Modern Business

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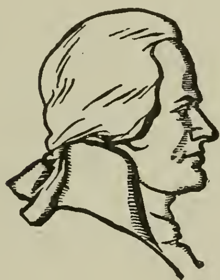

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Modern Business

BANKING PRINCIPLES AND PRACTICE

BY

Edward Lloyd
E. L. STEWART PATTERSON
Superintendent of Eastern Township Branches,
Canadian Bank of Commerce

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PREFACE

It would be impossible within the narrow confines of one volume to deal exhaustively with so extensive a subject as that of Canadian banking practice, but it is hoped that the parts of this subject dealt with herein will be found to be treated with due regard to their relative importance, and that no really essential information has been overlooked. As far as possible, all matters coming within the scope of the Bills of Exchange Act have been purposely omitted, because an intimate knowledge of the act itself is essential to every business man and banker.

Altho Canadian banks may differ in bookkeeping and methods, the general principles and aims of their systems are the same, and the reader should have no difficulty in understanding the forms and methods explained in the Text, and in interpreting them by his own experience. Too specific explanations have been avoided as far as possible, lest the principles involved should be buried under a mass of detail.

The present edition of the Text has been revised tho without any attempt to cover the post-war conditions which at the time of writing are still in process of readjustment. Many of the illustrations have been drawn from the experience of the years just preceding the war as they reflect the normal life of

Canadian banking. Statements regarding the years of war have been omitted as they are too indicative of abnormal conditions to be of more than passing interest in a study of the principles of banking.

J. L. Stewart Patterson.

Sherbrooke, Que.

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PART I
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BANKING PRINCIPLES

CHAPTER I

HISTORICAL SKETCH

1. *Introduction.*—In an intelligent study of the Canadian banking system particular stress should be laid on the fact that the system has been evolved, not made; that it has grown up with the country, suffered with it, prospered with it and, since the Confederation, been the backbone of commerce and agriculture. The careful decennial revisions of the banking laws have kept the system continually in touch with the requirements of Canada's constantly altering conditions. In fact, in no other country does the history of banking support so forcibly the contention of Horace White in his "Money and Banking":

> The principles of banking are the outgrowth of experiment. They must be learned from the history of banking and particularly from the laws that have been enacted from time to time. These laws are the crystallization of ideas dominant at given periods.

The history of banking in Canada may be roughly divided into four periods:

New France	1608–1763
British Occupancy	1763–1817
Provincial Banking	1817–1867
National Banking System	1867–

2. *New France.*—During this period (1608–1763) Canada had its first, and it is to be hoped its last, experience in "fiat" money. In lieu of a better circulating medium, beaver and other furs, wheat and tobacco were accepted in trade, and tho at first the issue of government obligations in the shape of "ordonnances" and card money were a welcome relief, the scandalous abuse of this privilege quickly brought it into disrepute, for no matter in what form, or under what conditions these obligations were issued, they all traveled the same road to ultimate depreciation.

The country found itself at the time of the capitulation, in 1760, loaded with a tremendous debt of over 80,000,000 livres outstanding, of which some 34,000,000 livres were in ordonnances, 7,000,000 in card money and treasury bonds and the balance in other forms of obligation. This formed one of the most difficult problems that confronted the British government and, notwithstanding the impoverished condition of France, the British insisted upon a definite basis of settlement. Accordingly, a convention was signed in 1766 under which bills of exchange and kindred obligations were to be redeemed by the French government at 50 per cent of their face value, and ordonnances and other forms of debt at 25 per cent. Owing to circumstances which need not be entered into here, the unfortunate holders eventually received only a moiety of this settlement.

The history of this period presents an instructive lesson on the evils of money issued on credit only, even tho the credit is that of a government. There is no doubt that Alexander Hamilton had the sad experience of New France before him when he made his severe stricture on government issues based on credit. In his report on banking in 1790, he said:

> The emitting of paper money by the authority of the government is wisely prohibited to the individual states by the national constitution, and the spirit of this prohibition ought not to be disregarded by the government of the United States. Tho paper emissions under a general authority might have some advantages not applicable and be free from some disadvantages which are applicable to the like emissions by the states separately, yet they are of a nature so liable to abuse, and it may even be affirmed so certain of being abused, that the wisdom of the government will be shown in never trusting itself with the use of so seducing and dangerous an expedient.

3. *British occupancy (1763–1817).*—The British government found the country practically without any currency, and immediately took steps to place the finances of the colony on a stable foundation by establishing an equitable and permanent standard of value for the various coins which now became current in Canada. The government imported and paid out large quantities of Spanish milled dollars at 4s. 6d. per dollar or \$4.44⅘ per pound sterling, the old par

of exchange. These were used for the payment of the army and the purchase of public supplies.

In 1791 representative government was established and during the next few years several unsuccessful attempts were made to obtain charters for banks of issue.

4. *Army bills.*—In 1812, during the war with the United States, the British government, finding itself hampered by a serious lack of currency, met the difficulty by the passage of the Army Bill Act. Under this act the Army Bill office was established and empowered to issue bills of various denominations. These bills were readily absorbed by the people, who were quick to realize the advantage of a system of financing so carefully thought out with a view to prompt and satisfactory redemption, and with that quality of elasticity which later became such a prominent feature in the bank note circulation of Canada.

5. *Provincial banking (1817–1867).*—The contraction of the Army Bills circulation naturally caused great inconveniences to the public; the principal business centers, Montreal and Quebec, being the greatest sufferers. The bills filled a long-felt want and in May, 1817, to supply their place, the Montreal Bank, now known as the Bank of Montreal, was founded, followed by the establishment of other banks under charter from the various provinces. Between 1817 and 1825 two banks were established in Lower Canada (Quebec), and one each in Upper Canada (Ontario), New Brunswick and Nova Scotia. There

was no attempt at uniformity in the conditions of the various charters, but little attention having been paid in those days to the theory of banking. As a rule, the charters were based upon the articles of agreement as drawn up by the incorporators and, as might be expected under such circumstances, many of the clauses were dictated by selfishness or originated in a total misconception of the functions of a bank.

This unsatisfactory situation was further complicated by independent ventures into the field of banking legislation by the Parliament itself, such as the "Free Banking Act" and the "Provincial Note Act." Fortunately, the British government was fully awake to the dangers of promiscuous banking, and even at the risk of having interference in these matters misconstrued, persisted in demanding that all legislation bearing on note issues, banking and the like, should receive the royal assent before going into effect. The young colony at first resented this restriction, but soon learned to appreciate the guidance of riper and more experienced judgment, and undoubtedly this wise action on the part of the Colonial Office saved Canada from being the exploiting ground of many unsound and dangerous banking theories. As it was, many vicissitudes were experienced, and in 1837, during the rebellion, a temporary suspension of specie payments occurred under permission of an order in council. The necessity for this, however, can hardly be considered a reflection on the banks, as it was due principally to similar tho more serious conditions which obtained at that time in the United States, Canada then as now being intimately concerned in the financial welfare of its neighbor to the south.

Considering the physical and other disabilities under which these early banks labored, their record is surprisingly creditable, and much of their experience and foresightedness is embodied in the present Bank Act. In fact, from 1829 to 1866, not one bank failed. True, trying times and heavy losses were met time and again, but with the exception of the authorized suspension in 1837, which was very reluctantly taken advantage of, the banks not only remained solvent, but maintained the redemption of their obligations in specie.

6. *National banking system.*—In July, 1867, the British North America Act was passed by the Imperial Parliament, under which the provinces of Canada were confederated into the Dominion of Canada. The framers of the Act, with creditable foresight, realized that the banks, like the railroads, in order to discharge most effectively their natural functions, must be national rather than provincial in character, and to this end vested in the parliament of the new Dominion the exclusive authority to legislate on all matters pertaining to banks and banking, currency and coinage, negotiable instruments and kindred matters. With the passing of the Act the existing banks came automatically under the new jurisdiction. Tentative legislation between 1867 and 1870 extended

the powers of the banks previously incorporated by the provinces to the whole Dominion and unified the laws as far as practicable.

7. *First bank act 1871.*—The first general bank act of the Dominion was passed in 1871. By this act the duration of a bank's charter was practically limited to ten years, and as the charters of the banks expired they were renewed until the following revision of the act. The renewals of the charters were thus made concurrent with decennial revisions of the act in 1880, 1890, 1900, and so on. Various amendments were made during the first few years, but since then, except at the regular revisions, changes have been infrequent, and have been made only to meet some contingency due to the rapid expansion of Canada, or to correct some omission or ambiguity overlooked in the previous revision.

The last revision should have been made in 1910, but owing to causes which it is not necessary to detail here, the charters of the banks were extended to 1913. The delay, however, was accompanied by little or no inconvenience to those concerned; the charters of the various banks were extended until the new act was finally passed. Changes that were imminently necessary were looked after by special amendments to the act of 1900.

In many ways the delay was not without its advantages. The tremendous expansion in the financial and commercial life of Canada demanded that the revision should be most carefully and presciently considered. During 1913, the banking system of Canada was freely discussed, both in the public press and in special committees appointed for the purpose.

It is notable that the revisions are made neither by theorists nor tainted with political expediency. The ablest men in the country, regardless of their politics, are consulted and give evidence before the parliamentary committee. Lawyers, merchants, farmers, bankers and others equally well qualified contribute their criticism and advice towards the advancement of the best interests of the country. The measures are then fully debated, and when finally passed, are acceptable to all interested.[1]

8. *Canadian Banking System under War Conditions.* — An historical sketch on Canadian banking would be incomplete without a reference to the notable services rendered the nation and the Allied cause by the quiet and efficient manner in which the Canadian banking system adapted itself to the troubled and abnormal conditions encountered. From the outbreak of the war in August 1914 to the present time under both war and after-war conditions, the branch system of banking combined with an asset currency gave further proof of its value for the equable and economic distribution of loanable funds throughout a vast area, under adverse conditions, and with the least possible disturbance of business or displacement of reserves.

[1] The changes effected by the Bank Act of 1913 are explained in the following chapters.

Elasticity and adaptability to new conditions have always been among the chief characteristics of the Canadian banking system, and these qualifications could be subjected to no more severe test than when Canada, as a belligerent nation, found herself confronted by the complicated and innumerable problems raised by war conditions. The majority of these problems at the outset of the war were of a financial and fiduciary nature, and the Government naturally looked to the banks for assistance and advice. The latter were equal to the occasion, and exhibited a reserve of power and a capacity for overcoming these new and trying conditions from their ordinary resources, with little or no recourse to the remedial measures passed by the Government, whose real value rested in their moral effect, in the assurance to the public that provision had been made, so far as lay in the power of the Government, to enable business to go on as usual.

Altho no moratorium was declared in Canada, the Dominion Government, more as a matter of preparedness than of necessity, made bank notes equivalent to gold or legal tender, extended the emergency currency privilege thru the whole year (instead of the usual period, September first to February twenty-eighth) and made provision whereby the banks could borrow from the Government against the deposit of approved securities or commercial paper.

It was fortunate for Canada that for some time prior to the war the banks had been strongly advising retrenchment in expenditure and discouraging any tendency on the part of their customers to overexpand or overproduce. The outbreak of war, therefore, found bank loans in process of satisfactory reduction, and no undue war pressure on the part of the banks was necessary to continue the healthy liquidation then in process, the public being more than ever aware of the necessity for reduction in loans and retrenchment generally. Commercial loans in Canada decreased $156,-000,000 between June 30th, 1914, and October 31st, 1916, when they stood at $884,000,000. From the latter date, however, a general increase was noticeable. due to the requirement of munitions and other war industries, and at the cessation of hostilities current loans amounted to over a billion dollars. The reconstruction period following the war, notwithstanding the restrictions placed by the banks on advances to non-essential industries, is responsible for a still further increase, and at the end of July, 1920, the loans stood at $1,377,000,000. A great deal of this amount, however, is ascribable to the heavy increase in the cost of goods, which has arisen 50 to 100%, requiring an additional amount to that extent to finance.

During the war and after, the banks assisted in financing both the Dominion and Imperial Governments to amounts running into hundreds of millions, and the banks, trust companies and brokers rendered the nation invaluable aid in the floating and collection of the various war loans

Altho Canada was in the war from the beginning of hostilities to the end, and her sacrifices in men and treasure were great, her gains also were great, in prestige, in prosperity, in national spirit and in self reliance. Her position financially and commercially is on as sound a basis as possible under present world conditions, and her currency is as little inflated as that of any nation in the world, the United States not excepted.

This brief account of banking in Canada is given, not as a history, which would be without the scope of this volume, but in order to assist the reader in realizing that the growth of the banking system of Canada has been one of evolution rather than of expediency or hasty legislation, and that the machinery provided for the systematic and regular revision of the Bank Act is invaluable in meeting the tremendous expansion and constantly changing requirements of Canadian commerce and agriculture. This chapter, read in conjunction with the chapter on the Bank Act, and the explanation of the branch system and note circulation, should demonstrate clearly how far the functions performed by the banks in Canada respond to the requirements of a new country, as defined so lucidly by Sir Edmund Walker:

> What is necessary in a banking system in order that it may answer the requirements of a rapidly growing country and yet be safe and profitable?
>
> 1. It should afford the greatest possible measure of safety to the depositor.
>
> 2. It should supply the legitimate wants of the borrower, not merely under ordinary circumstances, but in times of

financial stress, at least without that curtailment which leads to abnormal rates of interest and to failures.

3. It should possess the machinery necessary to distribute money over the whole area of the country, so that the smallest possible inequalities in the rate of interest will result.

4. It should create a currency free from doubt as to value, readily convertible into specie, and answering in volume to the requirements of trade.

