saying that the 2 per cent difference was to ensure that the lending institutions would continue to follow sound mortgage practices. The lending institutions felt this was another bitter pill to swallow as they believed such an incentive was unnecessary, especially as they would be already penalized by the low allowances the scheme permits to be included as charges and costs in their claims.

Mr. Atkinson, while not in the nature of an objection, pointed out that the guarantee offered by C.M.H.C. was not 98 per cent as the N.H.A. bill stated. He referred to the hypothetical example which Mr. Mansur presented to the Banking Committee on February 2, 1954, which showed a loss to the lender of 3.43 per cent.[14]

Another point of major concern expressed by bankers resulted from consideration of the effects of the scheme on their liquidity. As the Government wished to transfer their share of housing finance to the banks, it was necessary for them to make the forms of the finance as acceptable as possible. As it now exists, the new mortgage security is good paper but with limits on its liquidity. It is good paper because the C.M.H.C. insures 98 per cent of each loan and because an amendment to the Bank of Canada Act made all loans

[14] See appendix C.

eligible security for advances from the Central Bank. But as it is a new security, and one with complicated tax, insurance and amortization features, and with no active market existing for it, the banks felt its liquidity was poor. Even its eligibility as security for Central Bank loans does not add much to its liquidity because such loans are purely temporary; and even the habit of borrowing from the Central Bank is scarcely formed. In order to overcome this deficiency, the N.H.A. 1954 contained provisions to facilitate the development of a secondary market in insured loans. The act provides that the insurance policy on a mortgage loan made under the new legislation may be assigned to the purchaser should the loan be sold, the only requirement necessary is that the loan continue to be administered by an authorized lender. It will also be possible for individuals and other investors who are not authorized lenders to deal in these insured mortgages as long as it continues to be serviced by an approved lender. C.M.H.C. has also been given the authority to buy and sell insured mortgages as well as to make loans to approved lenders upon the security of insured mortgage loans. All these provisions were established to increase the supply of mortgage funds by endowing the insured mortgage loan with a greater degree of liquidity and transferability.

One point that bears mentioning here is that a mortgage is only marketable when the house is completed, the

loan fully advanced and the last payment made to the builder. But despite this limitation, which is a minor one, Vincent Egan writing in the Financial Post says "It seems certain that a secondary market in N.H.A. guaranteed mortgages will develop in 1955".[15]

Mr. Graham Towers was also called as a witness before the Committee in amending the N.H.A. On the question of Central Bank advances to chartered banks on mortgage collateral, Mr. Towers expressed the view that making mortgages eligible for Central Bank advances was done to avoid placing a black mark on the insured mortgages. His personal opinion was that the chartered banks, if they had cause to borrow, would continue to use government bonds as collateral because of their convenience. He also emphasized the fact that the Bank of Canada did not possess the authority to purchase mortgages. While Mr. Towers reiterated his remarks that the sale of mortgages was likely to be an impractical way for the banks to obtain cash quickly, he hoped that in time a sufficient interest in the mortgages would be developed among pension funds and other similar schemes.

A considerable amount of information has been presented outlining the background of the N.H.A., its operation and the new revisions of 1954. But the most important question which

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[15] Financial Post: Feature Article, New Bank Money, Dec. 4, 1954, p. 16.

still remains unanswered is what can we expect from the banks in the new venture?

E.P. Neufeld says that once the banks have overcome their reluctance to deal in these new securities and have gained the necessary practical experience to do so, the extent of their participation will depend essentially on three factors: "their present structure of assets; the supply of bank cash as maintained by the Bank of Canada; and the extent of the development of a broad market for the new security".[16] We have already discussed the measures that are available for the development of a market for these papers and the evidence to show that such a market is being created, and therefore we shall only direct our remarks to the first two factors.

The pattern of the banks assets have undergone a remarkable change since the war. There has been a continued rise in bank loans, while at the same time the bank portfolios of investments have been reduced by the large net redemptions of Government securities. The outcome is that the liquidity position of the banks has returned approximately to that of 1935, before, that is, the Bank of Canada's cheap money drive had swollen the banks liquidity ratios, especially evident during the war. The fact that bank portfolios are now more liquid than in preceeding years

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[16] The Banker: Changes in Canadian Banking, Sept. 1954, Vol. CII, No. 344, p. 165.

suggests that some switch to the new mortgages is possible. Mr. Neufeld says that "the exact extent of such a switch cannot be gauged; but it does not seem unreasonable to expect that mortgages may reach 6 per cent of deposit liabilities and a holding amounting to 10 per cent of deposits might well prove to be an attainable upper limit. Even the lower figure would at present involve a holding of over $500 millions, sufficient to offset the past rate of the C.M.H.C. joint-loan contributions for about nine years". This is not to suggest that it is only, or even mainly, by actual switching that the banks will be able to enter the mortgage field. The Bank of Canada is able to increase the availability of long-term housing finance by simply expanding bank cash, but this policy is only appropriate when general productive capacity is increasing or when building activity slackens. This extension of the influence of the Bank of Canada is important in itself because its former method of influencing long term investment was solely through market interest rates.

We must also bear in mind the fact that within the limitations of their statutory restrictions and to the extent that the Government will permit them to do so, the chartered banks have the ability to create new money. While the extension of this money creating power of the Central Bank and the chartered banks is not being contemplated , we

must not overlook the fact that it exists as an additional source of mortgage funds.

Another very important contribution that the chartered banks are making to the new housing program, is it's vast branch system in rural localities. The chartered banks have close to 4,000 branches whereas lenders previously qualified to service loans had only several hundred; mainly situated in the larger urban areas. Where other mortgage lenders could not afford to set up and maintain a mortgage lending service, the bank branches will now be able to serve even the smallest communities. This service will be offered by the local bank managers, and on a personal basis, a service that no other institution can provide. This feature, besides releasing the Government from the direct loan business, solves the difficulty of servicing the small communities, a problem that has existed since the inception of the National Housing Plan.

Another bone of contention during the debate on the N.H.A. was the rate of interest which lenders would be allowed to charge. Some opinions cautioned against a low rate of interest because it might not prove a sufficient stimulus to lenders; others felt it might go too high and suggested a 2 per cent maximum. As usual the Social Credit hurled their invectives at the chartered banks and suggested using the facilities of the Bank of Canada, presumably on an interest-free

basis. While much discussion took place, nothing could be decided until the bill became law. With the proclamation of the Act on March 22, the Governor-in-Council established the maximum interest rate at 5-1/2 per cent.[17]

This rate of interest did not rest well with the Premier of Quebec who announced on April 23, 1954, that his government would not provide the interest rate subsidy on loans under the N.H.A. 1954. Under the Quebec Housing Act, the Quebec Farm Credit Bureau is empowered to pay a subsidy on mortgage interest charges on approved mortgage loans borrowed by residents of the province. This subsidy is paid on interest charges in excess of 3 per cent, on dwellings not containing more than two units.

Mr. Duplessis was quoted in a Montreal newspaper[18] as saying that his decision to refuse provincial housing aid to persons borrowing money from chartered banks for homes should not be considered as a criticism of the banks: "I am not casting any reflection on our banks, not by any means", the Premier added - "it is not our intention, however, to co-operate in the enforcement of a law that is too onerous for those who should derive some benefit from it, a law incidently passed by a government which collects 77 per cent of all taxes paid by the Canadian citizen".

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[17] No loans were made at less than this rate during 1954: (1954 Annual Report of Bank of Canada).

[18] Montreal Daily Star: News Article, Apr. 24, 1954, p.3.

He further criticized the increase of 5-1/2 per cent interest from 5 per cent and the additional borrowing cost occassioned by the requirement of an insurance policy on a new house.

Whether it was the result of Mr. Duplessis' strong condemnation of the interest rate, or the lending institutions views that it was too high, the maximum interest rate was reduced to 5-1/4 per cent on all C.M.H.C.approved mortgages on February 16, 1955.

In the earlier stages of the debate on the N.H.A. there appeared to be a considerable amount of discussion both for and against the proposed legislation and an equal amount of confusion among the leading debaters, but one of the most poignant statements, and one which I felt corrected many misconceptions and placed the debate on a true perspective was an utterance by Graham Towers, who said and I quote:

> I am not sure whether Canadian banking history really indicates in any detail why the provision against lending on mortgages was there in the first instance. But I suspect that it had something to do with the fear that the banks might get into mortgage lending indiscriminately, on industrial properties; such bank loans, particularly in a young country, or vacant land might be something which was very risky. I suspect that is why that provision is in there.
>
> The banks can of course lend on mortgages by means of corporate bonds, which are mortgages in another name. I think it is perhaps time to review the situation and to approach it, not from the point of view that just because the prohibition has been there from the start that it should be carried on, but rather a query:- Is that prohibition necessary now from the point of view of safety of the banks or their liquidity. On the safety factor, the government insurance enters in. And on the liquidity factor I would not assume that the proportion of savings deposits employed in this way will ever be so high as to make liquidity a serious consideration.

> Having gone that far, we could then come to the question of desirability, from the borrowers point of view and that of the country as a whole. Having in mind shortages which are likely to exist in mortgage funds if vast amounts of people's personal savings are barred from that field, I would come to the conclusion that to open the door was a desirable thing to do.[19]

Despite continuing debate on the topic, the correct line of thinking was established and the ensuing criticism was directed more against particular details than the involved principle. This was evident when the second reading of the bill passed by a majority of 186 to 2.

With the passage of the N.H.A. on March 22, two statements concerning its future sphere of influence stood head and shoulders above all the rest. One by Mr. T.H. Atkinson and the other by Mr. Graham Towers.