There should be as complete a relation as possible between the currency requirements of trade and the cause which *issues* paper money, and, as it is quite as necessary that no over-issue should be possible, and that the supply of currency should be adequate, there should be a similar relation between the requirements of trade and the cause which *forces notes back* for redemption.

REVIEW

Upon what fact should we lay particular stress in studying Canada's banking history?

What were the first steps taken by the British government to place the finances of the colony on a stable foundation?

What is the duration of a bank's charter? Why is this desirable?

According to Sir Edmund Walker what should a banking system do to meet the requirements of a rapidly growing country?

CHAPTER II

KINDS OF BANKS

1. *Commercial banks.*—In the Bank Act of Canada, no attempt is made to define the functions of a bank in general terms; the Act merely states that "a bank means any bank to which this act applies." A bank in Canada therefore means one of the chartered banks, as the law prohibits the use of the word "bank" by any other institution.

Economists have defined the functions of a bank in many different ways, but all arrive at the same general conclusions.

Horace White, in his "Money and Banking," thus defines a bank:

> An institution where deposits of money are received and paid, where credit is manufactured and extended to borrowers, and where the exchange of property is facilitated. Having first acquired the confidence of the community, the bank extends its credit by purchasing interest-bearing securities, mainly business men's notes, payable at a fixed time and giving the sellers the right to draw checks upon itself payable at sight. The amounts thus authorized to be drawn are termed deposits, the bank being liable for them in the same way as for actual money deposited. . . . Bank notes are the bank's promises to pay money to the bearer on demand.

All these functions are discharged by the Canadian banks, but their economic value is greatly enhanced by the system of branches, which enables the banks to gather and distribute money over the whole area of the country, thus utilizing, as far as possible, the supply of loanable capital to meet the demand. In other words, thru the branch system, money is constantly working to find its own level. The Canadian banks are, therefore, essentially of a national rather than of a local character.

2. *Savings banks.*—The main function of a savings bank is to encourage thrift in a community by accepting, for deposit, money in small amounts and allowing interest thereon. Upon deposits of this class, no matter how small the amount, the chartered banks of Canada pay interest and they operate as part of each branch what is called a Savings Bank Department. Consequently the need of special institutions for this purpose has hardly been felt in Canada.

Outside the government savings bank there are practically only two savings banks in the country, namely: the City and District Savings Bank, Montreal, and La Caisse d'Economie, Quebec. These are well-known institutions and are highly successful in encouraging thrift especially among the Canadians of French origin.

The Dominion government supports two savings banks, one the Postal Savings Bank, which is operated by the Post Office Department and accepts deposits at every post office, and the other called the

Government Savings Bank, which is under the control of the Finance Department. The latter receives deposits at comparatively few points, principally in the larger towns in the maritime provinces, and its business is gradually being merged with that of the Postal Savings Bank. The money received from these savings banks is regarded by the government as a loan, which practically replaces money that could be borrowed outside of Canada. The rate of interest in both banks is 3 per cent. Each entry costs about 12 cents or .62 per cent of the average deposit, making a total of 3.62 per cent.[1] It is easily seen that if an adequate reserve were maintained it would bring the cost of these deposits to over 4½ per cent. The government, however, avoids the expense and responsibility of maintaining an adequate reserve by a clause in the Bank Act which makes it compulsory for the banks to honor government checks without charge wherever presented, and all withdrawals from the savings banks are in this form.

Theoretically these savings banks are intended for the benefit of the poorer and more ignorant classes of the community. It is not intended that the well-to-do should avail themselves of the privileges they offer, and to this end there is a limit placed on the amount which may be deposited.

3. *Trust and loan companies.*—Of late years a considerable number of these companies have been organ-

[1] Hearing before House Committee on Post Office Savings Bank 1909, page 70.

ized in Canada under provincial or Dominion charters, and as it is an open question whether their control is vested in the Federal or in the provincial authorities, some companies, to make sure of their position, have obtained charters from both sources.

Trust and loan companies are supposed to enter into the field of banking only in so far as it is necessary to transact their especial business. There is a tendency, however, recently developed, to enter into competition with the banks in various ways, especially in canvassing for demand deposits. This is a dangerous practice for trust companies to indulge in, for demand deposits require special provision in the shape of cash reserve, and a study of the annual statement of the average trust or loan company will show how little this responsibility is realized or provided for. Like the government, each company evidently thinks it can rely on the banks in case of trouble, overlooking entirely the fact that at such times the banks themselves are making every effort to protect their own reserves, and would hardly be willing to advance money to a corporation which has all its assets locked up in real estate and other fixed securities.

One of the basic principles of credit is that the currency of the assets should not exceed the currency of the liabilities, and any departure from this principle is bound to prove disastrous eventually. The assets of trust and loan companies in Canada are invariably based entirely on real estate and other non-liquid securities, and their deposits, if any, should be composed of the long time funds of the community—those which are not regularly employed in the quick turnover of commercial life. To accept demand deposits, and then lend on real estate the funds thus obtained, is to invite disaster. To be consistent, the same sound considerations which led the framers of the Bank Act to prohibit banks from lending on real estate should work inversely, and should withhold from companies lending on real estate the right to receive demand deposits.

REVIEW

Frame a brief yet complete definition of a bank.

What feature of the Canadian banking system enables the banks to perform their functions so efficiently?

What provisions are there for savings deposits in Canada?

What valuable service do trust and loan companies perform for the country?

CHAPTER III

THE BANK ACT

1. *The Bank Act of 1913.*—The present Bank Act,[1] which came into force on July 1, 1913, consists of one hundred and sixty sections or clauses. Its leading features may be briefly summarized as follows:

1. Interpretation and application	Sections	1–7
2. Incorporation of new banks	"	8–17
3. Purchase of the assets of a bank	"	99–111
4. Insolvency and winding up, etc.	"	115–131
5. Offences and penalties	"	131a–160
6. Internal regulations as regards directors, shares, annual statements, audits, etc.	"	18–60
7. Returns to government	"	112–114
8. Note issues	"	61–75
9. Business and powers of a bank	"	76–98

It will be noted that the first five divisions deal with special conditions, such as the establishment of new banks, amalgamations, etc., and are only of occasional application. The last four, however, deal with matters of everyday banking and call for careful study. The last division, "Business and powers of a bank,"

[1] Copies of the Bank Act or Bills of Exchange Act may be obtained by remitting twenty cents for each copy to the King's Printer, Ottawa.

wherein are defined the business relations of banks with the public, is therefore of particular interest to branch officers. The other three headings deal with matters more or less pertaining to, or under the direct control of the head office.

2. *Changes in the Bank Act.*—Two very important additions were made in the present act, namely: the sections providing for a shareholders' audit, and the creation of central gold reserves in connection with the issue of extra circulation when required. Authority was given to lend money to farmers on the security of threshed grain, and a number of minor changes were made, mostly of a routine or explanatory character, such as the opening up of registry offices in the different provinces, the printing of Section 125 on stock books, documents and the like, and the establishment of several new headings in the monthly and annual statements. The central gold reserves will be dealt with in the chapter on note issues.

3. *Shareholders' audit.*—A provision for the external supervision of banks is an entirely new feature of the Bank Act. No objection was advanced by any one as to the desirability or usefulness of the external audit itself, but the problem was how to effect an audit without evoking the aid of too cumbersome or too burdensome a mechanism and how to avoid placing too great a burden of responsibility on those assuming the work, without first ascertaining how far the physical limitations of any such examination, due

to the branch system, would affect the value of its conclusions. Three forms of external supervision were given consideration, namely: examination by the Dominion government, by the Canadian Bankers' Association, and by competent accountants.

The idea of government supervision was advocated by those who were admirers of the system of national bank examinations obtaining in the United States. It is obvious, however, that even if these examinations were effective in the United States (which is very much open to question), the plan itself would not be feasible in Canada on account of the branch system. Furthermore, there is no doubt that the government inspection of a bank is taken by the public, in a way, as a guarantee of solvency. In the United States such a belief is of only local effect whereas in Canada it would be national in its influence, would practically put all banks on the same footing in the public eye, and would work a palpable injustice to those banks which have, by years of sound banking, established themselves firmly in the confidence of the public.

With such supervision, therefore, would go a great deal of responsibility for a bank failure, and this responsibility the government was naturally reluctant to assume. Another objection to government supervision would be the fact that the appointments of examiners would run the risk of being occasionally based on political expediency rather than on expert knowledge and fitness for the positions. The Canadian government was well advised in not allowing itself to be burdened with a new and unknown responsibility.

The Canadian Bankers' Association was also averse to assuming the responsibility of inspection, as such action would be considered tantamount to a guarantee by the associated banks of the solvency of the individual banks. Furthermore, no matter how impartially such a supervision was exercised by the Association, it would always be open to misconstruction, and any bank whose affairs called for criticism, would not be likely to neglect an opportunity of appealing to the public sympathy with a cry of persecution.

The system finally adopted promises to overcome the above objections and to be a satisfactory solution of the question. The act provides for the appointment of auditors by the shareholders of each bank from a panel of forty or more, selected by the general managers of all the banks, and approved by the Minister of Finance. These auditors check the cash and verify the securities of the head office and such branches as they may deem necessary to visit, and report to the shareholders annually upon the affairs of the bank.

4. *Abstract of the Bank Act.*—A knowledge of the Bank Act is most necessary in the study of both the theory and the practice of Canadian banking, and in a volume of this nature a brief synopsis of the act will be found useful. The full text of the act should be consulted, of course, when the exact wording is desired.

5. *Title and interpretations* (Sections 1–2).—The Act may be cited as THE BANK ACT. The intention of the Act in its use of certain words and expressions is clearly defined.

6. *Application of the Bank Act* (Sections 3–7).—The provisions of the Act apply to the following banks:

Name of Bank	Chief Office of Bank
The Bank of Montreal	Montreal
The Bank of Nova Scotia	Halifax
The Bank of Toronto	Toronto
The Molsons Bank	Montreal
Le Banque Nationale	Quebec
The Merchants Bank of Canada	Montreal
La Banque Provinciale du Canada	Montreal
The Union Bank of Canada	Winnipeg
The Canadian Bank of Commerce	Toronto
The Royal Bank of Canada	Montreal
The Dominion Bank	Toronto
The Bank of Hamilton	Hamilton
The Standard Bank of Canada	Toronto
La Banque d'Hochelaga	Montreal
The Imperial Bank of Canada	Toronto
The Home Bank of Canada	Toronto
The Sterling Bank of Canada	Toronto
The Weyburn Security Bank	Weyburn

The Act extends these charters from July 1, 1913, to July 1, 1923. Since the passing of the Act five banks have been absorbed by amalgamation as follows: Metropolitan 1914; Quebec 1917; Northern Crown Bank 1918; Bank of British North America 1918; Bank of Ottawa 1919.

7. *Incorporation of banks* (Sections 8–12).—The conditions under which a new bank may be organized and the procedure necessary are clearly set forth. The first step is to obtain an Act of Incorporation by means of an application signed by at least five responsible men, known as provisional directors, who are able to satisfy the Parliamentary Committee on Banking and Commerce that their project is a genuine one, that they are fully aware of the responsibility of their undertaking, and that they have the ability and backing necessary to carry out the organization of a bank successfully. If the committee reports favorably, letters of incorporation are granted, and, after ten days' public notice, the provisional directors may advertise for public subscriptions and cause stock books to be opened. No bank, however, can be incorporated with a capital of less than $500,-000, divided into shares of the par value of $100 each.

8. *Organization of banks* (Sections 13–17).—If within a year the sum of not less than $500,000 of the capital stock of the bank has been bona fide subscribed, and not less than $250,000 paid in and deposited with the Minister of Finance, the provisional directors may, by public notice published for at least four weeks, call a meeting of the subscribers for the purpose of organizing the bank. At this meeting the subscribers shall elect five or more qualified directors to replace the provisional directors, determine the date of the annual meeting, etc. A certificate of the

Treasury Board[1] permitting the bank to commence business may now be applied for, but, before issuing such a certificate, the Treasury Board must be satisfied:

1. That the payments and subscriptions are all genuine and in form;

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

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

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

5. That all other requirements have been complied with.

If everything is found satisfactory a certificate will then be granted and the deposit of $250,000 returned, less a reduction of $5,000 as the initial payment on account of the Bank Circulation Redemption Fund (see Section 64). Then, and not until then, is the new bank able to issue notes, open branches and begin the general business of banking.

9. *Refusal of certificate.*—If, however, the certificate of the Treasury Board is not obtained within one year from the date of the passing of the Act of In-

[1] The Treasury Board exercises important functions under the act, and is frequently referred to. The Minister of Finance and Receiver-General is the chairman of the board, which consists of four other ministers belonging to the King's Privy Council for Canada, nominated from time to time by the Governor-in-Council. The Treasury Board acts as a committee of the Privy Council on all matters referring to finance and public accounts, and has power to call for any information it may require from corporations and persons, etc., who are bound by law to furnish the same to the government.

corporation, all the rights and privileges granted thereunder cease, and provision is made for the equitable liquidation of any bank so unsuccessful. The severe penalties attached to any infraction of the regulations covering the incorporation and organization of banks are set out in Sections 131 and 132.

10. *By-laws* (Section 18).—The shareholders may pass by-laws regarding the following matters: the date of the annual general meeting at which shareholders elect directors; regulations (subject to limitations mentioned in Act) as to proxies; the number, quorum, qualifications, remuneration, etc., of directors; limits of loans or discounts to directors or to any one person, firm or corporation; authority to contribute to guarantee and pension funds, etc. A copy of all the by-laws of a bank must be sent to each shareholder at the end of each fifth year, beginning December 31, 1913.