On February 19, Mr. Atkinson was quoted in an Ottawa newspaper as saying:

> There appears to be a view that banks have a very large pool of savings deposits which can be made available for mortgage lending. I think I should point out the misconception. It is true that the savings deposits of the banks aggregate something in the nature of $5 billion, but this money is not idle. Basically it is on loan to commerce, industry and individuals, on the one hand and to governments and municipalities through the banks on the other. Bill 102 will simply set up another avenue for the employment of these funds.[20]

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[19] W.E. McLaughlin - "Mortgage Lending by Canadian Banks" - The Canadian Banker, Spring of 1955, p.61.

[20] Ottawa Journal, Feature Article, Feb. 19, 1954, p.3.

Mr. Atkinson said that the decision of how much to lend was up to each bank and that he personally was not in a position to offer any estimate of the extent to which the banks might commit their funds in this new field, but he believed all the banks would perform every effort to make the plan a success.

Mr. Towers as a witness before the Committee on this same topic emphasized that the investment of the banks in this new scheme would not have any effect on their loans to commerce and industry. It would be normal to expect that as the demand for mortgages increased, the assets of the bank would undergo a simultaneous rise. He therefore intimated that with a sufficient demand under satisfactory conditions, the banks could easily loan $100,000,000 per year.

On one side we have Mr. Atkinson's cautious, not to say pessimistic view on the banks role in mortgage lending and on the other side we have the less cautious and decidedly optimistic view of Canada's Central Banker.

More than a year has now passed since these remarks were made and as hindsight is so much easier to formulate that foresight, we can put these prophetic utterances of two distinguished bankers to the test of time.

Mr. Vincent Eagen, writing in the December 4 issue of the Financial Post said that- "the entry of Canadian banks into the mortgage field this year is working out more success-

fully than anyone, particularly the bankers, dared to hope".[21] The last six months of 1954 saw the banks enthusiastically making government insured mortgage loans and as a result the banks have an important and profitable new source of income; homeowners have a new and convenient source of mortgage funds; Canada has substantially more new housing units than it would otherwise have had.

In the early part of 1954, interest rates were beginning to fall and then leveled off. But the 5-1/2 per cent interest rate on N.H.A. loans yielded the banks about 5.437 per cent and was a very attractive investment outlet during the year.

Another stimulus to bank lending occured July 1, 1954, when the cash reserves of the chartered banks were reduced from the traditional 10 per cent to 8 per cent. This meant the banks had about $200 millions more for investments.

All these factors contributed to the elimination of the natural hesitancy of the bankers. And while their degree of participation varied widely among the banks, the banking system had mortgage commitments that exceeded $160,000,000 by December 31, 1954.[22] It was therefore obvious that Mr. T.H. Atkinson's pessimism was far out of

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[22] Canadian Banker, Spring 1955, Mortgage Lending, p. 64.

[21] Financial Post, Feature Article, Dec. 4, 1954- New Bank Money, p. 16.

line with the actual results while Mr. Towers' only error was one of a conservative understatement.

A recent editorial in the Financial Post expresses a more current opinion on bank lending in the mortgage field and I believe it bears quoting:

> The banks received the news of their participation in a new system of mortgage loans in much the same way that a banker would unwrap a loud tie on Christmas morning. But as things worked out, the entry of the banks into the mortgage lending field has been a success. The banks now have nearly $100 millions outstanding in N.H.A. loans, with perhaps two and a half times that amount committed for future borrowing.[as]

In their year end reports officers of many Canadian banks spoke on the changes that 1954 had brought in mortgage lending. Excerpts from some of their statements bear quoting as it throws a great deal of light on their views and future positions in this field.

C. SYDNEY FROST
Vice President and General Manager, Bank of Nova Scotia.

Since the new housing act came into effect, the banks have in fact become an important source of residential mortgage funds. With the demand for commercial loans slackening, with bond yields declining and with ample cash, the banks have been in a position to make funds available for mortgages insured under the N.H.A.

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[as] Financial Post, Feature Article, Feb. 19, 1955- Loans for Housing- p. 56.

WILLIAM KERR
General Manager, Bank of Toronto.

This is a new type of bank investment made possible under the revised Bank Act. Its virtue has been the source of much discussion but in accordance with our comments a year ago we have felt that within proper limits it has a place in banking. Accordingly we have undertaken commitments for loans to the amount of $8,382,245 of which $2,404,365 had been made available on October 31, 1954.

A.C. ASHFORTH
General Manager, Dominion Bank.

Since mortgage lending is a new field of endeavour for the bank, we have followed a cautious policy, feeling that it was desirable to go slow until our staff had acquired some experience. Careful selection has been the rule, quality being preferred to quantity.

ARTHUR C. JENSEN
General Manager, Bank of Montreal.

At the end of our fiscal year we had outstanding $11 millions of these mortgage advances, but our total loans and commitments under this heading, including amounts approved but not yet dispersed, amounted to nearly $35 millions. All these mortgages are insured under the N.H.A.

T.H. ATKINSON
General Manager, Royal Bank.

At the end of the (fiscal) year we had advances

outstanding in this category amounting to $22,672,390. Actually, our total commitments were something over $62 millions. This represents approximately 40 per cent of the total commitments of all banks.

I think that it is quite safe to assume from the foregoing remarks that the banks have every intention of increasing their activities in this new field of investment.

An additional inducement to increase mortgage lending has been the fact that defaults on loans have been almost negligible. While it is too soon to say if this experience will be permanent, there is every evidence to believe that it will. The life companies who are the largest and oldest of the mortgage lending institutions offer their figures as an argument for mortgage lending safety. H.R. Stephenson, President of Crown Life says - "that not one of the Company's mortgages has been foreclosed in the past 12 years, nor has any loss been sustained".[24] J.T. Bryden, Vice-President of the North American Life says - "interest has been well collected, the total arrears at the year end amounting to $15,000 on a principal amount of more than $73 millions".[24]

These are just two of the many statistics available to prove the dependibility of mortgage loans and they cannot fail to influence the chartered banks.

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[24] Financial Post- Feature Article, Feb. 19, 1955- Loans for Housing, p. 56.

Home builders in the smaller communities have also found the entry of the banks to be a boom. Banks, rather than incurring loss of their good public relations, have seen it grow.

Even though the banks have now become an integral part of the N.H.A. scheme, their entry still appears to have left a number of questions yet unsolved:

Will the banks want to sell their mortgages? Banks have traditionally avoided long term investments, preferring liquidity, but they may decide that the return of approximately 5.437 per cent and the scarcity of alternate investment opportunities are sufficient reasons to maintain the mortgages.

Will the insurance companies (who are the likely buyers) want to buy? The life companies have made their greatest contribution to mortgages ever in 1954, and they may decide that their mortgage portfolios are at a maximum.

Will the banks and insurance companies break up the mortgages as they do municipal debentures? The banks might as an example hold the first four years of the mortgage and sell the life companies the balance.

Will the banks sell the mortgages to private interests, such as U.S. investment groups which have signified their intention to enter the Canadian housing field in the hope of finding higher rates of interest than those available in U.S.?

If the banks sell the mortgages what price will they receive for them? This poses an additional problem because the price to be paid for them would also include the administration fee. Since the banks must continue to service the mortgage for the new purchaser they might set their fee at 1/2 per cent to 1 per cent per annum.

These questions can only be answered in time. The scheme must develop greater scope and the banks greater activity before these problems can be put to the time tested method of trial and error. It appears that all these foreseeable difficulties can be resolved as the banks increase their knowledge and experience in this new and potentially important field of investment.

The 1954 annual report of the Bank of Canada says that "the chartered banks' participation in residential mortgage lending has enlarged their role in the financing of investment in Canada and improved the general structure and flexibility of the capital market". This is a significant contribution well worthy of note and it is strongly fortified by the Bank's announcement that-- "by the year end they (chartered banks) had made insured mortgage loan commitments on 17,000 housing units amounting to about $160 millions; net disbursements on such loans were $74 millions and in the second part of the year, about 40 per cent of all insured loans were being made by banks.

These figures offer articulate testimony to the chartered banks contribution in easing the money shortage for mortgages. They have more than vindicated the Government's confidence in them and surpassed their own expectations. After such an auspicious debut there is no doubt that this bold venture has become an integral part and accepted feature of the Canadian banking system.[25]

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[25] On May 10, 1955, the Royal Bank of Canada announced that the interest rate it was charging on N.H.A. mortgages was being reduced immediately from 5-1/4 per cent to 5 per cent. President James Muir stated- "we have voluntarily decided to reduce the rate for two very good reasons-- (1) a lower rate will encourage more people to take advantage of the very attractive terms and (2) the maximum existing rate is on the high side and unrealistic under present conditions". Later the same day the Bank of Nova Scotia announced that it was also lowering its interest rate to 5 per cent.

Mr. Stewart Bates, President of C.M.H.C. says that these reductions in the interest rate indicates increasing competition among banks for mortgage business.

## CHAPTER IV

## THE CREATION OF THE SHORT TERM MONEY MARKET

"If a central bank is to be able effectively to perform its functions of regulating the amount of the commercial banks' reserves, and in this way to exercise an influence on the whole credit structure and level of interest rates in the country, it badly needs a broad market in government securities in which to conduct its operations."[1] This statement by Mr. G. Towers expressed the policy behind the Bank of Canada's effort to create a money market in Canada.

It is a recorded fact that the Royal Commission led by Lord MacMillan noted among the many recommendations they submitted for the creation of the Bank of Canada, that the Central Bank would be handicapped by the lack of a money market.

When the Bank of Canada commenced operations in 1935, there was a reasonably good market for long-term government securities, but the short-term money market outside the chartered banks was almost non-existent. Treasury bills were first issued by tender in 1934 and for many months they were issued on an irregular basis. But in late 1935, the practice began of regular fortnightly issues and of keeping the

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[1] Statement by G.F. Towers at hearing of Committee on Banking and Commerce on Bill 297, March 18, 1954.

total amount outstanding relatively constant, with only periodic once-for-all increases. From July 1945 to January 1953, for example, the total outstanding remained at $450 millions. Therefore while Canada had a limited type of short-term security market, it possessed very few of the instruments and institutional arrangements that characterize the money markets in London and New York.