11. *Board of directors* (Sections 19–28).—The stock, property, affairs and concerns of the bank are managed by a board of directors who are to be elected annually and shall be eligible for re-election, subject, however, to the following provisions:

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

The majority of the directors must be British subjects living in Canada.

The method by which directors shall be elected is provided for, also the manner in which directors shall elect the president, vice-president and fill vacancies on the board.

12. *General powers of directors* (Sections 29–30). —The directors may make by-laws for the regulation of all matters in connection with the business of the bank, the duties and conduct of the employees, and the establishment of guarantee and pension funds for the staff.

The directors are required to obtain satisfactory security from all officers and clerks for the faithful performance of their duties.

13. *Regulations as to shares and shareholders* (Sections 31–32).—A special general meeting may be called at any time for any purpose by four or more of the directors, or by at least twenty-five of the shareholders who own not less than one-tenth of the paid-up capital stock of the bank.

Votes of the shareholders at any meeting must be by ballot, and each shareholder has one vote for each share owned. Shareholders may vote by proxy, but no shareholder who is also an employee of the bank is allowed to vote.

14. *Increase or decrease of capital stock* (Sections 33–35).—The capital stock of the bank may be increased at any time by a by-law passed at a general meeting of the shareholders, subject, however, to the approval of the Treasury Board.

New shares issued must be allotted to the shareholders pro rata, on such terms as are fixed by the directors, with certain limitations as to the price, the amount and the frequency of the calls for payment thereof.

Provision is made for the reduction of the capital stock of the bank if such action should become necessary.

15. *Shares and calls* (Sections 36–42).—Shares of the capital stock of a bank shall be personal property. The manner of subscribing for shares and making calls thereon is provided for. Calls shall be made at the option of the directors, but such calls shall be payable at intervals of not less than thirty days, and in amounts not exceeding 10 per cent of each share subscribed.

There must be printed on each page of the stock book upon which subscriptions for new stock are recorded, and "on every document constituting or authorizing such subscriptions, on a part of the page and document, respectively, which may be readily seen by the person recording the subscription, or by the person signing the document, a copy of Section 125," which provides for the double liability of the shareholders.

16. *Transfer and transmission of shares* (Sections 43–53).—No transfer is valid unless the stock has been accepted in writing by the person to whom the transfer is made, and the person transferring the stock has satisfied the bank as to any liability that may be due to it.

The bank may open and maintain in any province in Canada in which it has one or more branches a share registry office, at which the shares of the shareholders resident in that province shall be registered. A list of all transfers of shares registered each day at the respective places where transfers are authorized shall be made up each day, and kept for the inspection of the shareholders.

The procedure in connection with the sale and transmission of shares under special conditions, such as writ of execution, marriage of female shareholders, lunacy, bankruptcy, death and the like, is set forth.

A bank is not bound to see to the execution of any trust, whether expressed, implied or constructive, to which any share of its stock is subject. A person holding stock as executor, trustee, guardian, etc., is not personally liable unless the trust is not disclosed.

17. *Annual and special statements* (Sections 54–55).[1]—At every annual general meeting the outgoing directors must submit a full statement of the affairs of the bank.

A statement of the profit-and-loss account for the financial year next preceding the date of the annual general meeting must accompany the statement. These statements must be signed by the general manager or other officers of the bank next in authority, and on behalf of the board by the president or vice-president or any other two directors. Copies of these

[1] See Figure 2 for prescribed form for monthly statements.

statements must be sent to each shareholder of the bank and to the Finance Minister.

The directors must also submit to the shareholders such further statements of the affairs of the bank as the shareholders may require by by-law regularly passed.

18. *Shareholders' auditors* (Section 56, all new).—Shareholders of a bank shall, at each annual general meeting, appoint and fix the remuneration of an auditor or auditors, chosen from a panel of not less than forty selected by the general managers of the banks and approved by the Minister of Finance. Full provision is made for filling the vacancy caused by the death of an auditor or the failure of the shareholders to appoint an auditor. Written notice of the intention to nominate any auditor other than a retiring auditor must be given at least twenty-one days before the annual meeting; the bank must cause a copy of such notice to be delivered to the retiring auditor, and particulars of the nomination must be forwarded to each shareholder at least fourteen days before the meeting.

Every auditor of a bank shall have right of access to the books, cash, securities and records of the bank, and is entitled to require from the directors and officers such information and explanation as may be necessary for the performance of his duties.

An auditor is not required to visit any branch for the purpose of examining the books, cash, securities and records, but he may do so if he considers it advisable. It is sufficient for the purposes of the audit if he has access to the returns, statements, and the like, which are sent to the head office in the ordinary way. He must, at least once during the year, check the cash, securities, etc., at the chief office of the bank and at those branches at which he may consider it advisable.

The auditors shall make a report to the shareholders:

(a) On the accounts examined by them;

(b) On the checking of the cash and securities;

(c) On the statement of the affairs of the bank submitted at the meeting;

The report must also state:

(a) Whether or not they have obtained all the information and explanation they have required;

(b) Whether, in their opinion, the transactions of the bank which have come under their notice have been within the powers of the bank;

(c) Whether the cash and securities agreed with the books of the bank; and

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

This report must accompany the statement submitted to the shareholders at the annual general meeting.

19. *Special report to the Minister of Finance* (Sec-

tion 56A, new).—The Minister may require any duly appointed auditor, or any auditor whom he may select, to examine and inquire specially into the affairs and business of a bank, and the auditor so selected shall, at the conclusion of his examination, report fully to the Minister the results thereof.

20. *Dividends* (Sections 57–59).—These sections deal with dividends and the method of their payment. The directors are permitted to declare quarterly or half-yearly dividends, but no dividend or bonus shall be declared which will impair the paid-up capital of the bank, or which exceeds a rate of eight per cent, unless, after paying the same and providing for all bad and doubtful debts, the bank has a rest or reserve fund equal to at least 30 per cent of its paid-up capital.

Previous to the payment of any dividend or bonus the directors must give public notice for at least four weeks prior to the date fixed for payment.

21. *Cash reserve* (Section 60).—The bank must hold in Dominion of Canada notes not less than 40 per cent of the cash reserves which it has in Canada. Arrangements for issuing Dominion notes in exchange for gold, and for redeeming them, are made at the branch offices of the Department of Finance, namely: Toronto, Montreal, Halifax, St. John, Winnipeg, Victoria, Charlottetown, Regina and Calgary.

22. *General note issue and circulation of notes* (Section 61).—A bank may issue and reissue its notes

payable to bearer on demand and intended for circulation to the amount of its unimpaired paid-up capital. No such note, however, shall be for a sum less than five dollars or for any sum which is not a multiple of five dollars.

23. *Additional issue for moving crops* (Section 61, sub-sec. 15–20.—During the usual season of moving crops—that is to say, from and including the first day of September in any year to the last day of February next ensuing—a bank is allowed to issue additional notes to an amount not exceeding 15 per cent of its combined unimpaired paid-up capital and rest or reserve fund, as stated in the monthly return to the government for the month immediately preceding that in which the additional amount is issued. While such excess notes are in circulation the banks must pay to the Minister of Finance interest on the excess at a rate not exceeding 5 per cent per annum, the interest to be calculated on the amount of notes in circulation for each day during the month, as shown in a return to be sent monthly to the Minister. This feature was added to the Bank Act in 1908 in the form of an amendment to the Act of 1901.

24. *Central gold reserve issue* (Section 61, sub-sec. 3–13).—In addition to this special provision for emergency circulation during the crop-moving period, the new act provides for an increase of circulation at any time against the deposit of current gold or Dominion notes, in what is termed the central gold reserves. These central gold reserves are under the control

of four trustees, three appointed by the Canadian Bankers' Association, and one by the Minister of Finance. It is the duty of the trustees to receive gold coin and Dominion notes that any bank may desire to deposit with them, and the bank may then issue extra circulation up to, but not exceeding, the amount of such deposit. When any part of the amount deposited in the central gold reserves is not required for the purpose of issuing notes, the surplus may be returned to the bank by the trustees upon formal application. The central gold reserves are subject to frequent inspection and audit by the Department of Finance.

25. *Note issue in British colonies* (Section 62).—Provision is made for issuing notes in pounds sterling or in dollars at agencies of a bank in any British colony or possession other than Canada. The denominations of such notes are limited to one pound sterling or any multiples of that sum, or five dollars or multiples thereof, and the amount issued in this way must be treated as a part of the general circulation of the bank.

26. *Pledge of notes prohibited* (Section 63).—A bank shall not pledge, assign or hypothecate its own notes, and no loan thereon shall be recoverable from the bank or its assets.

27. *Bank Circulation Redemption Fund* (Sections 64–69).—Each bank must maintain with the Minister of Finance a deposit equal to at least five per cent of the average amount of its notes in circulation during

the year. These deposits are known as the Bank Circulation Redemption Fund, and are held only for the purpose of redeeming the notes of any banks which fail to redeem their own issues in specie or Dominion notes. For all notes so redeemed the fund has the same rights against the estate of the failed bank as any other holder. Interest at three per cent is allowed by the Government on the fund. The amount at credit of the banks in this fund is to be adjusted on the first of July of each year, in such a way as to make the amount at credit of each bank equal to five per cent of its average note circulation during the preceding twelve months. In calculating the average circulation the average amount at the credit of the bank in the central gold reserves is to be deducted.

If a bank suspends payment of its notes, interest accrues thereon at five per cent per annum[1] until the day named for their redemption, of which public notice is given by the liquidator, after which interest on the notes outstanding ceases. If, after the expiration of two months from the date of suspension, the liquidator has not funds to redeem the notes, the Minister of Finance may redeem them out of the Circulation Fund. If payment made from the fund exceeds the contributions of the failed bank, the other banks must recoup the fund pro rata for the amount of the excess, recoveries from the liquidation of the failed

[1] The provisions contained in Sections 64–69 were added to the Bank Act of 1890, at the suggestion of the banks themselves. The rate was changed from six per cent to five per cent in the revision of 1900.

bank being, of course, distributed in like proportion. For this purpose, however, no bank shall be required to pay in any one year more than one per cent of the average amount of its notes in circulation.

In the winding-up of a bank, if satisfactory arrangements are made for the redemption of the outstanding notes, with interest, the Treasury Board may return the amount to the credit of the bank or such part as may seem expedient.

The Treasury Board will make all necessary rules and regulations as to the management of the Circulation Fund.

The Minister of Finance may take legal action, if necessary, to enforce payment of any sum due by a bank to the fund.

28. *Redemption at par* (Sections 70–71).—Banks are obliged to make arrangements to ensure the circulation at par of their notes in any and every part of Canada, and must maintain offices or redemption agencies for the payment of notes at Toronto, Montreal, Halifax, St. John, Winnipeg, Victoria, Charlottetown, Regina and Calgary, and at such other places as are from time to time designated by the Treasury Board. Altho the notes of a bank are almost invariably payable only at its head office, they must be accepted at par at any of the branches, agencies or offices of the bank.

29. *Payments in Dominion notes* (Section 72).—In making a payment a bank must, if required, pay in Dominion notes (legal tender) in denominations of

$1, $2 and $5, not, however, exceeding $100 in any one payment. No payment in Dominion notes or notes of the bank shall be made in unclean or torn bills, and the Treasury Board has the right to make regulations regarding the disinfection and sterilization of bank and Dominion notes by the banks.

30. *Signing of bills, etc.* (Sections 73–74).—Bills or notes issued by a bank are binding on a bank, tho not sealed with the corporate seal of the bank. The directors may deputize an officer of the bank to sign notes intended for circulation.

If both the signatures on a bank note are impressed by machinery, at least one name, together with a distinguishing device and number, must be impressed or engraved, under authority of the bank, after the notes have been received from the engraver or printer.

31. *Counterfeit notes* (Section 75).—Officers receiving public moneys and bank officers must stamp or write on fraudulent bank notes or Dominion notes such words as "Counterfeit," "Altered," or "Worthless," as the case may be. If, however, a bill is wrongly stamped it must be redeemed at its face value by the officer at fault.

REVIEW

What are the leading features of the Bank Act of 1913?

Give the argument for and against an audit of the banks by the Dominion Government.

State the procedure in incorporating a new bank.

What information should be contained in the auditor's report?

What provision is made for note issue in British colonies?

Are banks obliged to keep their notes circulating at par?

CHAPTER IV

THE BANK ACT (*Continued*)

1. *Business and powers of a bank* (Sections 76–83).—The first section, 76, is of sufficient importance to give in full. It states that a bank may:

(a) Open branches, agencies and offices;
(b) Engage in and carry on business as a dealer in gold and silver coin and bullion;
(c) Deal in, discount and lend money and make advances upon the security of, and take as collateral security for any loan made by it, bills of exchange, promissory notes and other negotiable securities, or the stock, bonds, debentures and obligations of municipal and other corporations, whether secured by mortgage or otherwise, of Dominion, Provincial, British, foreign, and other public securities; and
(d) Engage in, and carry on, such business generally as appertains to the business of banking.

Except as authorized by this act, the bank shall not, either directly or indirectly:

(a) Deal in the buying or selling or bartering of goods, wares and merchandise, or engage or be engaged in any trade or business whatsoever;
(b) Purchase, or deal in, or lend money, or make advances upon the security or pledge of any share of its own capital stock, or of the capital stock of any bank; or
(c) Lend money or make advances upon the security, mortgage or hypothecation of any lands, tenements or immovable property, or of any ships or other vessels, or upon the security of any goods, wares and merchandise.

The bank shall have a privileged lien on shares of its own stock or on dividends for any debt or liability of a shareholder. In case of default, provision is made for the sale and transfer of such shares within twelve months after the maturity of the debt and after due notice to the debtor.