This prompted the Bank of Canada, which is the focal point of all securities and money markets in this country, to undertake measures which would strengthen the short-term security market and build the foundation upon which a money market could be developed.

Let us digress for just a moment and review the structural composition of a money market.

Unfortunately there is no standardized universally accepted definition of the term money market. In its broadest meaning the money market encompasses all the available facilities for borrowing and lending money. In this sense the money market includes the market for long-term as well as short-term borrowing or lending. Many experts make a distinction here and refer to the market for long-term funds as the capital market and restrict the term money market to the market for short-term funds.

In the more restricted sense the money market consists of two sectors:

(1) The direct, or customer's loan market, distinguished by the close and personal connection between the borrowing customer and his bank.

(2) The impersonal or open money market, characterized by objective relations between the borrower and lender where the loan is usually negotiated through middlemen, and the lender and borrower do not meet.

The term money market shall be used in this thesis in a narrow sense, that of the open money market.

The open money market is informally organized. For the most part, there is no formal meeting place at which the middlemen come together as in the buying and selling of securities on the stock exchanges. The negotiations are carried on in the officesof brokers, dealers and banks with the use of the telephone, telegraph and mail.

To those with short-term funds, the money market provides a temporary outlet; to those seeking funds, it provides a source of supply. Through it funds are made mobile. Both debtors and creditors obtain access to a broader market organized on a regional and in some markets, on a national or international scale. The relatively high degree of competition on both sides results in the rate of interest being determined by the forces of demand and supply.

The money market is not a single simple market but is a family of closely related markets, each having its own characteristics. As a result of a long period of development, the money market is centered around facilities for dealing in four principal types of paper:

(1) Commercial paper, i.e. the promissory notes of borrowers which are sold in the open market.

(2) Bankers acceptances, i.e. time drafts drawn on and accepted by banks.

(3) Stock exchange collateral loans, including both call and time loans with security collateral.

(4) Government short-term loans, known as treasury bills and notes.

The bankers acceptance and commercial paper markets provide specialized commercial financing facilities to finance foreign and domestic trade. The call and time money markets facilitate the flotation of new issues and trading in existing securities. Each of these markets has as a counterpart direct financing for their customers by commercial banks. The government securities market, ranging from treasury bills to long term bonds, but confined for the present purpose to issues maturing in not over three years, helps finance the deficits of governments.

The institutions necessary for the operation of a money market are a central bank, commercial banks, brokers, security dealers, acceptance and discount houses, etc.

Fortified with this brief review of the main instruments and institutional facilities that comprise a money market, let us now return to the situation that existed at the end of 1952.

## BROADENING THE SHORT-TERM MARKET

From 1935 when the Government first issued treasury bills up to the present, the bill market had been generally confined to three groups-- the Government, the Bank of Canada, and the chartered banks. The Government's role in this limited short-term securities market stemed from its policy of placing an adequate proportion of the national debt in short maturities. This was done in order to reduce the heavy interest payments on the debt, which in 1954 amounted to eleven per cent of the total budget outlay.

To the chartered banks the treasury bills meant a bulwark of safe and profitable liquid assets which formed their second line of defence against any unforeseen demands for cash.

As the fiscal agent for the Government, the Bank of Canada is responsible for the purchase and sale of securities

for the account of government trust funds, assistance in the flotation of government securities and in their exchange and redemption. It logically followed from these duties that the Bank's interest in this field was to help maintain orderly security markets and to exercise some control over the supply of money and credit. Therefore, while the total amount of their holdings of government securities was necessarily determined by considerations of monetary policy, they endeavoured to help make a market for all government issues by being substantial buyers and sellers.

These were the background factors that contributed to the money market dilemma in 1952.

Treasury bills had been sold by tender since the mid thirties but were now held almost exclusively by the chartered banks, who used them as secondary cash reserves. The treasury bill had become one of the most liquid of investments due to the fact that the Bank of Canada, while officially uncommitted to demand purchases, had never failed to buy any bills offered to it and moreover not at a penalty rate but at one closely related to the last average tender. But despite this high liquidity a large non-banking treasury bill market had not developed. There was no commercial paper, and there was no interbank loans. Borrowing by the chartered banks from the Bank of Canada was uncommon, and there was no rediscounting. There was in short, no regular market into

which temporarily idle funds of banks and business concerns could flow, and upon which banks and business concerns could draw to meet short-term needs.

The Bank of Canada had long recognized the deficiencies associated with the current security market and the void in the financial structure caused by the absence of a money market. The Bank therefore, decided that the time had come to lay the groundwork for a future money market; the first measure being the extension of the existing market in federal government securities.

In order to encourage a wider market in treasury bills, the active participation of two new groups was required -- the general public and the securities dealers. The public group would consist largely of big corporations and provincial and municipal governments. This sector of the economy could be enticed into the market on the right conditions because they had a constant need for employing idle cash balances in safe and liquid assets. The addition to the market of the securities dealers was necessary in order to sell the treasury bills to the general public. Their role would be to maintain a large portfolio of treasury bills and short term bonds which could be sold to the corporations.

In order to add stimulus to the participation of these two new groups, the Bank of Canada undertook three significant

steps in 1953 to broaden the short-term market.

The first step was taken on January 30, 1953, when the Bank, in co-operation with the Government, changed its regular offers of treasury bills from a fortnightly to a weekly basis.

The second step was taken simultaneously with the first when the weekly offering was broadened to include 273-day bills in addition to the regular 91-day bills then in vogue. This change allowed buyers to choose from 39 different maturities, giving an investor an option of obtaining bills maturing in any given week within the next nine months. The treasury bill issue was increased from $450 millions to $650 millions. By the first of May 1953, these new bills were fully in circulation and the weekly issue consisted of $35 millions in 91-day bills and $5 millions in 273-day bills. In April 1954, the Bank of Canada started issuing $10 millions in 273-day bills and $30 millions in 91-day bills each week. This was to increase the total amount of treasury bills to $780 millions by the end of 1954.[a] It was hoped that this measure would encourage corporate, municipal or other bodies to make use of this form of investment.

The third step taken by the Bank of Canada was the establishment of a purchase and resale agreement with a number of Canadian investment dealers. These dealers agreed to

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[a] R.M. Macintosh- The Money Market - Canadian Banker, Autumn, 1954, p. 72.

become "jobbers" in treasury bills and short term securities. These agreements provided the dealers with credit facilities at the Bank of Canada to finance large inventories of short-term securities, and offered an alternative to borrowing from the chartered banks. In a tight money market, the Bank of Canada acted as a lender of last resort. The Bank agreed to buy treasury bills and other short-term securities on agreement that the dealers would re-purchase them within a relatively brief period of time at a fixed price. Under this arrangement the finance of jobbers' inventories was in effect guaranteed, and jobbers were consequently better able to meet the demand for such paper. An additional benefit of this scheme is its ability to relieve the money market from oppressive pressure in the event of a temporary shortage of cash on the part of chartered banks. An extended market in short-term securities is also a decided asset to the chartered banks when they decide to adjust their cash positions by altering the composition of their portfolios.

During the years prior to these major changes the Bank of Canada had progressively widened the spread between its buying and selling levels of treasury bills in order to increase the incentive for the development of jobbing intermediaries. It had created a difference in yield of .15 per cent - .25 per cent between bills held to maturity and

discounted bills. The Bank had hoped this would lead the chartered banks to seek other bill dealers and thus broaden the market, but as the Bank always stood ready to buy bills when offered, this plan wasn't too successful.

The new program initiated by the Bank of Canada had better results. Both the increased amount of treasury bills and the greater scope of maturity dates found favour with the market and increased the demand for and turnover of such securities. From January, 1953, to June 1954, the Bank of Canada had made a considerable amount of funds available for the financing of dealers inventories of treasury bills and short-term government bonds through purchase and resale agreements. The total provided in this way reached a maximum of $73 millions in June.[s] This alliance had made it possible for the dealers to obtain financing for their holdings of short-term securities at a cheap rate from the Bank of Canada, instead of paying normal rates of 2-1/2 per cent or 3-1/2 per cent as charged by the chartered banks.

With its initial project, that of extending the facilities of the short-term government security market well begun, the Bank of Canada in collaboration with the chartered banks and the investment dealers evolved a plan which was to be the cornerstone in the creation of Canada's

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[s] Bank of Canada Annual Review 1954, p. 11.

first money market. On June 14, 1954, the base of the short-term market was further broadened by an agreement whereby the chartered banks would make loans at competitive rates on a day-to-day basis to individual investment dealers against the pledge of treasury bills and Government of Canada bonds maturing within three years.

There had been much active discussion between the banks, the Bank of Canada and the dealers before this new arrangement had been worked out. The major problem centered around the fact that the dealers, in order to maintain substantial portfolios of short-term government securities, required large bank loans on small margin, and at low interest rates. The chartered banks countered this proposition by advising the dealers that they could not profitably make loans to them at the requested rates unless the loans were recoverable on demand. The bankers worked on the old principle governing all types of assets which stated that there has to be a compensating increase in liquidity for every decrease in yield. As the returns on these dealers loans were to be the lowest yielding of all bank assets, they must necessarily be the most liquid. It was therefore decided to designate them as "day-to-day loans" to emphasize their new characteristic. This ability to recall a loan within a few hours was a distinct departure from the ordinary call loans to brokers, which, while theoretically subject to immediate recall had in practice

not been done due to long standing customer relationships.

The new day-to-day loan is to be impersonal in that it is a known and accepted condition that demand calling is part of the arrangement. Under the new regulations, if a day-to-day loan is called before noon, it has to be repaid that day; also if a dealer wants to pay off a loan, he must signify his intention to his bank before noon.