Provision is made for the sale of collateral security held by the bank in case of default in the payment of the relative debt.

A bank may hold real property for its own use and occupation, and may sell the same and acquire other property in its stead for the same purpose.

A bank may take a mortgage on real estate or personal property by way of additional security for a debt already contracted.

A bank may acquire title to real property on which it has a lien as security by purchasing the equity of redemption or by foreclosure. No bank, however, is allowed to hold property except for its own use and occupation longer than twelve years.

2. *Warehouse receipts as collateral security* (Sections 84–90).—A bank may lend money upon the security of standing timber and on the rights held by persons to cut or remove such timber.

A bank is empowered to lend money to a receiver or liquidator appointed under the Winding-up Act, and to take security in connection therewith.

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

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

The provisions embodied in what is known as "Section 88" have proved an important factor in the industrial and agricultural development of Canada. The clause permitting loans to farmers under this section appears for the first time in the Act of 1913. The main text of Section 88 is as follows:

> The bank may lend money to any wholesale purchaser, or shipper of, or dealer in, products of agriculture, the forest, quarry and mine, or the sea, lakes and rivers, or to any wholesale purchaser or shipper of or dealer in live stock or dead stock or the products thereof, upon the security of such products, or of such live stock or dead stock or the products thereof.
>
> The bank may lend money to a farmer upon the security of his threshed grain grown upon the farm.
>
> The bank may lend money to any person engaged in business as a wholesale manufacturer of any goods, wares and merchandise, upon the security of the goods, wares and merchandise manufactured by him, or procured for such manufacture.

All advances secured under Sections 86–88 have priority to the claim of an unpaid vendor unless he had a lien, of which the bank was aware, on the goods. The material or goods on which a bank has a lien by warehouse receipt or pledge, under Section 88, may be converted by manufacture without the bank losing its lien thereon. In the case of the non-payment of a debt thus secured, the goods may be sold under certain specified conditions.

A bank cannot acquire or hold any warehouse receipt, bill of lading or pledge of goods to secure any debt unless such debt is negotiated at the time of the acquisition of the security by the bank, or upon the written promise or agreement that such warehouse receipt, bill of lading or security would be given to the bank. Such liability, however, may be renewed from time to time without affecting the condition of the security. A bank may also exchange warehouse receipts for bills of lading, or vice versa, without affecting this security.

3. *Rates of interest and exchange* (Sections 91–94).—A bank may stipulate for, or exact such rate of interest or discount as may be agreed upon, and may receive in advance any such rate, but no higher rate than seven per cent shall be recoverable by the bank.

A bank may allow any rate of interest whatever upon deposits. The liability of the bank to repay money deposited with it is not affected by any statute of limitations or any law relating to prescription.

A branch bank, when discounting bills payable at another branch, may take commission, in addition to interest, to an amount not to exceed ⅛ of one per cent; minimum, 15 cents.

In discounting bills drawn on places where a bank has no branches this rate may be increased to ¼ of one per cent; minimum, 25 cents.

4. *Deposits* (Sections 95–98).—A bank may receive deposits from any person, whether qualified by law to contract or not, and may repay the same to such person unless the money is lawfully claimed by

CHARTERED BANKS' STATEMENT TO THE DOMINION GOVERNMENT—JULY 31st, 1920

LIABILITIES

	NAME OF BANK	Capital Authorized	Capital Stock: Capital Subscribed	Capital Stock: Capital Paid Up	Amount of rest or reserve fund	Rate per cent of last dividend declared	1. Notes in circulation	2. Bal. due to Dom. Gov. after deducting advances for credits, pay-lists, etc.	3. Balances due to Provincial Governments	4. Deposits by the public, payable on demand in Canada	5. Deposits by the public, payable after notice or on a fixed day in Canada	6. Deposits elsewhere than in Canada
		$	$	$	$	$	$	$	$	$	$	$
1	Bank of Montreal	28,075,000	22,000,000	22,000,000	22,000,000	12	40,563,523	17,134,218	4,325,871	138,133,764	214,696,847	67,886,579
2	Bank of Nova Scotia	15,000,000	9,700,000	9,700,000	18,000,000	16	22,204,618	6,343,330	567,701	38,011,323	103,844,244	32,958,791
3	Bank of Toronto	10,000,000	5,000,000	5,000,000	6,000,000	12	8,139,373	3,251,396	122,155	25,532,363	46,266,861	
4	Molsons Bank	5,000,000	4,000,000	4,000,000	5,000,000	12	6,575,518	10,727,301	188,283	16,394,605	45,230,682	
5	Banque Nationale	5,000,000	2,000,000	2,000,000	2,300,000	12	6,104,445	8,676,509	474,080	7,112,335	36,328,223	6,053,432
6	Merchants Bank of Canada	15,000,000	9,894,300	9,667,840	8,400,000	12	16,189,372	14,010,044	3,591,865	53,167,281	85,570,502	2,571,853
7	Banque Provinciale du Canada	5,000,000	3,000,000	2,810,124	1,100,000	8	2,976,613	2,270,051	257,558	4,820,803	24,070,605	
8	Union Bank of Canada	15,000,000	8,000,000	7,999,850	5,600,000	10	10,592,629	17,120,564	2,773,664	30,987,477	66,388,697	8,219,456
9	Canadian Bank of Commerce	25,000,000	15,000,000	15,000,000	15,000,000	12	29,684,879	33,065,042	6,562,809	115,564,089	173,277,759	42,277,646
10	Royal Bank of Canada	25,000,000	19,452,000	18,969,120	17,984,560	12	40,959,871	9,405,921	2,810,407	97,003,283	180,262,496	185,187,714
11	Dominion Bank	10,000,000	6,000,000	6,000,000	7,000,000	12	10,395,959	10,115,471	626,494	28,457,784	66,731,576	2,853,074
12	Bank of Hamilton	5,000,000	4,834,200	4,736,810	4,568,405	12	6,588,307	7,396,286	359,570	18,232,980	41,421,288	
13	Standard Bank of Canada	5,000,000	3,500,000	3,500,000	4,500,000	14	5,882,128	8,784,504	256,674	19,016,205	45,518,984	
14	Banque d'Hochelaga	10,000,000	4,000,000	4,000,000	3,900,000	10	7,033,594	7,631,905	67,743	10,035,186	39,611,256	
15	Imperial Bank of Canada	10,000,000	7,000,000	7,000,000	7,500,000	12	13,792,512	4,797,225	1,951,295	25,880,336	60,231,201	
16	Home Bank of Canada	5,000,000	2,000,000	1,959,162	500,000	7	2,123,045	3,669,592	913,400	4,665,113	11,657,290	
17	Sterling Bank of Canada	3,000,000	1,266,600	1,229,571	450,000	7	1,389,352	5,364,382	490,365	5,439,317	10,792,451	
18	Weyburn Security Bank	1,000,000	655,700	478,661	225,000	7	338,495	426,561	4,663	960,781	1,269,481	
	Total	197,075,000	127,302,800	126,051,138	130,027,965		231,534,233	170,190,302	26,344,597	639,415,025	1,253,170,443	348,008,545

	NAME OF BANK	7. Loans from other banks in Canada, secured, including bills re-discounted	8. Deposits made by and balances due to other banks in Canada	9. Due to banks and banking correspondents in the United Kingdom	10. Due to banks and banking correspondents elsewhere than in Canada and the U. K.	11. Bills payable	12. Acceptances under letters of credit	13. Liabilities not included under foregoing heads	Total Liabilities	Aggregate amount of loans to directors and firms of which they are partners	Average amount of current gold and subsidiary coin held during the month	Average amount of Dominion notes held during the month	Greatest amount of notes in circulation at any time during the month	
		$	$	$	$	$	$	$	$	$	$	$	$	
1	Bank of Montreal		2,864,662	35,597	2,413,746	3,454,571	7,838,753	1,484,558	500,832,695	774,246	25,032,013	43,207,249	42,242,555	1
2	Bank of Nova Scotia		1,414,494	180,408	3,451,388		706,959	12,792	209,696,051	1,186,430	12,163,689	10,634,618	23,146,922	2
3	Bank of Toronto		217,904		1,224,530		1,005,348	1,634	85,761,567	512,579	969,539	7,955,095	7,714,400	3
4	Molsons Bank		929,649	253,381	170,380		242,515	540,346	81,252,663	187,658	582,384	3,136,888	6,937,193	4
5	Banque Nationale		3,229		73,452	549,500		3,518	65,378,726	814,942	326,800	1,442,100	6,104,445	5
6	Merchants Bank of Canada		3,147,932	268,849	797,079		2,246,653	278,195	181,839,632	925,477	4,012,359	6,252,606	16,995,292	6
7	Banque Provinciale du Canada		5,373		310,337			150,123	34,861,466		126,628	344,275	3,035,553	7
8	Union Bank of Canada		221,140	2,512,005	2,917,697		3,987,907	112,021	145,833,260	1,736,435	1,020,115	10,497,119	10,768,104	8
9	Canadian Bank of Commerce		102,751	1,002,870	7,726,980	250,483	13,756,850	6,767	423,278,931	858,643	20,724,000	29,080,000	31,069,575	9
10	Royal Bank of Canada		18,101	488,226	14,465,573	1,616,626	9,357,040	15,228	541,590,492	778,856	14,311,368	22,564,868	42,206,599	10
11	Dominion Bank		603,036	988,948	1,341,759	432,960	2,598,864	678,053	125,823,982	550,182	2,122,000	9,821,000	10,456,174	11
12	Bank of Hamilton		193,229	298,790	615,148		324,581		75,430,183	379,568	911,336	3,377,858	6,960,452	12
13	Standard Bank of Canada		1,298,719	758,346	894,219	30,816	789,500		83,230,099	387,051	1,761,233	4,824,204	6,519,978	13
14	Banque d'Hochelaga		809	24,348	692,712		152,275		65,249,832	243,150	455,467	1,938,734	7,820,459	14
15	Imperial Bank of Canada		814,054	26,146	321,987		235,770		108,050,529	112,258	2,651,429	6,402,963	14,819,910	15
16	Home Bank of Canada		10,393		661,577			1,272	23,701,685	394,995	174,180	2,031,465	2,255,945	16
17	Sterling Bank of Canada		354,220				18,180	2,863	23,851,132	547,386	111,851	1,054,487	1,393,725	17
18	Weyburn Security Bank				25,648			25,974	3,051,606	18,465	15,535	115,147	356,405	18
	Total		12,199,695	6,837,914	38,104,212	6,334,956	43,261,195	3,313,344	2,778,714,531	10,408,321	87,471,926	164,680,676	240,833,686	

ASSETS

	NAME OF BANK	Current Gold and Subsidiary Coin: In Canada	Current Gold and Subsidiary Coin: Elsewhere	1. Total	Dominion Notes: In Canada	Dominion Notes: Elsewhere	2. Total	3. Deposit with Minister of Finance for the security of note circulation	4. Deposit in central gold reserves	5. Notes of other banks	6. Cheques on other banks	7. Loans to other banks in Canada, secured, including bills rediscounted	8. Deposits made with and bal. due from other banks in Canada	9. Due from banks and banking correspondents in the United King.	10. Due from bks. and banking correspondents, elsewhere than in Canada and U. K.	11. Dominion Government and Provincial Government securities	12. Can. municipal securities, and Brit., foreign and Colonial public securities other than Canadian
		$	$	$	$	$	$	$	$	$	$	$	$	$	$	$	$
1	Bank of Montreal	23,710,438	977,456	24,687,894	50,074,046	5,333	50,079,380	1,038,166	17,200,000	3,982,048	19,216,465			4,012,255	8,979,420	14,670,613	37,567,824
2	Bank of Nova Scotia	8,764,587	3,390,560	12,155,148	10,247,835	42,385	10,290,221	485,399	12,500,000	3,823,511	8,946,038			3,587,964	2,851,648	13,647,012	21,392,883
3	Bank of Toronto	971,482		971,482	8,041,189		8,041,189	254,834	3,500,000	723,630	3,447,376			137,463	852,877	5,235,624	7,692,492
4	Molsons Bank	581,327		581,327	6,335,959		6,335,959	235,000	2,000,000	687,003	3,989,965		10,953	132,731	1,519,256	5,342,736	6,926,110
5	Banque Nationale	360,462	1,581	362,043	1,420,932		1,420,932	100,000	3,700,000	855,665	2,640,061		13,257	62,022	1,350,062	5,494,705	6,832,158
6	Merchants Bank of Canada	4,083,195	11,078	4,094,273	5,526,967		5,526,967	450,000	5,500,000	1,311,356	9,713,771		5,701	453,552	2,435,205	8,441,979	12,505,035
7	Banque Provinciale du Canada	133,627		133,627	264,815		264,815	114,608		502,295	2,165,282		3,405,845	120,463	243,614	2,688,615	4,344,367
8	Union Bank of Canada	1,028,194	28,532	1,056,726	12,079,628	1,620	12,081,248	355,000	1,250,000	1,412,096	6,556,261		97,506	2,834,594	1,838,223	4,544,137	13,237,303
9	Canadian Bank of Commerce	8,682,643	5,802,929	14,485,572	23,460,144	4,907	23,465,051	908,245	14,000,000	2,912,426	15,728,812		29,044	818,960	8,941,354	13,302,171	23,804,570
10	Royal Bank of Canada	5,965,998	8,267,346	14,233,344	22,738,306	3,026	22,741,332	860,000	23,000,000	23,253,523	23,878,501		5,847	2,081,268	28,234,010	13,020,964	22,610,658
11	Dominion Bank	2,144,844	739	2,145,584	9,911,375		9,911,375	305,000	4,000,000	1,127,099	4,394,284		1,821	180,970	1,914,526	4,841,664	11,271,031
12	Bank of Hamilton	947,073		947,073	3,583,831		3,583,831	200,000	1,500,000	755,086	3,303,126		1,382,130	15,333	551,297	2,381,165	6,626,177
13	Standard Bank of Canada	1,769,042		1,769,042	6,016,923		6,016,923	175,000	2,400,000	501,885	3,227,669			161,324	690,651	4,262,343	7,192,690
14	Banque d'Hochelaga	456,682		456,682	2,198,897		2,198,897	200,000	2,300,000	1,284,574	2,929,652		401,385	55,529	526,584	2,319,784	4,769,149
15	Imperial Bank of Canada	2,653,673		2,653,673	6,623,459		6,623,459	375,994	7,000,000	1,372,646	4,713,871		573,418	631,186	1,272,058	6,076,990	10,708,632
16	Home Bank of Canada	191,315		191,315	1,598,510		1,598,510	108,000		305,926	738,175		117,668	310,106	537,478	1,362,091	1,550,357
17	Sterling Bank of Canada	120,615		120,615	1,015,130		1,015,130	65,000		199,424	785,175		5,159	27,925	303,287	9,229,048	3,171,211
18	Weyburn Security Bank	15,090		15,090	112,731		112,731	22,196		34,127	14,991		354,829		121,382	176,290	268,714
	Total	62,580,287	18,480,221	81,060,510	171,250,677	57,271	171,307,950	6,252,442	99,850,000	45,044,320	116,389,475		6,404,563	15,613,645	63,162,932	117,037,931	202,471,301

	NAME OF BANK	13. Railway and other bonds, debentures and stocks	14. Call and short (not exceeding 30 days) loans in Canada on stocks, debentures and bonds	15. Call and short (not exceeding 30 days) loans elsewhere than in Canada	16. Other current loans and discounts in Canada	17. Other current loans and discounts elsewhere than in Canada	18. Loans to the Government of Canada	19. Loans to Provincial Governments	20. Loans to cities, towns, municipalities and school districts	21. Over-due debts	22. Real estate, other than bank premises	23. Mortgages on real estate sold by the bank	24. Bank premises at not more than cost, less amounts (if any) written off	25. Liabilities of customers under letters of credit, as per contra	26. Other assets not included under the foregoing heads	Total Assets	
		$	$	$	$	$	$	$	$	$	$	$	$	$	$	$	
1	Bank of Montreal	4,359,230	1,823,865	89,460,795	217,761,897	14,507,117		3,816,048	24,470,224	551,056	34,650	43,052	5,500,000	7,838,753	56,414	551,657,178	1
2	Bank of Nova Scotia	2,872,827	5,561,823	16,768,180	96,649,972	15,733,297			5,379,392	251,309	145,824	177,284	5,459,175	706,959	204,910	239,590,785	2
3	Bank of Toronto	716,455	2,895,321	1,000,000	56,987,708				1,722,519	486,364			3,616,096	1,005,348		99,286,783	3
4	Molsons Bank	723,552	7,917,310		50,605,610				969,913	112,954	52,102	25,103	2,746,373	242,515	312,279	91,468,758	4
5	Banque Nationale	944,382	4,826,969		37,915,517				1,328,284	29,803	366,720	301,223	1,604,078		87,684	70,225,572	5
6	Merchants Bank of Canada	4,318,371	8,302,647	3,954,795	120,642,858	1,372,351			4,123,605	379,536	645,469	680,603	2,860,281	2,246,653	203,230	200,168,246	6
7	Banque Provinciale du Canada	1,889,406	9,944,760		11,485,016				1,004,119	76,931	7,500	16,758	282,550		289,420	38,979,997	7
8	Union Bank of Canada	2,519,942	5,628,152	3,429,762	82,951,101	5,283,291		4,217,995	7,001,744	185,183	245,392	140,522	1,000,470	3,987,907	39,319	161,893,885	8
9	Canadian Bank of Commerce	6,019,075	20,212,644	27,143,434	209,186,501	37,724,447		5,296,733	10,431,898	780,275	485,414	192,178	6,721,440	13,756,850	118,433	456,465,536	9
10	Royal Bank of Canada	6,218,238	13,745,753	56,105,943	182,144,170	115,525,787		108,343	6,992,877	392,625	1,131,421	54,794	8,855,283	9,357,040	27,637	584,579,369	10
11	Dominion Bank	1,779,235	11,317,187	4,182,300	72,937,903	742,974			611,446	144,844	5,468	19,057	5,722,331	2,598,864	40,865	140,195,838	11
12	Bank of Hamilton	461,381	7,463,061		49,641,661			398,680	2,724,435	169,411	447,239	199,744	2,809,762	324,581	292,755	86,177,874	12
13	Standard Bank of Canada	764,742	3,383,959		56,690,479				2,061,519	157,471	4,915	70,850	1,517,235	789,500	51,004	91,889,208	13
14	Banque d'Hochelaga	139,272	5,257,484		42,792,105				4,777,491	341,908	436,402	228,208	2,668,851	152,275	84,376	74,320,617	14
15	Imperial Bank of Canada	409,952	4,619,206	1,000,000	63,178,138			1,157,000	4,469,344	530,033	542,024	398,883	4,936,265	235,770	654,285	124,132,835	15
16	Home Bank of Canada	1,214,522	2,304,564		14,331,054	24,788			304,841	105,443	63,417	99,409	971,838		95,366	26,334,875	16
17	Sterling Bank of Canada	387,812	156,189		9,244,800				284,321	7,801			422,394	18,180	267,039	25,710,516	17
18	Weyburn Security Bank				2,130,363				134,850	113,799	11,818	7,794	201,583		62,995	3,783,559	18
	Total	45,738,394	115,360,894	203,045,209	1,377,276,853	190,914,052		14,994,799	78,792,822	4,816,746	4,625,775	2,655,462	57,896,005	43,261,195	2,888,011	3,066,861,431	

Column No. 4 Of this deposit $10,500,000 is in gold coin; the balance is in Dominion notes.

FINANCE DEPARTMENT

OTTAWA, August 23rd, 1920

FIGURE 1

T. C. BOVILLE,

Deputy Minister of Finance.

another. Where this conflicts with the law of a province regarding minors, married women and other persons not competent to enter a contract, the total amount received from such person shall not exceed $500.

A bank is not bound to see to the execution of any trust in relation to deposits.

Provision is made facilitating the transmission of deposits not exceeding $500 in case of the death of the depositor.

Official checks of the Dominion of Canada shall be cashed at par at the branches of every bank in Canada.

5. *Purchase of the assets of a bank* (Sections 99–111).—These sections provide for the amalgamation of banks and set forth the necessary procedure. However, before a bank can enter into any agreement to sell the whole or any portion of its assets to another bank, it is necessary to obtain the consent of the Minister of Finance in writing. The agreement to sell and purchase must then be submitted to the shareholders of the selling bank either at its annual general meeting or at a special general meeting called for that purpose, a copy of the agreement having been mailed to each of the shareholders at least four weeks previous to the date of the meeting.

To carry a resolution approving of the agreement the votes of shareholders representing not less than two-thirds of the amount of the subscribed capital stock of the bank are necessary. The agreement may then be executed under the seals of the banks, and ap-

RETURN OF THE TOTAL LIABILITIES
CANADIAN BANKS AS REPORTED

			Percentage to	
			Total Assets	Liabilities to Public
	Capital authorized	197,075,000	6.43	7.09
	Capital subscribed	127,302,800	4.15	4.58
	Capital paid up	126,051,138	4.11	4.53
	Amount of rest or reserve fund	130,027,965	4.24	4.68
	Rate per cent of last dividend declared, per cent			
	Liabilities			
1	Notes in circulation	231,534,233	7.55	8.33
2	Balance due to Dominion Government after deducting advances for credits, pay-lists, etc.	170,190,302	5.55	6.12
3	Balances due to Provincial Governments	26,344,597	.86	.95
4	Deposits by the public payable on demand in Canada	639,415,025	20.85	23.01
5	Deposits by the public payable after notice or on a fixed day in Canada	1,253,170,443	40.86	45.10
6	Deposits elsewhere than in Canada	348,008,545	11.35	12.52
7	Loans from other banks in Canada, secured including bills rediscounted	....	......	....
8	Deposits made by and balances due to other banks in Canada	12,199,695	.40	.44
9	Due to banks and banking correspondence in the United Kingdom	6,837,914	.22	.25
10	Due to banks and banking correspondents elsewhere than in Canada and the United Kingdom	38,104,212	1.24	1.37
11	Bills payable	6,334,956	.20	.23
12	Acceptances under letters of credit	43,261,195	1.41	1.56
13	Liabilities not included under foregoing heads	3,313,344	.11	.12
		2,778,714,531	90.60	100.00
	Aggregate amount of loans to directors, and firms of which they are partners	10,408,321	.34	.37
	Average amount of current gold and subsidiary coin held during the month	87,471,926	2.85	3.15
	Average amount of Dominion notes held during the month	164,680,676	5.37	5.92
	Greatest amount of notes in circulation at any time during the month	240,833,686	7.85	8.67

I declare that the above return has been prepared under my directions and is correct

We declare that the foregoing return is made up from the books of the Bank, and that to the the Bank, and we further declare that the Bank has never, at any time during the period to which it has in Canada.

.............................this.........day of........................19....

Figure 2

Form prescribed for

AND ASSETS OF ALL THE

TO THE GOVERNMENT *On the Thirty-first Day of July, 1920*

	Assets			Percentage to Total Assets	Percentage to Liabilities to Public
1	Current gold and subsidiary coin:				
	In Canada	62,580,287			
	Elsewhere	18,480,221	81,060,510	2.64	2.92
2	Dominion notes:				
	In Canada	171,250,677			
	Elsewhere	57,271	171,307,950	5.59	6.17
3	Deposit with the Minister of Finance for the security			.20	.23
	of note circulation		6,252,442	3.26	3.59
4	Deposit in central gold reserves		99,850,000	1.47	1.62
5	Notes of other banks		45,044,320	3.79	4.19
6	Checks on other banks		116,389,475		
7	Loans to other banks in Canada, secured, including bills rediscounted		....	......	....
8	Deposits made with and balances due from other banks in Canada		6,404,563	.21	.23
9	Due from banks and banking correspondents in the United Kingdom		15,613,645	.51	.56
10	Due from banks and banking correspondents elsewhere than in Canada and the United Kingdom		63,162,932	2.06	2.27
11	Dominion Government and provincial government securities		117,037,931	3.82	4.21
12	Canadian municipal securities, and British foreign and colonial public securities other than Canadian		202,471,301	6.60	7.29
13	Railway and other bonds, debentures, and stocks		45,738,394	1.49	1.65
14	Call and short (not exceeding thirty days loans in Canada on stocks debentures and bonds)		115,360,894	3.76	4.15
15	Call and short (not exceeding thirty days) loans elsewhere than in Canada		203,045,209	6.62	7.31
16	Other current loans and discounts in Canada		1,377,276,853	44.91	49.56
17	Other current loans and discounts elsewhere than in Canada		190,914,052	6.22	6.87
18	Loans to the Government of Canada		....	......	....
19	Loan to provincial governments		14,994,799	.49	.54
20	Loans to cities, towns, municipalities and school districts		78,792,822	2.57	2.83
21	Over due debts		4,816,746	.16	.17
22	Real estate other than bank premises		4,625,775	.15	.16
23	Mortgages on real estate sold by the bank		2,655,462	.09	.10
24	Bank premises at not more than cost, less amounts (if any) written off		57,896,005	1.89	2.08
25	Liabilities of customers under letters of, as per contra		43,261,195	1.41	1.56
26	Other assets not included under the foregoing heads		2,888,011	.09	.11
			3,066,861,431	100.00	110.37

according to the books of the bank.

....

Chief Accountant.

best of our knowledge and belief it is correct, and shows truly and clearly the financial position of the said return relates, held in Dominion notes less than forty per cent of the cash reserves which

....

President.

....

General Manager.

Figure 2 — *continued*

Individual Statement

plication made to the Governor-in-Council, thru the Minister, for approval thereof.

The approval of the Governor-in-Council is not given, however, until the Minister is satisfied that all the requirements of the act have been complied with and the necessary publicity given by the insertion of notices in the *Gazette* and certain newspapers. The approval by the Governor-in-Council of the agreement will then be evidenced by a certified copy of the Order-in-Council approving thereof.

The notes of the selling bank, of course, cannot be reissued, but must be called in, redeemed and cancelled as quickly as possible.

6. *Returns to government* (Sections 112–114).—Banks must send a statement in a specified form[1] at the end of each month to the Minister of Finance. The statement must be signed by the chief accountant and by the president and general manager, or persons duly authorized to act in their stead.

The Minister of Finance may call for special returns from any bank at any time.

A bank at the end of each calendar year shall transmit to the Minister:

(a) Detailed returns of all unpaid dividends, bills of exchange, drafts and certified checks outstanding for more than five years and of all balances in respect of which no transactions have taken place or upon which no interest has been paid during the five years prior to the date of such return;

(b) A list of shareholders with their addresses and the number of shares held by each.

1 See combined statements of all banks, Figure 2.

7. *Payments to the Minister of Finance upon dissolution of a bank* (Sections 115–116).—The liquidator of a bank must, after three years, pay to the Minister of Finance all amounts due to shareholders or depositors remaining unclaimed, together with all interest due. The government will hold the money in trust for the owners and, in case of interest-bearing deposits, will continue to allow for six years' interest at the rate of three per cent per annum.