With the attainment of this much greater liquidity, the banks were now in a position to offer these loans at the reduced rate. As promised to the dealers, the rate of interest on the day-to-day loans is set competitively. The banks are obligated to submit the rate established in all proceedings involving $1,000,000 or more to the "exchange broker" who acts as an impartial middleman. Through the medium of this market place, competitive trading establishes the day-to-day loan rate. It is expected that this rate will fluctuate with the highly sensitive interest rate on treasury bills. While the precise rate on these call loans will be determined by the law of supply and demand, it should normally be about one-eighth or one-tenth of one per cent below the treasury bill rate. The daily rates, therefore, should prove to be flexible and responsive to competitive money conditions in the economy generally. These conditions should normally allow the dealers to carry their treasury bill inventories without loss.

In London and New York, where the banks have for years made these genuine call loans, the interest rate is generally just below that prevailing on treasury bills. The London rate at present is actually about the same as the treasury bill rate: in New York it is fractionally lower.

This new offer of the chartered banks to lend the dealers money at somewhere around 1 per cent or 1-1/2 per cent instead of the 2 per cent-- 3-1/2 per cent on former call loans has led to the replacement of the purchase and resale agreements as the main source of finance for dealers. It has now become more advantageous for the jobbers to deal with the chartered banks than the Bank of Canada on a day-to-day basis, but the Bank still remains as the lender of last resort.

As outlined earlier, the past few years have witnessed the Bank of Canada's effort to broaden the short-term security market by increasing the difference between its buying and selling prices to the chartered banks on the latters sales of treasury bills. This was done as an incentive to the chartered banks to sell the treasury bills outside the banking system in order to increase their circulation and prevent loss to themselves. This policy served as an introduction to the day-to-day loans at rates slightly less than the tender rate on 91-day treasury bills

since the yield on these loans is competitive with the yield on rediscounted treasury bills.

From September 1953, to April 1954, an atmosphere of easy money prevailed and as a consequence the yield on treasury bills fell to a level below the Bank of Canada's rediscount rate. This was a wished for occurence because the proper functioning of a day-to-day loan market depended upon the money market rates being lower than the rate set by the Bank of Canada. Had the interest rates not declined, it would have been necessary to create an artificial spread by raising the rediscount rate. A glance at the actual rates used to inaugurate the day-to-day loan market on June 14, 1954, showed that the theory of this type of a market was put into practice; the treasury bill yield was 1.60 per cent, the initial day-to-day loan rate was 1.50 per cent and the rediscount or Bank rate was 2 per cent.

Under the new conditions set out by the day-to-day loan agreement, a chartered bank can recall its loan any day. When this occurs, the jobber can simply replace the first loan with a second procured from another chartered bank at approximately the same rate of interest. In the event that the chartered banks create a tight money situation by simultaneously calling in their day-to-day loans, the dealers can still obtain their financing from the Bank of Canada, but at the rediscount rate, which we now know as a penalty rate. Therefore, while

the purchase and resale agreement still exists as a guarantee to the liquidity of the treasury bills, it will only be used as a desperation measure by the dealers.

One of the additional advantages accruing to the dealers in virtue of the new agreements, concerns margin. The bank's margin on loans to investment dealers, secured by short-term government bonds and treasury bills, used to vary between 2 per cent and 5 per cent depending upon negotiation. This margin has now been greatly reduced and is expected to range between one-tenth and one-half of 1 per cent on the new call loans.[4]

## IMPORTANCE OF THE SHORT-TERM MARKET TO THE BANKING SYSTEM

The broadening of the short-term market has brought some very important advantages to the banking system. Under the regulations that existed prior to the creation of a genuine call loan market, the cash position of each chartered bank had to be adjusted by strictly bilateral transactions with the Bank of Canada. If a bank found itself temporarily short of cash, it would sell bills or bonds to the Bank of Canada; if it had a surplus cash position, it would in due course correct this situation by buying bills or bonds from the Bank.

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[4] Financial Post- Short Term Money Market- Vincent Egan, June 19, 1954, p.4.

This situation has been changed with the new development in the short-term money market. Banks which have some surplus cash on hand now make the new type of call loan to the jobbers of short-term securities. A bank wishing to replenish its reduced cash reserves may call part or all of its day-to-day loans and present the borrowers cheque through the Clearing House for credit to its account with the Bank of Canada.

This new short-term market has also added to the flexibility of the banking process by introducing the advantages associated with inter-bank dealings. This practice has long existed in the New York and London money markets, where its ease and simplicity in adjusting daily cash ratios was recognized. For example suppose that one day bank "A" finds itself short of cash, and bank "B" finds itself long on cash. Bank "A" will go to the Bank of Canada to replenish its position by selling bonds. Bank "B", under ordinary circumstances, will not be so quick to go to the Bank of Canada and buy bonds. So bank "A's" need for more immediate cash actually leads, if only temporarily, to an increase in the total cash volume of the banking system. In times like the present, when official policy is for easy credit, this is not important, but it could be unpleasant in more inflationary times when the Bank's policy would be to restrict the cash supply. The best way to handle these

inevitable variations in the cash ratio of individual banks, would be for bank "A" and bank "B" to adjust their complimentary situation without recourse to the Bank of Canada at all-- in fact, through a money market.

The chartered banks would make use of any spare cash available by lending it "on call". Other banks or bond jobbers needing cash would take these cheap call loans, and they would be shopped around from day to day. Each day each bank would decide if it had surplus money to lend or whether it had to call in some loans.

Therefore this new development has provided the chartered banks with a convenient and efficient method of adjusting their daily cash positions. This advantage increased in significance when the Bank of Canada was given the power to vary the cash ratio of chartered banks. The authority was given to the Bank as a potent adjunct to monetary control and it brought with it the need for greater flexibility in adjustments of the chartered banks cash ratios. Thus it becomes quite evident that the continued development and expansion of the short-term money market will facilitate the smooth operation of the banking system-- in the event that the Bank of Canada decides to alter the existing cash ratio.

Another revision to the Bank Act which dovetailed neatly, although perhaps only accidently, with the initiation of day-to-day loans, was the provision which now allows a

chartered bank to determine its cash reserve position on the basis of four consecutive average weekly figures in the preceding month, instead of a minimum daily average. This means that a chartered bank can more precisely anticipate its monthly financial structure and arrange its holdings of short-term securities with the intention of having its surplus money fully invested.

In summary of the advantages of the money market to the banking system one might mention three important contributions. First, it has given the chartered banks a very liquid asset coming between cash and treasury bills in liquidity. This will enable the banks to make more efficient use of temporarily idle funds for short periods of time without undue loss of liquidity, a factor which is vital to the operation of the banking system.

Secondly, the presence of day-to-day loans will reduce the number of times that banks must resort to treasury bill sales to replenish their dwindling cash.

Third, the extension of the public market in treasury bills has led to competitive bidding in the determination of their prices and has reduced the spread between buying and selling rates. This has increased the liquidity of treasury bills by reducing the loss incurred in discounting them.

There was also two very important ramifications of the day-to-day loan market which specifically concerned the chartered banks. One of these was the problem of obtaining cash through the clearing system, and the other dealt with over-certification charges to the security dealers.

THE NEW CLEARING SYSTEM

One of the ways a chartered bank guarantees its solvency is by guarding against adverse clearing balances. In normal conditions over a period of time even adverse balances tend to compensate each other and banks are able to maintain their cash reserves. But there is always the possibility that a bank could gain or lose a sizable amount of cash on any single day due to unforeseen and sudden alterations in large accounts. When a bank increases its cash reserve in the clearing process, it naturally wants to invest this money as quickly as possible. This can be done only after the favourable clearing balance has become available in the form of a chartered bank cash deposit at the Bank of Canada. Therefore, speed is of the essence in this transaction. Normally the procedure of settling accounts between the banks is made in "clearing funds" which become available on the day after a transaction takes place.[5]

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[5] This is true for money-market transactions which can be cleared very quickly through the local clearing houses in Toronto or Montreal, where such dealings take place. It is also true of other transactions in the above cities and in the district clearing house cities of Winnipeg, Regina, Calgary and Vancouver. In other parts of the country there may be a time lag of one to several days, depending on the proximity of the district clearing house, before settlement is actually made in "clearing funds".-- Canadian Banker, Autumn,1954, R.M. Macintosh, p.68.

These funds increase the amount of a banks assets, but they do not increase the official cash reserves until the clearing transaction is recorded in the accounts of the chartered bank at the Bank of Canada. This may happen the same day the clearing funds are received or the day following.

Up until June, 1954, the only methods available for obtaining Bank of Canada funds quickly were to sell treasury bills to the Bank of Canada or to borrow from it. In actual practice the banks have seldom availed themselves of the option of borrowing from the Central Bank for two reasons; it was easier to sell treasury bills and because there was a long standing tradition against being in debt to the Bank. Therefore, in order to dispel the odium of borrowing from the Central Bank and also to encourage the use of the new call loan procedure, the Bank of Canada initiated the method of paying for treasury bills by means of "clearing vouchers" which are received the day after the sale and which become Bank of Canada funds only on the succeeding day. Thus the payments for security deals involving the chartered banks and the Central Bank no longer result in an almost instantaneous cash adjustment as they formerly did, a distinct advantage of dealing directly with the Central Bank has therefore been removed. In fact it is more advantageous from the point of view of acquiring cash reserves, and probably cheaper in terms of reducing the loss in revenue resulting from the sale of assets, for a chartered bank to call in day-to-day loans instead

of selling treasury bills for immediate cash. Although borrowing from the Central Bank is even quicker than selling treasury bills, it is sometimes more expensive due to the condition that Bank of Canada advances are extended for a minimum period of one week. All these deliberate moves were designed to increase the flow of short-term money and the demand for short-term securities.