Liquidators of banks are also required to pay to the Minister of Finance within three years an amount equal to the excess of the outstanding notes in circulation over the amount at the credit of the bank in the Circulation Fund, the same to be held by the government for the purpose of redeeming such notes.

8. *Canadian Bankers' Association* (Section 117–124).—In the event of the suspension of a bank the Canadian Bankers' Association is intrusted with the appointment of a curator who continues to supervise the affairs of the bank until it resumes business or until a liquidator has been appointed to wind it up.

The association may make by-laws, rules, and regulations respecting:

(a) All matters relating to the appointment or removal of a curator, and his powers and duties;

(b) The supervision of the making of the notes of the banks which are intended for circulation, the delivery thereof to the banks, the disposition made of them, and their final destruction;

(c) The custody and management of the central gold reserves and the carrying out of the provisions of this act relating to such reserves.

No such by-law, rule or regulation, however, shall be in force until approved by the Treasury Board.

9. *Insolvency* (Section 125).—In the event of the property and assets of a bank being insufficient to pay its liabilities, each shareholder shall be liable for the deficiency to an amount equal to the par value of the shares held by him, in addition to any amount not paid up on such shares.

10. *Suspension* (Sections 126–131).—The non-payment in specie or Dominion notes of any of its liabilities, as they accrue for ninety days consecutively, constitutes a bank insolvent and suspends the working of its charter. The charter shall remain in force a length of time sufficient only to enable the directors to make and enforce the calls on the shareholders deemed necessary to pay all the liabilities and to wind up the business of the bank. The total amount of such calls is limited by Section 125.

Shareholders of a bank who have sold or transferred their stock are not relieved from the double liability until the expiration of sixty days.

In case of insolvency the payments of notes then in circulation shall be the first charge on the assets of the bank, the second charge being the payment of money due to the Dominion government, and the third charge the payment of the money due to the Provincial government.

11. *Penalties* (Sections 131A–158).—The remaining sections deal entirely with offenses against the act and the penalties incurred. The majority of the pen-

alties are applicable to banks and bank officers, but the following five may be incurred by the public:

For selling or transferring shares contrary to the requirements of the act;

For issuing or drawing any instruments intended to circulate as money or to be used as a substitute for money;

For mutilating or defacing bank notes or Dominion notes;

For making false statements in connection with warehouse receipts or bills of lading, or for wilfully disposing of or withholding from the bank goods covered by security under Section 88, an indictable offense;

For using the word "Bank," "Savings Bank," "Banking Company" or any equivalent term without being authorized to do so by the act, nor can any words in a foreign language with a similar import be used.

12. *Amendments to Bank Act since* 1913.—At the outbreak of the war in August, 1914, the Dominion Government extended the emergency currency privilege thruout the whole year, instead of limiting it to the usual period from September first to February twenty-eighth. It also authorized the chartered banks to make payments in bank notes instead of in gold or in Dominion notes, until further official announcement. These amendments were not availed of to any appreciable extent, except that gold was not paid out.

An amendment to section 88 of the Bank Act was made in March, 1915, permitting the banks to lend money to farmers for the purchase of seed grain upon the security of the grain and the subsequent crop. This privilege was availed of to a very limited extent as the banks were content in most cases to rely upon the general credit of the borrower, as they had in the past.

In May, 1916, another amendment to Section 88 of the Bank Act was passed, permitting banks to lend money to a farmer or to any person engaged in stock raising upon the security of live stock. In provinces where chattel mortgages are legal the security of the live stock must be taken in the form of a chattel mortgage duly registered. In any province in which there are no statutes or ordinances in force relating to bills of sale or chattel mortgages, security may be taken by way of an assignment but a memorandum of such security must be published in the *Official Gazette* of the Province within thirty days after the date of the assignment. These onerous requirements defeated the object of the amendment and little advantage was taken of it. The borrower naturally objected to the publicity incurred and the banks on their part were unwilling to undertake the responsibility and work entailed by such a transaction.

The act referred to in the first paragraph of this section is known as the Finance Act 1914, and altho nominally not an amendment of the Bank Act, is so virtually. In June, 1919, an act was passed which continued the regulations under the Finance Act 1914 for two years after the war, authorized the issue of emergency circulation for the years 1919–1920, and prohibited the export of gold except under license by the Minister of Finance.

The official definition of "peace" is that the war will terminate with the conclusion of peace with the last of the enemy powers. Canada is still at war with Turkey (September, 1920), so that the two years mentioned in the act have not yet commenced to run.

13. *Bills of Exchange Act.*—The whole business of banking is so intimately concerned with negotiable instruments and the laws governing their existence and validity that a fair knowledge of the general principles of the Bills of Exchange Act is essential even to the youngest bank clerk, and such knowledge is best obtained by a study of the act itself. For this reason little or no attempt has been made in this book to explain the nature of the various cases of negotiable instruments. Copies of the act are easily obtainable—if annotated, so much the better, and every student of banking should make a systematic study of the act until it is thoroly mastered. Concise notes should be taken under the different heads, and sufficient space left for comments or illustrations gathered from actual experience or from legal decisions. This rough classification gives an idea of the scope of the act:

Sections	1–16	Interpretation and general provisions of the act.
	17–164	*Bills of Exchange.*
	17–34	Form of bill and interpretation.
	35–39	Acceptance and interpretation.
	40–41	Delivery and oral evidence.
	42–46	Computation of time, non-juridical days and days of grace.
	47–52	Capacity and authority of parties
	53–59	Consideration.

60–74	Negotiation of bills.
75–84	Presentment for acceptance.
85–94	Presentment for payment.
95–126	Dishonor and protest.
127–138	Liabilities of parties.
139–146	Discharge of bill.
147–164	Miscellaneous.
165–175	*Checks (Crossed checks).*
176–187	*Promissory notes.*
	Schedule.

The Bills of Exchange Act, like the Bank Act, is a Dominion statute and is largely based on and follows, almost word for word, the English Bills of Exchange Act.[1]

REVIEW

What are the powers and limitations of a Canadian bank?

What are the regulations governing deposits?

What information must a bank submit to the Minister of Finance each year?

Under what conditions is a bank declared insolvent?

[1] Copies of the Bills of Exchange Act can be obtained by forwarding twenty cents to the King's Printer, Ottawa.

CHAPTER V

NOTE ISSUES AND BRANCH BANK SYSTEM

1. *Monetary System.*—The monetary system of Canada consists of gold, paper currency, and silver and copper subsidiary coins, the latter, however, not being legal tender for amounts over $10 and 25 cents respectively. The unit is a dollar of 23.22 grains of pure gold. Gold coins in the United States and the British sovereign (worth 4.86\frac{2}{3}$) are legal tender for any amount, and still form the bulk of the gold reserves of the government and of the banks, as it is only of recent years that Canada has had a distinctive gold coinage of its own. Gold coin is seldom seen in circulation and its use is practically confined to reserve purposes and international exchange operations. Silver is used for the subsidiary coins of the denominations from five to fifty cents and copper for the cents. With these exceptions, paper currency is practically the only form of money used in Canada. It consists of two kinds, Dominion notes and bank notes.

Of late years, owing principally to conditions induced by the war, Canada has increased the circulating medium including token currency from $20.34 per capita in 1913, to $31.83 in 1919.[1] The total

[1] Canada Year Book 1919.

amount in circulation of both issues in the hands of the public, in thousands, exclusive of bank holdings, is as follows:

	June 30th 1913	July 31st 1920
Total amount of bank notes.........	$105,700	$231,534
Less bank notes held by banks........	11,000	45,044
Total bank notes in circulation.......	94,700	176,490
Total Dominion notes in circulation....	21,800	32,883
Total circulation with public.........	116,500	209,373

an increase of $93,000,000, or nearly 80%.

The total amount of notes in the hands of the public is $209,000,000,[1] for the protection of which apart from other safeguards $176,571,000 in gold is held, or 84.50%.

An outstanding feature of the Canadian currency system is elasticity. The laws regulating the issue of both Dominion and bank notes are conservative in their avoidance of undue expansion and at the same time provide fully for the currency requirements of the nation. Contraction is an element as important to elasticity as expansion, and the machinery of redemption is efficient and sensitive in its operations.

No man, except an occasional hoarder, carries more money than his occasions warrant. To do so involves not only loss of interest but risk. When the money has served his purpose it returns at once thru various channels to the issuer for redemption. Thus daily

[1] Of this amount $10,500,000 is protected dollar for dollar by gold deposited in the central gold reserve. Deducting this leaves $198,873,000 protected by 89%.

the ability of the government and the banks to redeem their currency obligations is severely tested.

Owing to the conditions under which notes are issued and redeemed the Dominion was able to cope with the difficult financial situation arising from the Great War with slighter strain upon its credit system than the other countries involved and with the minimum disturbance of the circulating medium. The gold reserve of 40.5% of the total currency indicates the stronger position of the currency than in other countries while the machinery of issue can be relied upon to contract as easily as it expanded when such contraction would better accord with public needs. Joseph French Johnson in speaking of the unique redemption system of Canada, says:

"The redemption system, besides making currency inflation impossible, results in what is commonly called 'elasticity,' by which is meant capacity to expand and contract in automatic response to the country's need of currency. Such elasticity is desirable for the reason that it enables the banks to satisfy the mere currency needs of a country without increase of their liabilities or diminution of their power to lend.

"That the redemption system contributes to the acceptability and elasticity of the Canadian bank note more than any other factor must be evident to anyone who considers how the system would operate if the efficient redemption machinery were lacking."

2. *Gold Reserves.*—Altho the monetary system of Canada is on a gold basis, there is practically none in

circulation, as the public prefer the more convenient paper currency issued against gold reserves, and practically all the gold in Canada is in the hands of the Government or the banks, and held for that purpose. The total amount of gold on hand on 31st July, 1920, was $191,000,000, distributed as follows:

Gold held by Government for redemption of Dominion notes.	$95,510,383	$293,541,399
Gold held by banks for reserve purposes	81,060,510	231,534,233
Total gold to secure circulation	$176,570,893	$525,075,632
Gold held in Central Gold Reserve	10,500,000	
Gold held as reserve for Government Savings Deposits......	4,079,589	
Less Dominion notes held in Cen-		
Total gold in Canada........	$191,150,482	
tral Gold Reserve covering an equal amount of bank notes..		89,350,000
Net circulation outstanding....		$435,725,632
Amount held by banks and government		$227,352,622
Circulation in hands of the public		$208,373,010

Bank notes are the first lien on the total assets of a bank, and gold held can consequently be considered as applicable thereto. Therefore, total gold available to secure circulation represents 45.50% of the net circulation. The amount of gold held by the Government for the redemption of its own notes is 32.60% of the outstanding notes, or deducting the amount of notes otherwise secured, 69%. These percentages of gold reserves against paper currency will compare favorably with those of any other country. It is true that Canada has at present an embargo on the export of gold. This is a precautionary measure to conserve her reserves. As will be noticed from the figures above, the supply of gold in the hands of the Government and the banks may be considered ample for the safeguarding of the country's paper currency, and gold payments could be resumed at once if the international situation were more normal.

In 1908 a branch of the Royal Mint was opened in Ottawa, and authority to issue Canadian gold coins was first conferred in 1910. Gold coins amounting to $4,867,605 were struck up to the end of 1919, at which date $3,408,300 were held in the Government reserves. British and United States gold coins are legal tender to an unlimited amount in Canada, and it is of interest to note the different proportion of these coins held by the Government. At the end of 1919 the Government gold reserves were represented by British coin 24%, United States coin 51%, bullion 22%, and Canadian coin 3%. The American gold it will be seen greatly preponderates, and there is a considerable additional amount held by the banks as it is legal tender in both countries, and therefore convenient in international transactions.

3. *Dominion Notes.*—Dominion notes or "legal

tenders" or "legals" as they are often called, are issued by the Dominion Government under the authority of the "Dominion Note Act" and subsequent amendments made in 1914 to meet war conditions. Under the former act an unlimited issue was permitted under the following conditions: the Minister of Finance shall always hold for the security and redemption of Dominion notes up to and including $30,000,000 issued and outstanding at any one time, an amount equal to not less than 25% of the amount of such notes in gold, or in gold and securities of Canada, the principal and interest of which are guaranteed by the Government of the United Kingdom. The amount held in gold, however, shall never be less than 15% of the notes so issued and outstanding. As security for the redemption of Dominion notes issued in excess of $30,000,000, the Minister of Finance must hold an amount in gold equal to such excess. The total amount of gold held by the Government on June 30th, 1913, in connection with the outstanding amount of Dominion notes on that date was $93,863,538, as follows:

		Gold held
Total amount of outstanding circulation	$116,363,538	
Less amount protected by 25% of gold..................	30,000,000	$7,500,000
Excess over $30,000,000 protected by full amount of gold	86,363,538	86,363,538
		$93,863,538

$22,500,000 is uncovered by gold and the balance is covered dollar for dollar, or in other words, the whole amount of the outstanding circulation is protected by 81% of gold. Of the amount of notes outstanding, $94,544,199 was held by the various banks, the balance, $21,819,339, being in the hands of the public.

Dominion notes are legal tender for any amount, and may be redeemed at the offices of the Assistant Receivers General, situated in the various provisional capitals. They may be issued in any denomination, but the one and two dollars are practically the only denominations in active circulation, the larger bills being used principally by the banks for clearing and reserve purposes. The four dollar bills were never popular and have been withdrawn from circulation.

On the outbreak of the war in 1914 the Government, recognizing the moral effect under such conditions of having an ample supply of circulating medium and credit facilities, passed the Finance Act of 1914, which among other things made bank notes the equivalent of gold or legal tender, extended the emergency currency period of the banks over the whole year and made provision whereby the banks could borrow from the Government against the deposit of approved securities and commercial paper.

An amendment to the Dominion Note Act was also passed which raised the limit of the amount against which only 25% of gold need be held from $30,000,000 to $50,000,000, in other words $37,500,000 could be issued without gold cover. In 1915 a further amendment was passed which authorized an additional amount of $16,000,000 against the guaranteed securities of the Canadian Northern and the Grand Trunk Pacific Railways, and an uncovered issue of $10,000,000 to meet maturing obligations of the Government, or $26,000,000 in all, an increase in the uncovered issue to $47,500,000.

The total amount of Dominion notes outstanding at July 31st, 1920, was as follows:

Total amount of circulation in the hands of the public and the banks................	$293,541,399
Consisting of amounts:	
(1) Advanced to banks against approved securities and rediscounts.........	139,749,125
(2) Advanced against guaranteed railway securities	16,000,000
(3) Protected by reserve of 25% gold....	50,000,000
(4) Protected by reserve of 100% gold...	83,010,383
(5) Unsecured (balance under act of 1915 authorizing $10,000,000)..........	4,781,891

Three fourths of item 3 is uncovered and this with item 5 makes a total uncovered issue of $42,281,891 as against an authorized amount of $47,500,000. The gold held against items 3 and 4 aggregates $95,510,383 and this represents 32.60 per cent of the total circulation. It is also equivalent to 69% of that part of the circulation not backed by various kinds of securities.

The particulars of the circulation outstanding are as follows:

Provincial		$27,743.25
Dominion Notes		
Fractional		1,278,434.92
$1		17,915,343.00
$2		14,391,528.50
$4		38,095.00
$5		4,868,455.00
$50		3,800.00
$100		
$500		2,641,000.00
$1,000		4,464,000.00
Legal Tender Notes for Banks:		
$500	$79,000.00	
$1,000	979,000.00	
$5,000	210,510,000.00	
$50,000	36,350,000.00	247,918,000.00
		$293,546,399.67

Of the above amount $171,307,950 is held by the banks ($158,568,000 in "bank legals" and $12,739,950 in ordinary "legals"); $89,350,000 all in "bank legals" is deposited in the Central Gold Reserve and the balance, $32,883,449, is in the hands of the public.

It will be noted that $247,918,000 is given as "legal tenders between banks." This amount consists of special notes that are payable only to chartered banks in Canada. These notes can be sent safely by mail, as they are of no value except to a bank.

4. *Bank Note Issue.*—By the Bank Act, Canadian banks are empowered to issue notes of $5 and multiples thereof up to the amount of their unimpaired paid-up capital against the general security of their total assets on which the notes form a first lien. All

the banks are required to insure the circulation of their notes at par in every part of Canada. This is effected by requiring each bank to provide known redemption agents in the cities of chief commercial importance, namely, Halifax, St. John, Charlottetown, Montreal, Toronto, Winnipeg, Regina, Calgary and Victoria. Every bank accepts the bills of every other bank at par and forwards them to the nearest branch or redemption agent of the bank of issue; hence every day all over Canada the banks undergo a severe test of their ability to redeem their circulation no matter how freely it is offered for redemption. This is one of the strongest advantages of the system, and makes the circulation perfect and free from stagnation. The circulation thus varies in velocity and volume as the activity and requirements of the country demand, revealing to the experienced banker the conditions of trade and finance throughout the country.

It is important to remember in considering the note issue that, in the tills of its own bank, a note has absolutely no value except as so much stationery. This enables the banks to carry a good supply of bills at each branch, as they do not become a liability of the bank until they are paid over the counter. This is a very valuable feature, as it not only allows a bank to keep a good supply of till money on hand without loss, but it enables a small branch to meet an unusually large demand for cash either in the way of repaying a heavy deposit or of making a large loan.

5. *Security to note holder.*—The note holder is

amply protected, first, by the total assets of the bank; second, by the double liability of the shareholders; and third, by the entire redemption fund. The amount of circulation outstanding at the end of July, 1920, was, in round numbers, $231,000,000 for the whole of Canada, and to meet this the banks show total assets of $3,067,000,000 (including five per cent redemption fund, $6,300,000), and double liability $126,000,000, or after deducting the amount offset by deposit in the Central Gold Reserves, nearly $125 for every five dollars issued. Then also penalties for over-issue are extremely heavy.

To prevent the charging of discount on notes in case of suspension, notes of failed banks bear interest at the rate of five per cent per annum from the date of suspension until redeemed either by the liquidator or by the government, and each bank is obliged to keep a deposit with the government for this purpose, equal to five per cent of its average circulation. This is called the Bank Circulation Redemption Fund, and should it ever happen that the assets of a failed bank are insufficient to redeem the notes outstanding at the time of failure, the entire fund is liable for the deficiency and the other banks have to bear the loss pro rata. This fund was established in 1890 at the suggestion of the banks themselves.

The question may perhaps be raised, why should all this care be taken to protect the note holder against the principal creditor of the bank, the depositor, but it must be recognized that there is an essential difference between a note holder and a depositor, the former being an involuntary creditor and the latter a voluntary one. The depositor becomes a creditor of his own free will and for his own benefit, and exercises his own choice in the selection of a bank. The holder of a note, however, receives it in good faith in payment for labor or merchandise and should be fully protected. A note issue, to fulfill its best and most useful function, must be absolutely and without question as good as gold. One of the strongest elements of security, however, is the fact that the notes are subjected to daily redemption. A Canadian bank is prohibited by law from pledging or assigning its own notes, consequently the only way it is able to put them into circulation is to pay them out over the counter. It would be fatal for a bank to issue notes except with due regard to its ability to redeem them. It is seldom in the interest of any bank to hold or pay out the notes of other banks; as soon as a bill has done its work in the hands of the public and has been paid into another bank it is promptly presented for payment.

6. *Elasticity.*—The most admirable feature of the note issue is its quality of elasticity. In every country, more especially every new country where the agricultural interests naturally predominate, the alternations of the seasons and the succession of the various agricultural and lumbering products have an important influence on the currency requirements of the nation. In Canada the machinery of the circulation system is such that it expands and contracts auto-

matically according to the wants of the country. It will expand to pay for the making of butter and cheese, the moving of the crops, and for lumbering operations, but when it has performed these duties it will contract silently and without disturbing the money market or any of the banks' numerous functions.

Dunbar, in his "Economic Essays," thus defines elasticity in currency:

> It means responsiveness to present increase or diminution of demand—the power of adaptation to the needs of the month, the week, or the day, whether rising or falling. . . . Elasticity implies the operation of counter forces, in a currency as well as in a steel spring That a currency may be responsive to demand, it is necessary that the forces tending respectively to expand or to restrict, should be forces at work in the daily business of the bank, where it is brought into contact with the community by the stream of loans, deposits and payments.

7. *Seasonal fluctuations.*—The study and analysis of the monthly circulation returns afford much interesting and useful information. The monthly and annual fluctuations show, year by year, and season by season, every change and pulsation in the financial life of the nation, increasing annually in volume as the business of the country demands, while each month, tho sharing in the general annual increase, shows a rise or fall corresponding with the same months of previous years. The tables in Figure 3 are compiled from the government returns and illustrate that fact very forcibly. It must not be overlooked that the figures given do not show either the maximum or

the minimum amount of circulation during the respective months, but simply the point at which the issue stood at the *end* of each month. The maximum amount of circulation during the month is given in the government statement, but the figures at the end of the month are generally considered as the most satisfactory figures to deal with.

8. *Annual changes.*—Figure 3 shows the amount of notes in circulation at the end of each month from January, 1901, to December, 1919, inclusive; and the average circulation in millions for each year is as follows:

Circulation

	Average	Minimum		Maximum		Paid-up Capital
1901	50	45	Jan.	60	Nov.	67
1902	56	49	—	68	Oct	73
1903	60	55	—	71	Oct.	79
1904	62	57	—	74	Nov.	80
1905	64	58	—	79	—	85
1906	71	61	—	86	Oct.	95
1907	76	68	—	69	Nov.	96
1908	71	67	—	86	—	96
1909	74	66	—	92	—	97
1910	82	73	—	99	—	100
1911	90	77	—	112	—	108
1912	100	88	—	116	Nov.	115
1913	106	95	—	119	—	118
1914	105	93	April	124	Oct.	115
1915	105	96	Feb.	124	Nov.	114
1916	127	111	Jan.	149	Dec.	113
1917	161	133	—	196	Nov.	112
1918	199	172	—	235	—	111
1919	219	203	—	238	—	115

An examination of the average circulation shows a more or less steady annual increase from $50,000,000 in 1901 to $105,000,000 in 1913. During the first two years of the war the circulation remained stationary, but in 1916, owing to activities in war industries and agriculture, the average increased to the extent of $22,000,000 and attained its greatest increment in 1918, amounting to $38,000,000 over the previous year. The year 1919 shows a higher average, but the increase is smaller, being only $20,000,000, and it is likely that the annual increase will now assume more normal proportions as the country settles down to peace conditions.

A study of the monthly fluctuations shows that from 1868 to 1891 the lowest point in the circulation was generally reached about the middle of the year instead of in January, which is now the lowest month. About 1889 evidences of a change began to appear, until by 1895 the readjustment was completed, and January became the largest redemption month, the circulation then reached its lowest point, and it has held that position ever since. Such a radical change must mark an epoch-making event in the history of the Dominion, and this was no less an occasion than the opening up of the great Northwest and the entering of Canada into the arena of the world's wheat growers.

Previous to 1906 the circulation returns in the government statement formed a very reliable barometer of the outstanding circulation in the hands of the public, but in 1907 the banks began to realize that the moving of the crops and the opening up of the Northwest was beginning to test the efficiency and volume of the available circulation. A number of the banks increased their capital. For the requirements of the average circulation this would have sufficed amply, but it was impossible to increase capital at a sufficiently rapid rate to cover the "soaring peak" of the October and November demand for currency. In 1908 an amendment to the Bank Act was passed permitting banks to issue emergency currency during the crop-moving months, based on a percentage of their combined capital and reserve. This, tho useful, proved of only temporary and limited advantage. Another expedient was tried by the government in permitting banks to deposit gold with the Receiver-General and obtain Dominion notes in exchange. This was not taken advantage of to any great extent, as it was found to be not only slow and clumsy in operation, but lacked the essential feature of elasticity. As might be surmised, during the past few years the banks have frequently found themselves uncomfortably near the limit of their circulation, and at these times they do not present the notes of other banks for redemption in the usual way, but retain them for their own use over the counter. For instance, in June, 1912, the banks evidently held each other's notes until the June demand was satisfied, and in consequence the July redemption was abnormally large. In studying the circulation returns for recent years therefore, these peculiar conditions, and the expedients resorted to for supplying the extra circulation required, must be taken into account.

9. *Monthly changes.*—Figure 3 shows the difference month by month, six months of redemption and six months of issue. The months arrange themselves naturally into three groups, as follows:

Months of Issue	*Months of Redemption*
February.	April.
March.	May.
June.	July.
August.	November (4th week).
Months of Issue	*Months of Redemption*
September.	December.
October.	January.
November (3 weeks).	

The circulation year commences with the month of February, which shows a slight output varying in amount, and due principally to the requirements of the lumbering industry. March again calls for an increased issue, as in this month the lumbering camps are paid off, and only sufficient men for the drives are retained. In April and May most of the March circulation is redeemed, as the lumbermen return from the woods and pay their family bills for the winter at the village stores, or otherwise spend their winter's pay.

CIRCULATION OF CANADIAN BANKS

Volume in Millions as reported in the Government Statement at the End of Each Month

1901–1913

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Capital
1901	45	46	48	47	46	49	49	51	56	58	58	54	67
1902	49	50	52	51	51	54	52	55	61	66	65	61	73
1903	55	56	58	56	57	59	58	60	64	71	67	63	79
1904	57	58	60	59	58	60	60	60	64	72	69	65	80
1905	58	59	59	60	58	62	61	62	70	77	73	70	85
1906	61	62	66	67	64	69	68	70	77	84	81	78	95
1907	68	71	76	73	71	76	73	77	79	84	84	78	96
1908	67	69	69	67	68	68	67	70	76	83	80	73	96
1909	66	67	69	67	69	70	71	72	79	90	86	81	97
1910	73	75	78	79	77	80	81	81	87	96	90	88	100
1911	77	80	82	84	82	89	89	91	97	106	102	102	108
1912	88	89	96	95	94	102	96	102	104	111	116	110	115
1913	95	97	102	98	103	106	99	106	111	118	119	108	118
1914	97	96	97	93	98	99	95	115	120	124	115	106	115
1915	97	96	97	96	99	100	100	100	106	123	124	122	114
1916	111	114	115	119	115	122	124	123	135	145	148	149	113
1917	133	138	148	146	143	157	155	156	178	190	196	193	112
1918	172	176	191	181	182	195	188	201	212	228	235	224	111
1919	203	205	215	209	216	218	207	222	226	236	238	232	115
1920	217	223	226	223	226	228	231						

Difference in Millions over Previous Month, 1901–1913
Decrease shown thus: — 2 (minus two)

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
1901	– –	1	2	– 1	– 1	3	0	2	5	2	0	– 4
1902	– 5	1	2	– 1	0	3	– 2	3	6	5	– 1	– 4
1903	– 5	1	2	– 2	1	2	– 1	2	4	7	– 4	– 4
1904	– 6	1	2	– 1	– 1	2	0	0	4	8	– 3	– 3
1905	– 7	1	0	1	– 2	4	– 1	1	8	7	– 4	– 3
1906	– 9	1	4	1	– 3	5	– 1	2	7	7	– 3	– 3
1907	– 10	3	5	– 3	– 2	5	– 3	4	2	5	0	– 6
1908	– 11	2	0	– 2	1	0	1	3	6	7	– 3	– 7
1909	– 7	1	2	– 2	– 2	1	1	1	7	11	– 4	– 5
1910	– 8	2	3	1	– 2	3	1	0	6	9	– 6	– 2
1911	– 11	3	2	2	– 2	7	0	2	6	9	– 4	0
1912	– 14	1	7	– 1	– 1	8	– 6	6	2	7	5	– 6
1913	– 15	2	5	– 4	5	3	– 7	7	5	7	1	– –
1914	– 9	– 1	1	– 4	5	1	– 4	20	5	4	– 9	– 9
1915	– 10	– 1	1	– 1	3	1	0	0	6	17	1	– 2
1916	– 11	3	1	4	– 4	7	2	– 1	12	10	3	1
1917	– 16	5	10	– 2	–3	14	– 2	1	22	12	6	– 3
1918	– 21	4	15	– 10	1	13	– 7	13	11	16	7	– 11
1919	– 21	2	10	– 6	7	2	– 11	15	4	10	2	– 6
1920	– 15	8	3	– 3	3	2	3					

June, especially during the last three or four years, has shown a very considerable rise in circulation; then navigation opens, the large lumber drives are completed and the men paid off. Payments for dairy products increase in amount and general activity prevails thruout the country. July is a redemption month, and generally shows a considerable falling off; factories are closed down for repairs and stock taking, and the steady circulation of factory pay-day asserts itself by its absence. In addition to this the summer exodus to the seaside and to Europe begins with the consequent purchase of traveling funds. August is the first of the three great months of issue. Butter, cheese, and hay, with vegetables and all manner of fruit for cannery and table use, call largely for currency, and with increased momentum join forces with the cereals in September and October until the highest point of the circulation is reached, usually in the third week of November. Toward the end of November the steady return of the circulation begins and continues all thru December and January.