## OVER- CERTIFICATION

The second problem occasioned by the innovation of day-to-day loans was the rate of "over-certification". This is a charge made by the chartered banks to jobbers for daylight over-drafts. A dealer in securities participates in the market both as a buyer and a seller; as a buyer he often requires large amounts of money which he will not actually receive until he resells the securities later in the day. The banks, who realize that this shortage of cash is but momentarily, accomodate the dealer by certifying his cheque on the condition that the deficiency is made up by the end of the day with the income of his security sales. Without this overdraft service a dealer would be obligated to permanently maintain a very substantial amount of money in order to finance his large business transactions. The current charge for this service, which was 1/100 per cent per diem, was considered by the jobbers as prohibitive to the furtherance of extensive dealings in treasury bills.

The banks therefore decided to further assist the broadening of the short-term market by reducing this charge to 1/250 per cent per diem.

## REDISCOUNT RATE

While we have gone to great lengths to stress the many advantages of short-term security and money markets accruing to the chartered banks, we have not overlooked the benefits received by the Bank of Canada. But until we had become familiar with the operation of the money market and the individual roles of the chartered banks and the security dealers, we were not in a position to appreciate them.

As mentioned in the beginning of this chapter, the Bank of Canada had acted as the unofficial godfather to this broadening movement for a number of reasons not the least being the extension of its monetary policy. With the creation of a money market, the effectiveness of monetary control was increased through the medium of short-term interest rates.

Under the new procedure the majority of short-term financing of securities is done through the day-to-day loan policy of chartered banks. But through the purchase and resale agreements, the Bank of Canada still remains as the lender of last resort. If for some reason, jobbers were unable to secure adequate funds from the chartered banks during a tight money situation, they would be forced to borrow from the Central Bank

at the rediscount rate. As this rate is now normally above the rate on treasury bills and day-to-day loans, it has become a penalty procedure.

Therefore since the possibility of being "forced into the bank" is always present, the rediscount rate has taken on increased significance both for the dealers and the chartered banks.

The recent development of facilities for rapid and inexpensive adjustment of the banks' reserve position has tended to encourage the chartered banks to carry smaller cash reserves above the minimum requirements. As a result, relatively moderate shifts in the over-all supply of reserve funds may make borrowing from the Central Bank necessary; in fact several of the chartered banks did borrow from the Bank of Canada in 1954.

The bank rate also serves as an indicator of business forecasting. An increase in the rate would be a sign of impending tightness in the money market, and would probably be followed by an increase in interest rates on treasury bills, day-to-day loans and eventually other short-term rates. A lowering of the rediscount rate would signal the acquiescence of the Central Bank towards an easier money policy, and a general decrease in interest rates.

Therefore the broadening of the short-term money market has made the rediscount rate a more potent instrument

of monetary control by establishing a direct mechanical relationship between it and the market in short-term securities.[6]

As the chartered banks have never made regular use of the chance to borrow from the Bank of Canada, the bank rate had remained largely an academic figure, and its rare changes have had symbolic and psychologic, rather than practical effects.[7] The creation of a money market completely altered this purely representative position of the rediscount rate by allowing it to perform its rightful function.

As the short-term market became wider and more active, the Bank of Canada took steps to further encourage its development by getting the rediscount rate into a more practical relationship with the money market. Therefore, on February 14, 1955, the Bank of Canada reduced its lending rate from 2 per cent to 1-1/2 per cent. This change to a more flexible and realistic bank rate was accompanied by a broad hint that the rediscount rate will change much more frequently from now on.

The long-term effect will be to give the bank rate a practical as well as symbolic importanee, and greatly strengthen the influence which the Bank of Canada can wield through using it.

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[6] _Canadian Banker_- Autumn, 1954,p.71

[7] The rate was 2-1/2 per cent from 1935 until Feb. 7, 1944, 1-1/2 per cent until Oct. 17, 1950, and 2 per cent until Feb. 14, 1955, when it went to 1-1/2 per cent.

Once the bank rate has established a real relationship to other interest rates, the money market and the chartered banks may begin to use the Central Bank as a source of short-term funds. This would mean that future alterations will be far more important than they have been in the past.

While it is obvious that the re-energizing of our rediscount rate was influenced by the Bank of England, there are some differences in the two procedures due to the greater complexity of the London money market.

The Bank of England is more often resorted to for short-term funds by the commercial banks than is the Bank of Canada. While the Canadian chartered banks, prior to the creation of day-to-day loans, generally adjusted their daily cash ratios by bilateral transactions of short-term securities with the Bank of Canada, the bank and discount houses in the United Kingdom more often borrow from the Bank of England for short periods of time, or use the rediscounting facilities of the Bank of England for commercial paper which they have discounted. As in Canada, the clearing banks lend money on call to the brokers and the dealers, and the latter may borrow as a last resort from the Bank of England at the rediscount rate. The English bank rate is also a penalty rate and is set high enough to dampen regular advances.

Thus the effectiveness of the bank rate as an instrument in influencing the general volume of credit and the general

structure of interest rates has in the U.K. been more satisfactory than in Canada due to our country's lack of a sensitive money market. Therefore, the recent development of such a market here should give the Bank of Canada a similar measure of control.

The situation in the United States is again different due to the fact that the rediscount rate is usually lower than the yield on commercial bills of exchange. Thus the U.S. bank rate is not a penalty rate, and a commercial bank can borrow from the central bank without loss when it requires cash. But the Federal Reserve authorities place a good deal of emphasis on the reluctance of commercial banks to show indebtedness in their financial statement. It is asserted that the sentiment against showing indebtedness leads banks to repay their borrowing as quickly as possible. Thus, Burgess states the tradition against continuous borrowing is well established and it is the policy of the Reserve Banks to maintain it.[8]

In the United States the individual banks clear their daily balances through the Federal Reserve System, and the adjustment of reserve positions is made by selling or buying short-term securities, either through the Federal Reserve or through the market, with the dealer financing his temporary holding of such securities by a callable loan from another

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[8] W.R. Burgess: The Reserve Banks and the Money Market, 2nd Ed., New York, 1946, p. 219.

bank; by rediscounting commercial paper; or by making call loans or calling outstanding loans or by trading in federal funds. This method of daily cash adjustment is very similar to the new Canadian procedure except that recourse to our Central Bank's lending facilities results in a loss to the individual bank. While the rediscount rate in the U.S. has never been an important tool of monetary control due to the difficulty of employing it at a penalty level under the Federal Reserve Act, it has through its alterations exerted important psychological influences in the money market.

Another factor to consider is that the structure of the U.S. banking system differs from that in Canada and England, in that it is a system of unit banking, rather than of branch banking and as a result "Moral Suasion" does not exert much influence. The Federal Reserve System has therefore depended to a greater degree upon fluctuations in the member banks' cash ratios---a power which until the revision of the Bank Act, the Bank of Canada did not possess-----and upon open market operations, which have in the post-war years been the most effective method in controlling the total volume of money and credit in the country.

## FUNCTION OF THE BANK OF CANADA IN THE SHORT-TERM MARKET

The function of the Bank of Canada has been modified. Instead of being the main source of funds to the short-term

securities dealers, it has now moved one step to the rear to serve as a backstop, and has become the lender of last resort. No longer does the Central Bank participate directly in the daily transactions of the short-term market through the purchase and resale agreements with the jobbers, except in circumstances of a temporarily tight money situation. By setting the rate of interest on loans to the dealers higher than the current yield on treasury bills, it discourages their direct borrowing from the Bank, although recourse to the purchase and resale agreements is still available to the dealers in the event that the chartered banks are unable to supply the required money.

The role of the Bank has also been altered in its relationship with the chartered banks. As previously stated, the Bank now does not need to function to as great a degree as before as an intermediary in the adjustment of the reserve position of the chartered banks. The Bank of Canada may, however, continue to exercise its control over the market by purchasing or selling treasury bills or short-term bonds if it finds there is a shortage or surplus of short-term funds in the market at any time. It may also, by movement of the rate of interest charged on loans to short-term security dealers, encourage or discourage their borrowing from the Central Bank in the situation when other sources are not available.

The principal advantage of a well-developed short-term market to the Bank is the degree of control which it can quickly exert through it in the financial structure of the country directly and through the chartered banks.[9]

FUNCTION OF THE CHARTERED BANK IN THE SHORT-TERM MARKET

The chartered bank has three main functions in the short-term market:[9]

(1) To make the most efficient use of its short-term funds by dealing in short-term securities and/or lending such funds on a day-to-day basis through one or more jobbers at the most advantageous rate of interest obtainable.

(2) To ensure the smooth functioning of the short-term market by acting as a lender of first resort to the jobbers.

(3) To implement the monetary policies of the Bank of Canada through the adjustment of its cash ratio from time to time,(if so directed by the Bank) by dealing in short term securities and/or day-to-day loans.

FUNCTION OF THE JOBBER IN THE SHORT-TERM MARKET

The function of the jobber in the short-term market is twofold:

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[9] Burns Bros. and Denton - A Review of the Short-Term Securities and Money Market in Canada-Aug. 1954, p.5.

(1) To act as an intermediary between the banks and/or the banks and the public by providing a market in short-term securities, both bonds and treasury bills, by maintaining at all times inventories of these securities.

(2) To facilitate the most efficient use of short-term funds within and without the banking system by borrowing money on a day-to-day basis from banks or other sources.

Jobbers' earnings are derived first, from the margin between the rate of interest which they pay on the new day-to-day loans from the chartered banks and the interest which they earn on the short-term securities purchased by means of such loans, and secondly, from the difference between purchase and selling prices on securities traded.

THE SIGNIFICANCE OF THE SHORT-TERM MARKET

There is no reason for us to recapitulate on the "raison d'être" of the money market, the glaring need was all too obvious. As Mr. T.H. Atkinson put it:

> The expansion of the short-term money market will fill one of the very few remaining gaps in the Canadian financial system. With its establishment, Canada reaches another economic milestone because it should be borne in mind that an active money market operates in all countries that have attained any substantial degree of economic maturity. Such a

market-- should have a direct bearing on the efficient channeling of funds for development purposes and capital investment. It should increase the mobility of short-term capital, thereby helping to reduce the cost of doing business, a highly desirable factor in a nation such as Canada that is so dependent on world markets.[10]

So far I think that the advantages of this market to the Central Bank, the commercial banks and the jobbers have more than justified their participation. But a major objective of the new market is to attract the participation of corporations, municipalities and individuals. The initial reaction to this market by corporations was one of caution due to unfamiliarity, but once the advantages were recognized, their entry was substantial.

Let us examine the way that non-banking groups who have substantial amounts of available assets can benefit from the development of a wider short-term market.

Up until the present, only a small proportion of short-term securities and treasury bills have been held outside the banking system. With the enlargement of the securities market, a larger variety of more readily marketable short-term securities were made available through the investment dealers.[11]

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[10] T.H. Atkinson: The Canadian Banking Progress-Address delivered at Annual Meeting of Canadian Bankers Assoc.,June 11, 1954.

[11] In conjunction with the new procedure for bank financing of the dealers, the Government expanded the proportion of the national debt which is issued in very short maturities: the outstanding total of three-month and nine-month treasury bills was raised from $650 millions to $780 millions between June 1954 and Dec. 1954,and since January 1955, an extra $10 millions has been added each week. Apart from the dealers inventories, approximately $200 millions or 25 per cent of the total treasury bill issue, is now held outside the banking system compared to perhaps $50 to $75 millions before the day-to-day system was adopted. (Bank of Nova Scotia Monthly Review- Feb. 1955, p.2.)

These concerns now have two alternatives open to them for profitable investment of idle funds:

(1) The corporations may invest available idle cash balances for a definite period of time by purchasing short-term Government of Canada bonds or treasury bills, the maturity date of which corresponds to their own need for the money. If the purchaser is uncertain as to when his funds may be needed, a more flexible arrangement may be worked out under a sale and repurchase agreement. Under this arrangement the buyer may place his funds for an indefinite period at a pre-determined yield. Funds invested in this manner are available to the purchaser at any time between the date of purchase and maturity.

(2) The corporation may lend its funds on a day-to-day loan or by repurchase agreement to the jobber, receiving as collateral, short-term Government of Canada treasury bills or bonds. Such a day-to-day loan (made in units of 100,000) is extremely liquid and the funds may be recalled by the lender on less than 24 hours notice to the jobber.[12]

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[12] Burns Bros. and Denton, Aug. 1955, p.6.

It is not surprising that the extremely liquid nature of this market has succeeded in attracting the idle funds of many non-banking organizations. Although this money market is but one year old, its tremendous potentialities for invigorating the economy have been acknowledged and appreciated by both the banking and the non-banking financial organizations of our economy.

To round out this presentation of the money market's composition, we should mention two additional features. The new call-loan market is a telephone market, operating in Toronto and Montreal; and there are only 13 investment houses which have obtained Bank of Canada approval to participate in the day-to-day call-loan market.[13] Other investment dealers may be added to the "approved" list as operation of the money market expands. Any jobber in Government of Canada securities who has been granted rediscount facilities with the Bank of Canada, may apply to the Central Bank for permission to take part in the new market. If the dealer shows a serious interest in this market, and if the Central Bank thinks that it is advisable to enlarge the market, the dealers application would probably be approved.

Canada's growing economic maturity was the motive which influenced the Bank of Canada to sponsor the creation

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[13] See Appendix D

of a short-term money market. But a full fledged money market, such as those operating in New York or London, where a much more extensive organization exists, could not be created overnight. Instead, the Bank of Canada decided to use the basic principles and organization of these two markets as the prototype on which to build. During this thesis, we have attempted in many places to point out the similarities and dissimilarities of these two money markets with the Canadian embryo. Closer inspection of the organization of the London money market shows some of the deficiencies that still exist in the Canadian market, for example money market transactions in London involve, to a substantial degree, bills of exchange, bankers' acceptances and additional types of commercial paper which can be used as collateral for call loans. Therefore, discount houses and bill brokers play a far more important role in day-to-day money market proceedings than they do in Canada, where no extensive market for commercial paper is functioning at the present time and where transactions are restricted to the banking system and the thirteen approved investment dealers.

The United Kingdom Financial Times, when commenting on the new Canadian money market, further emphasized this deficiency in an editorial when they wrote:

> It would be well to point out that such a market in Canada would not, at least for a long time, be anything like the money market in this country. Whether eventually, anything like a bill market will also emerge is another matter. The bill of exchange as we know it, is unknown in Canada. There are domestic bills of course, but these are held either by banks or trading firms and never come into the market. Another difficulty is that there is no one great financial centre like London in Canada. There are in fact, two banking centres-- Montreal and Toronto-- with an element of professional jealousy between them.[14]

This quotation verifies the importance of commercial paper in the London market, but in New York as in Canada, Government securities form the bulk of the paper in the money market. A quote from Steiner and Shapiro testifies to this fact:

> Prior to 1913 the call-loan and commercial paper markets were the most important sectors of the money market and during the 1920's the call-loan and acceptance markets predominated. Since 1929 the United States Government securities market has far overshadowed all others.[15]

A very great distinction that exists between the money market in Canada and those in London and New York is that the latter two are international financial centres. Such a centre acts as a clearing house for a large volume and variety of international financial transactions. It acts as a bank for the entire world. In normal times the

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[14] Financial Times-London- Money Market for Canada by Lombard, March 27, 1954, p.14.

[15] Steiner and Shapiro- Money and Banking, 3rd Ed.- Henry Holt and Co., Inc., New York, p. 218.

services it renders greatly facilitate the flow of goods and capital among nations. Some of its functions are unique, others are closely comparable with those performed on a national or regional scale by domestic financial centres. There are a certain number of basic prerequisites and financial institutions necessary for the development of an international money market, the outlining of which are beyond the encompass of this paper.[16] In spite of the deficiencies that still exist in the Canadian money market in comparison to London and New York, its start has been auspicious because of its sound basic principles and adequate organization.

## OPERATION OF THE MONEY MARKET

One of the underlying fears associated with the initiation of the short-term money market was whether or not the market would be sufficiently strong to withstand the calling in of funds by the banks without the dealers having to sell bills to the Central Bank. When the market for short-term securities opened on June 14, 1954, activity was very brisk. The interest rate in the first week of operations was set at 1-1/2 per cent, one-tenth of a per cent below the yield on treasury bills. An adequate supply of funds induced a reduction of 1/8 of one per cent in the rate after it was freed at the end of the first week. The rate then began to

[16] For further information see Money Market Primer- Hadden, Nadler, Heller, - Ronald Press, N.Y., 1948.

fluctuate between 1-3/8 per cent and 1-1/4 per cent all during the first month. The 1-1/4 per cent rate was made possible by the large bank reserves. When the legal reserves of chartered banks were reduced from the traditional 10 per cent to 8 per cent July 1, the banking system's reserves were increased by about $200 millions. This liquid position of the chartered banks was further strengthened when a $100 millions issue of Canada 2 percent bonds matured July 1 and was not refunded.

By September it was evident that more and more non-financial corporations and municipalities were showing an interest in the market. One dealer told of receiving an inquiry from a large U.S. corporation which had never invested in Canada on a short-term basis, but was now weighing the advantages of placing some of its temporarily idle funds in Canada's new short-term money market. The present discount on the U.S. dollar in relation to Canadian exchange is expected, however, to act as a deterrent to U.S. participation for the time being.

During the month of August, Canadian banks increased their holdings of treasury bills by $39 millions, bringing the month-end total to just over $400 millions.[17] This, said the bankers, was proof of the growing tendency of the banking

[17] Financial Post- Editorial- Bank Loans Down - Nov. 6, 1954, p. 18.

system to take advantage of all profitable outlets for its money.

In November the day-to-day loan market met and passed its severest test, as the market suddenly grew to unprecedented size.

The Bank of Canada, made loans to investment dealers for the first time since the money market was launched in June. Most of the chartered banks discovered early in November that their outstanding loans had exceeded their self-imposed maximum and they therefore took three steps to bring the loans back into balance.

(1) Interest charged to investment dealers for day-to-day loans which had been 7/8 per cent was raised to 1 per cent, later to 1-1/8 per cent.

(2) Some banks called in their outstanding day-to-day loans. One Toronto investment dealer "guessed" that 20 per cent of total loans were recalled. At October 6, day-to-day loans amounted to an all time high of $100.6 millions indicating that something in the order of $20 millions may have been called.[18]

(3) In some cases, banks stopped making day-to-day loans altogether. Investment dealers needing funds then were forced to borrow from the "Bank of last resort" at the rediscount, or penalty rate of 2 per cent.

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[18] Financial Post- Editorial-Day Loans Meet First Test- Nov. 6, 1954, p. 22.

But this crisis was very brief because the day after the banks called in their loans, they were back in funds again. Day-to-day loans were being made normally, at interest of 1 per cent and investment dealers began repaying their loans to the Bank of Canada. Since these loans were only held for 24 hours, the higher interest rate charged (2 per cent vs. 1-1/8 per cent) was more of an inconvenience than a financial burden to the dealers. Within a week the interest rate had dropped back to 7/8 per cent.

As the volume of trading in treasury bills increased, the spread between the bid and offered quotes for short-term bonds narrowed.

The next few months saw a trend of continuous fluctuation in the amount of call loans, the interest rate on them, and the yield on short-term securities.

By the end of January 1955, short and long-term rates had eased. Ninety-day treasury bills, which the Bank of Canada sold at a yield of 0.98 per cent at the end of January, were down to 0.78 per cent. After their sale, they became even stronger and sold "on the street" at 0.70 per cent yield before falling back to a 0.75 per cent yield in early February.[19]

The interest rate on day-to-day loans stiffened the second week in February. Investment dealers were inclined to

[19] Financial Post- Editorial- Easy Money Policy, Feb. 19,1955, p.3.

attribute the change to a sudden and probably temporary shortage of funds for this purpose at the chartered banks. Dealers had been paying the banks the all-time low interest rate of 1/2 per cent as late as February 19, but by February 22, the prevailing rate went to 3/4 per cent. On February 23, the day-to-day loans outstanding at chartered banks totaled $87.1 millions.

During the first two weeks of March the interest rate continued to fluctuate around 1 per cent and was 1-1/8 per cent on March 12. This trend towards higher rates reflected the difficulty that dealers were experiencing in procuring loans from the chartered banks, and towards the middle of March, dealers were again obliged to seek funds from the Bank of Canada at the recently reduced penalty rate of 1-1/2 per cent. Day-to-day loans outstanding had been reduced from the February 23 position of $87.1 millions to $72.9 millions at March 2.

The investment dealers attributed this tightness in the money market to three reasons: First there was an increased demand for higher yielding call and short-term loans from the bank. Second, as deposits had been on the increase, the banks were obliged to hold more cash on hand to maintain their 8 per cent reserve. Third, the Government had recently increased it's weekly offerings of treasury bills from $40 millions to $50 millions and thus took an additional $10 millions in

cash from the banks each week. The 91-day treasury bill issue of March 10 declined to 1.07 from 1.13 per cent the week before, but rose from 1.21 to 1.25 per cent for the 9 months bills.

This has been a brief and general presentation of the mechanical workings of our newly created money market up to the end of March 1955. Although a year is too brief an interlude to pass judgement upon the money market experiment, certain conclusions are admissable.

The foundation upon which the money market was built and the mechanism of its operation was severely tested twice, and was not found wanting. The money market was well able to weather the storm of recalled loans without damage to its structure. The lenders have fulfilled their obligation to determine interest rates competitively and to have this rate fluctuate with the sensitive interest rate on treasury bills. The impersonal atmosphere of the new market has prevailed and day-to-day loans have varied between $50 and $100 millions. The chartered banks now possess a liquid asset which represents about one-half per cent to one per cent of their deposit liabilities.

An increase in the flow of short-term funds seeking investment is already very apparent; the chartered banks have taken advantage of the facilities provided by the market, and non-financial corporations and municipalities have found this

market a decided advantage in investing idle funds.

As yet the market is mainly confined to short-term government securities, but this in itself is a major advance. In time, a better market for non-government instruments may develop and thus help to channel funds in directions that will further the growth of the economy.[20] A progressive market is bound to increase the efficiency of monetary policy and enhance the role of rediscount policy. A broader money market would also tend, by creating more sensitive connections with the related markets for longer-term government securities, to increase the effectiveness of open market policy. There is little doubt that the development of an active short-term securities and day-to-day market will in time become one of the most significant contributions to the economic structure of Canada.

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[20] The problem of surplus funds occasioned another monetary change when the Provincial Central Credit Unions received a Federal Charter to assist them in strengthening the economic structure by making a greater and more efficient use of idle capital. (See Appendix E).

## CONCLUSION

As a result of the extensive recent changes in our monetary structure, in the nature of economic thinking and in the economic problems confronting contemporary Canada, this thesis has been written.

It has attempted to extend the frontiers of knowledge which circumscribed these important innovations.

The first chapter presented a broad perspective of the most important revisions to the Bank Act and the Bank of Canada Act.

In Chapter II the central theme was the powerful instrument of monetary control that the Bank of Canada received with the establishment of variable legal cash reserves. As there have been no excessive inflationary tendencies in our economy this authority has not been used as yet, but the change is a future manifestation of the belief in Canadian banking circles that the real check to monetary abuses lies in the sagacity of the Central Bank, a belief already exemplified in the fact that there is no legislative restriction on the amount of the note issue or on the size of the Central Bank's deposit liabilities.[1]

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[1] While section 23(1) of the Bank of Canada Act requires the Bank to maintain a reserve of gold of 25 per cent of its outstanding notes and deposit liabilities, the Governor-in-Council may suspend this regulation for a period not exceeding one year.

It has also been quite evident that the cash reserves of the chartered banks, now guided by an 8 per cent minimum, have been more than adequate to allow the banks to meet all demands for loans and still to take a very active part in the new day-to-day loan market.

The easing and extension of bank loan regulations have had a very important and beneficial effect upon the whole economy. While the banks have not availed themselves of the chattel mortgage privilege to any great extent so far, sections 82 and 88 have aided immeasurably the people who fall within their category. These sections play no small part in the continued growth and strength of the natural resources industry.

One of the most surprising and pleasing features arising out of the broadened bank loan regulations has been the wholehearted support given the N.H.A. (1954) by the chartered banks. In fact, the actual results have been a revelation to the Government and to the banking system itself. Since the inception of the Act on March 22, 1954, to April 30, 1955, the chartered banks have made commitments for N.H.A. mortgages of more than $210 millions. This figure represents about 23,000 homes built, or being built on bank credit, a highly commendable contribution towards alleviating the Canadian housing shortage. The banks also point with personal pride to the significant number of homes they have financed

in the smaller and more isolated areas. This too is a notable achievement stemming directly from one of the most important of the structural changes.

The creation of a short-term money market has more than justified its existence during the past year. It has proven to be an effective method for the efficient channeling of money for development purposes and capital investment. After one year of operation this market has been instrumental in increasing the holdings of treasury bills by the general public. On May 31, 1954, there were $74 millions in treasury bills held outside the banking system, a large amount of these were held by investment dealers and a relatively small proportion by the general public. On April 27, 1955, holdings of treasury bills outside the banking system amounted to $338 millions, a substantial increase of which approximately $250 millions were held by the general public, the remainder by investment dealers.

The introduction of the day-to-day loans also had a significant influence upon the chartered banks. On May 31, 1954, the banks had $266 millions in treasury bills and no day-to-day loans. On April 27, 1955, they held $366 millions in treasury bills and $69 millions in day-to-day loans, an over-all increase of $169 millions which represented 1.7 per cent of the Canadian deposit liabilities.

## CONCLUSION

The interest rates on day-to-day loans offer a very clear pattern of the keen and unrestricted competitive forces in the market to-day. Rates have ranged from a high of 1.5 per cent in June 1954, to a low of 0.5 per cent in January, February and May 1955.

It has often been said in the past decade that Canada is a little giant that is standing on the threshold of greatness, and this is quite true. But much of the time these platitudes of plenty have been based on superficial appraisals of the economy. True greatness occurs by design and not by accident. Therefore, these structural changes in our economy have been part of a predetermined plan to direct the nation towards its ecomonic destiny.

This thesis has attempted to adequately express these significant revisions in their true light and to present a reliable forecast of their future influence.

Therefore an important question now before us is, "what future influence will the foregoing alterations in our monetary framework have upon the Canadian economy?".

As long as the Canadian banking system continues in its established tradition of sound and stable banking procedures and is guided by a foresighted policy of evolutionary adaption to changing financial needs, as was evident in the last Bank Act revision, the banking system is well prepared to continue to play a dynamic role in the future development of Canada's great economic potential.

As long as the Canadian monetary authorities continue to realize that monetary stability must be achieved with a maximum of freedom, then the individual initiative of the commercial enterprisers and the general public will prevail in a strong and healthy environment, highly conducive to rapid and sustained economic growth. The new monetary control powers of the Bank of Canada were influenced by this intelligent policy.

The creation of a broad and responsive market in short-term securities and the existence of the machinery which directs its operation has made possible the use of all available funds into the most highly productive channels. The utilization of our domestic savings will insure that the rate of capital investment, so necessary for Canada's expansive formation will be adequate.

These recent monetary changes have been momentous strides towards the attainment of a truly mature economic system.

Thus the long-term outlook is one of continued growth and development. Canada's position of pre-eminence in the field of natural resources, coupled with the ingenuity of her people possess the key to continued prosperity if these resources are adequately developed. The fruition of this goal can be attained through the concentrated and co-operative efforts of a progressive banking system, an enterprising and industrious public, and a zealous and responsible government.

If the growing trend towards closer harmony between these three powerful forces continue, then the realization of Canada's great economic destiny is but a matter of time.

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## APPENDIX A

## LIST OF APPROVED LENDERS UNDER NATIONAL HOUSING ACT, 1954

The definition of an approved lender as outlined in section 2(2) of the National Housing Act 1954 is as follows:

"approved lender means a lender approved by the Governor-in-Council for the purpose of making loans under this act".

There are no specific requirements set out in the National Housing Act for approved lenders, but each application is appraised on its individual merits by the Governor-in-Council.

### NATIONAL HOUSING ACT, 1954 - APPROVED LENDERS

| Company | Head Office for Canada |
|---|---|
| Bank of Montreal | Montreal, Quebec |
| Bank of Nova Scotia, The | Toronto, Ontario |
| Barclays Bank (Canada) | Montreal, Quebec |
| Canada Life Assurance Company, The | Toronto, Ontario |
| Canada Permanent Trust Company, The | Toronto, Ontario |
| Canada Trust Company, The | London, Ontario |
| Canadian Bank of Commerce, The | Toronto, Ontario |
| Chartered Trust Company | Toronto, Ontario |
| Confederation Life Association | Toronto, Ontario |
| Crown Life Insurance Company, The | Toronto, Ontario |
| Crown Trust Company | Toronto, Ontario |
| Dominion Life Assurance Company, The | Waterloo, Ontario |
| Empire Life Insurance Company, The | Kingston, Ontario |
| Equitable Life Insurance Company of Canada, The | Waterloo, Ontario |
| Equitable Trust Company, The | Winnipeg, Manitoba |
| Excelsior Life Insurance Company, The | Toronto, Ontario |
| Fidelity Life Assurance Company | Regina, Saskatchewan |
| Great-West Life Assurance Company, The | Winnipeg, Manitoba |
| Guaranty Trust Company of Canada | Toronto, Ontario |
| Guardian Trust Company | Toronto, Ontario |
| Huron and Erie Mortgage Corporation, The | London, Ontario |
| Imperial Bank of Canada | Toronto, Ontario |

| Company | Head Office for Canada |
|---|---|
| Imperial Life Assurance Company, The............ | Toronto, Ontario |
| Independent Order of Foresters, The............. | Toronto, Ontario |
| Industrian Life Insurance Company.............. | Quebec, Quebec |
| Investors Syndicate of Canada, Ltd............. | Winnipeg, Manitoba |
| La Laurential Companie- D'Assurance Sur La Vie. | Montreal, Quebec |
| London Life Insurance Company, The.............. | London, Ontario |
| Manufacturers Life Insurance Company, The....... | Toronto, Ontario |
| Mercantile Bank of Canada, The.................. | Montreal, Quebec |
| Montreal City and District Savings Bank........ | Montreal, Quebec |
| Montreal Trust Company......................... | Montreal, Quebec |
| Mutual Life Assurance Company of Canada, The.... | Waterloo, Ontario |
| National Canadian Bank......................... | Montreal, Quebec |
| New York Life Insurance Company................ | Toronto, Ontario |
| North American Life Assurance Co. of Canada.... | Toronto, Ontario |
| Northern Life Assurance Company of Canada, The.. | London, Ontario |
| Provincial Bank of Canada, The.................. | Montreal, Quebec |
| Prudential Assurance Company Limited, The....... | Montreal, Quebec |
| Prudential Insurance Company of America, The.... | Toronto, Ontario |
| Prudential Trust Company Limited............... | Montreal, Quebec |
| Royal Bank of Canada, The....................... | Montreal, Quebec |
| Royal Trust.................................... | Toronto, Ontario |
| Sovereign Life Assurance Company of Canada, The. | Winnipeg, Manitoba |
| Standard Life Assurance Company, The........... | Montreal, Quebec |
| Sun Life Assurance Company of Canada........... | Montreal, Quebec |
| Toronto-Dominion Bank.......................... | Toronto, Ontario |
| Toronto General Trusts Corporation, The......... | Toronto, Ontario |
| Victoria and Grey Trust Company................ | Owen Sound, Ontario |
| Waterloo Trust and Savings Company, The........ | Kitchener, Ontario |

## CHART A

# SOURCES OF THE NEW CANADIAN HOUSING DOLLAR

## 1953

| OWNERS | | | | | PRIVATE MORTGAGE LENDERS | | | | | GOVERNMENT | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Full Owner Financing | | | Owners Equity | | Life Companies | | T & L | | Others | Joint Loans | Direct Mortgages | Direct Gov't Hous'g |
| From Sales of Real Estate | From Cash and Sales of Securities | Owner Labour and other | Subject to Mortgages from Lending Institutions | Subject to Mortgages other than from L. I. | N. H. A. | Conventional | N.H.A. | Conventional | Conventional | | | |
| 11¢ | 11¢ | 6¢ | 16¢ | 15¢ | 14¢ | 4½ | ½ | 2¢ | 7¢ | 5¢ | 4¢ | 4¢ |
| 28¢ | | | | | | | | | | | | |
| 59¢ | | | | | 28¢ | | | | | 13¢ | | |

### EXPENDITURES ON HOUSING FACILITATED BY MORTGAGE LOANS

| LENDING INSTITUTIONS | OTHERS |
|---|---|
| 42¢ | 26¢ |

### Sources of Funds for Expenditures on Housing Facilitated by L. I. Mortgages

| Lending Institutions | | Owners' Equity | | Gov't |
|---|---|---|---|---|
| N.H.A. | Conventional | N.H.A. | Conventional | |
| 14¢ | 7¢ | 10¢ | 6¢ | 5¢ |
| 21¢ | | 16¢ | | 5¢ |

Economic Research Dept., C.M.H.C.

APPENDIX B

Appendix "C"

## APPENDIX C

### HYPOTHETICAL EXAMPLE OF LOAN PROCESSING AND LOSS SETTLEMENT

| | | Principal | Borrowers Charges | Interest | Total |
|---|---|---|---|---|---|
| Jan. 1 | Amounts owing at default | $9,900.000 | $750.00 (taxes) | Nil | $10,650.00 |
| Jul. 1 | Interest charges (assume 5 per cent) | | | $266.25 | $10,916.00 |
| Nov. 1 | Foreclosure completed Interest acrued | | | $183.93 | $11,100.18 |
| Nov. 1 | Solicitors Fees | | $220.00 | | |
| Nov. 1 | Solicitors Disbursements | | $ 45.20 | | $11,365.38 |
| Nov. 1 | Total Debt at Completion of Foreclosure | | | | $11,365.38 |
| Dec. 1 | Accrued Interest to settlement with CMHC | | | | 46.71 |
| | | | | | $11,412.09 |

Settlement Details

| | | | | |
|---|---|---|---|---|
| (a) | Sec. 9(1)(a) | Principal............. | $9,900.00 | |
| (b) | Sec. 9(1)(b) | Taxes ................ | 750.00 | |
| (c) | Sec. 9(1)(c) | Interest ............. | 266.25 | (6 mos. at 5 per cent on (a) and (b)) |
| (d) | Sec. 9(1)(d) | Interest ............. | 137.23 | (5 mos. at 3 per cent on (a)(b)and(c) |
| (e) | Sec. 9(1)(d) | Acquisition Fee ...... | 125.00 | |
| | | -Taxed Disbursements | 45.20 | |
| | | | $11,233.73 | |

Less 2 per cent of (a) ...$198.00
Less 2 per cent of (c) ... 5.32

| | |
|---|---|
| | 203.32 |
| | $11,020.41 |

Loss to Lender ......................$391.68 or 3.43 per cent of its account.

# APPENDIX D

## AUTHORIZED INVESTMENT HOUSES IN DAY-TO-DAY CALL LOAN MARKET

A.E. Ames and Company

Burns Bros. and Denton Limited

Dawson, Hannaford Limited

Dominion Securities Corporation

Equitable Securities of Canada Limited

Greenshields and Company

Harris and Partners Limited

McLeod, Young, Weir and Company

Mills, Spence and Company

Nesbitt Thomson and Company

Royal Securities Corporation

E.M. Saunders Limited

Wood, Gundy and Company

## APPENDIX E

### CO-OPERATIVES OBTAIN FEDERAL CHARTER

The necessity of having an organization capable of channeling surplus funds into productive channels was the reason seven provincial central credit unions[1] petitioned Parliament for a federal charter to incorporate the Canadian Co-operative Credit Society Limited. The provincial centrals felt that they were unable to accomplish their full purpose without a dominion central.

The great growth of the credit union movement in the last fifteen years was phenomenal. In 1935, there were approximately 200 or 300 credit unions with the majority in Quebec; by 1940 there were about 1,000; by 1944, 2000, and at the present time there are approximately 3,600 of them spread all across Canada.[2]

This expansion brought with it changing conditions and new problems. Operations on a larger scale naturally brought about different demands for loans between the credit unions. Some unions accumulated surplus funds and being unable to find loan outlets with their subscribers, were forced to seek out investment opportunities. The new mode of operations brought about the need for a central co-ordinating body which could direct all surplus funds into the most productive places. This gap between the various local credit

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[1] See Schedule A

[2] See Schedule B

unions was closed when Quebec formed its first provincial federation in 1932.

With a provincial federation, the individual credit union with a surplus of funds may deposit them with the central credit department of the provincial league. If an individual credit union does not have enough current assets to meet loan demands, it can borrow from the league's central credit department. Thus the provincial leagues function as credit unions for credit unions.

As the other provinces recognized the value of this federation they soon followed the example of Quebec and established their own provincial centrals.

As the credit union movement continued its prodigious expansion the provincial federations began playing a more vital and important role in the credit union structure. The provincial centrals themselves began to expand, and a prime example is that of the Saskatchewan Central which has assets over seven million dollars. The movement expanded until in 1953 it had total assets of nearly 500 million dollars and held 4.8 per cent more savings than the trust and loan companies.[a] It was these factors of growth that prompted some of the provincial centrals with the backing of the Co-operative Union of Canada to feel that they could contribute a greater service to the financial life of the nation if allowed to operate on a dominion basis. They believed that operating on

[a] Financial Post: Feature Article, January 15, 1955, p.[illegible].

this enlarged scale would allow them to fully utilize the surplus funds of all provincial centrals in the most beneficial manner possible.

Therefore, in the late Autumn of 1952, seven of the provincial centrals petitioned Parliament for incorporation of a Dominion Central which in April 1953 was granted to them.

After being incorporated as a Dominion Central, the Canadian Co-operative Credit Society Limited was organized in late 1954 and is only awaiting certification by the Treasury Board to begin operations.

## SCHEDULE A

Saskatchewan Co-operative Credit Society Limited
Nova Scotia Credit Union League Limited
British Columbia Central Credit Union
Ontario Co-operative Credit Society
Prince Edward Island Credit Union League Limited
Alberta Central Credit Union Limited
Co-operative Credit Society of Manitoba Limited

## SCHEDULE B

### CREDIT UNION COUNT, COAST TO COAST
### DECEMBER 31,1953

| Province | No. | Membership | Assets |
|---|---|---|---|
| Newfoundland | 78 | 3,338 | 310,614 |
| Prince Edward Island | 53 | 9,625 | 1,137,211 |
| Nova Scotia | 221 | 49,831 | 7,255,455 |
| New Brunswick | 162 | 51,823 | 7,422,022 |
| Quebec | 1,252 | 804,101 | 337,740,617 |
| Ontario | 910 | 237,399 | 63,167,673 |
| Manitoba | 170 | 46,467 | 11,038,964 |
| Saskatchewan | 268 | 68,286 | 28,471,111 |
| Alberta | 210 | 34,857 | 7,800,024 |
| British Columbia | 283 | 87,808 | 28,040,331 |

(Information taken from Financial Post)
January 15, 1955, p.49