It is, of course, impossible to detail all the influences which affect circulation, but the above covers more important points.

A late winter or spring, for instance, will, of course, affect the figures for the spring months slightly, and those for the fall may be influenced by the lateness of the crops or by the holding of their produce by the farmers in the hope of better prices, but these changes are all adjusted within six months, the year's average is not affected, and the fluctuations, tho delayed, take place as usual.

A study of the circulation returns of the various banks as given in the Government statement of July 31st, 1920 (Figure 1), will show the manner in which the excess circulation is taken care of by each bank.

Every bank with one exception has circulation in excess of its paid up capital, fourteen banks are depositors in the central gold reserve (four in excess of requirements), three banks issue their excess entirely as emergency circulation, and eleven banks partially so.

Total circulation July 31st, 1920 (000 omitted)		$231,534
Paid up capital (eighteen banks)		126,051
		$105,483
Circulation margin (one bank)		140
Total excess circulation (seventeen banks)		$105,623
Less central gold reserves	$99,850	
Less surplus deposited in excess of circulation (four banks)	1,596[1]	98,254
Total excess circulation issued as emergency currency		$7,369

The total amount that could be issued by all the banks as emergency currency is $38,412,000, but

[1] This amount is allowed to remain on deposit probably in anticipation of the increase in circulation. Pending such increase it becomes part of the general reserve of the bank, and could be withdrawn if required.

the majority of banks, especially the larger ones, prefer to deposit in the central gold reserve.

The banks issue excess circulation at a distinct loss. A deposit in the central reserve entails the depletion of cash reserves and a charge for safe keeping. The emergency currency is taxed 5% for the time it is outstanding.

10. *Emergency currency.*—The provision for a special issue during the crop-moving period, tho limited in operation, was found sufficiently useful to be incorporated in the Act of 1913. It provides that during the crop-moving period, from the first of September to the end of February, banks are at liberty to increase their note circulation to the extent of 15 per cent of the combined total of their paid-up capital and reserves. A bank, for instance, with a paid-up capital of $10,000,000 and a reserve of $5,000,000 would, of course, at all times be able to issue notes up to $10,000,000, but during the period from September 1 to February 28 it can make a further issue of 15 per cent of $15,000,000, namely, $2,250,000, excess, or a total of $12,250,000. As this excess is subject to a government tax of five per cent, its use entails a loss to the bank, and consequently it is used only when absolutely necessary.

In August, 1914, this privilege was extended thruout the whole year.

11. *Central gold reserves.*—For some time it had been felt that the emergency currency and other expedients were only tentative measures, and that in the

revision of the Bank Act a satisfactory solution of the difficulty would be found. The central gold reserve furnishes a solution of the difficulty, and is a consistent amplification of the note-issue system, which has so completely met the requirements of the country during the last fifty years.

The central gold reserve is an ingenious plan whereby the banks are enabled to issue bills to an unlimited amount without departing from the well-established principles of an asset currency limited to the amount of paid-up capital. The notes issued under this plan possess all the desirable features of elasticity and convertibility in common with the ordinary issue. As a matter of fact, there is only one issue, and the central gold reserves come automatically into operation as soon as the circulation issued by a bank exceeds its authorized amount, and are immediately released by the retirement of the excess in the ordinary course of redemption.

The machinery is simple. Under the new law four trustees are appointed—three by the banks and one by the Minister of Finance—and the banks are empowered to deposit with these as much of their gold as they like. This deposit is called the central gold reserves. The banks are then permitted to issue against the reserves their notes, dollar for dollar, as and when required.

Thus, as has already been said, a bank with $10,000,000 paid-up capital, $5,000,000 reserve, would at all times be able to issue up to $10,000,000, and during the emergency period (September 1 to February 28), would be enabled to increase its circulation to $12,250,-000. This bank would in all probability deposit with the central gold reserves, say, $5,000,000 in gold or Dominion notes. It would then be at liberty to allow its circulation to run up to $15,000,000 at any time, or to $17,250,000 during the emergency period, and it could issue a still larger amount of notes by making a further deposit with the central gold reserves.

Under previous acts, Canadian bank notes have proved themselves to be as good as gold; and the excess circulation protected by the central gold reserves have proved equally as good, even under the severe test of war and reconstruction conditions. The system of issue and redemption thru the branches could not be improved upon. A note issue which has absolute security, rapid convertibility, and unlimited elasticity must surely come as near perfection as it is possible to reach.[1]

12. *Lost and destroyed notes.*—There is a very exaggerated idea in the mind of the public as to the amount of notes that are lost or destroyed, and never presented to the banks for redemption.

So far as the banks themselves are concerned, the amount is immaterial; they cannot profit by it in any way, except in so far as the notes form part of their general outstanding circulation. In case of the failure of a bank, the liquidator, at the end of three years, pays to the government an amount sufficient to re-

1 See Chapter III Section 16 "Reserves."

deem all outstanding notes; in this way the government eventually gets the benefit of any notes not presented for redemption.

Very few people can give instances within their personal knowledge of notes destroyed beyond recovery, either by fire or other agencies. When such accidents do occur the banks always stand prepared to consider a refund of the amount lost, provided satisfactory affidavits and bonds are submitted.

No bank is able to give any figures as to the amount of destroyed notes represented in its circulation; notes issued forty or fifty years ago are still being presented for payment.

A study of the course of redemption of the Sovereign Bank circulation is interesting. This bank failed at the beginning of 1908 with an outstanding circulation of $1,988,585; at the end of six years (January 1, 1914) there remained $23,520 unredeemed or only 1.18 per cent of the amount outstanding on January 1, 1908. On August 31, 1920, this amount had been further reduced to $12,455 or 61 per cent. During 1920 redemption averaged over $65 monthly. The outstanding balance consists entirely of fives and tens, all larger denominations having been redeemed.

13. *Branch system.*—Practically every country in the world except the United States has recognized the utility, if not the absolute necessity, of the branch system banking in handling commodities as liquid as money or credit. A bank system without branches is on a par with a city without waterworks or a country

without a railroad so far as an equable distribution of credit is concerned.

On September 1st, 1920, there were in Canada eighteen banks, with head offices situated principally in Montreal and Toronto controlling 4,819 branches[1] of which 4033 are situated in Canada, forty-eight in Newfoundland and one hundred thirty-eight elsewhere, chiefly in the West Indies. Some of these banks have over five hundred branches scattered thruout the Dominion, receiving money in Vancouver today and lending it in Halifax tomorrow, or the reverse; and ceaselessly working to remove money from where it is least needed to where it is most needed. With a branch system money always finds its own level. A merchant in the West pays no more for his banking accommodation than his confrére of equal standing in the East. The immense territory covered

[1] The Branches of Canadian Banks on August 31, 1920, were distributed as follows:

Canada	4,633
Ontario, 1550; Quebec, 1138; Nova Scotia, 168; New Brunswick, 124; Prince Edward Island, 39; Manitoba, 343; Alberta, 429; Saskatchewan, 599; British Columbia, 240; Yukon, 3.	
Newfoundland, 48; and St. Pierre et Miquelon 1	49
Elsewhere	137
Great Britain, 8; Spain, 1; Cuba, 46; Mexico, 2; France, 3; United States, 15; West Indies, etc., 48; South America, 14.	
Total	4,819

During the war the banks opened comparatively few branches, and at the signing of the armistice their number was 3,415. Since that date however the banks have been most active in opening branches thruout the country and abroad, and over 1,500 new branches have been opened and 100 closed, leaving a net gain over the armistice figures of 1,404 branches, or an average of 70 a month.

by Canada alone makes branch banking an absolute necessity for the economic and efficient distribution of loanable capital and banking facilities. Any other method would be cumbersome and wasteful.

Under the Bank Act banks are permitted to "open branches, agencies, and offices." No restriction is placed by the government on the number or situation of the branches to be opened by any bank, and to this absence of red tape may be ascribed in great measure the successful working of the system in Canada.

As a practical illustration of the work accomplished by the branches in distributing wealth, let us take two towns—it is immaterial whether they are ten miles or three thousand miles apart. A is a comparatively wealthy town, with a population composed in great part of retired merchants and farmers, with practically no industries and with little or no enterprise. Its deposits are large with no demand or outlet for money in the town. B, on the other hand, is a busy little manufacturing town with all its money invested in its constantly increasing industries, and the branch here receives but meager deposits to meet the heavy demands for advances. Now this is where the branch system steps in and enables the B branch to use the surplus funds of A, thus supplying the legitimate requirements of B's customers, to the profit of the bank and the benefit of the town. When it is remembered that this principle is working every day in hundreds of branches thruout Canada in towns and villages ten, one hundred or one thousand miles apart, and yet just as intimately interdependent of each other as in the above instance, the benefit and economy of the branch system will be realized. From this it will be seen that no matter how small the deposits are in a branch, its loanable funds are limited only by the available resources of the bank of which it forms an integral part. A branch till is like the widow's cruse of oil; it can never be emptied nor yet, on the other hand, can it be made to overflow.

A consideration of the great area over which the branches of Canada are spread and the variety of interests to which they minister, impresses one with the fact that Canadian banks are not local in character, and that their interest and their activity are not bounded by the confines of any one town or province, or even by the Dominion itself.

14. *Branch system and circulation.*—The branch system and the note issues are the two principal factors which have enabled the banks to assist so materially in the expansion and upbuilding of Canada. They are so closely connected and interdependent that it is necessary to consider them together. Without branches the circulation would lack in a great measure the elasticity of issue and redemption which is its most useful and characteristic feature. Without the circulation privilege it would be impossible for the banks to open branches in new and sparsely populated districts.

It is well known that the average branch is run at a loss for the first three or four years, and bearing this in mind a consideration of the large number of branches opened yearly by the banks, must lead to the conclusion that many banks are devoting at least the whole of their profits on circulation to the opening of branches and the development of new districts. An average of three or four new branches opened yearly might easily absorb the profit on $1,000,000 circulation, especially in the West, where the initial and the operating expenses are high.

Branch banking was long ago brought to a high degree of perfection in Scotland, but that country must yield the first place to Canada in the number of banks or branches in proportion to the population. Contrast with other countries is afforded by the following figures which tho of different dates can be used for broad general comparisons.

Country	Date	Estimated Population	Banks Number	Banks per 100,000 Population
Canada	1919	8,835,000	4326	49
United Kingdom.	1917	42,945,738 (*a*)	9386	22
Scotland	1917	4,854,738 (*a*)	1300	27
England & Wales	1917	33,711,000 (*a*)	7092	21
United States...	1919	107,600,000 (*b*)	25125 (*c*)	23
United States...	1919	107,600,000	29238 (*d*)	27

(*a*) Statesman's Year Book, (*b*) Treasury Estimate, (*c*) National and State banks, (*d*) Foregoing with Savings Banks, Private Banks, Loan and Trust Companies added.

As regards cities it was estimated at a somewhat earlier date (1912) that there were in Canada 32 banks per 100,000 population and in the United States 10 banks for the same number. It will be seen from this that Canadian banks have given a good account of their stewardship so far as supplying banking facilities to the country is concerned. Without asset currency, however, such expansion would have been impossible.

15. *Branch system and the borrower.*—The economical and equable distribution of loanable funds made possible by the branch system has already been referred to. The control of these funds and the ability to direct them to different parts of the country, according to the demands of trade and agriculture, has enabled the banks to accomplish astonishing results with the means at their disposal. The banks, as a whole, form a vast clearing house not only between the depositor and the borrower, but also between borrower and borrower. A little consideration shows that the latter is an important factor in the financial life of a country so extensive as Canada. The banks are continually lending to Peter to pay Paul, altho these two gentlemen may be quite unconscious of the relation and have probably never even heard of each other.

There is practically little or no fluctuation in the *total* amount of commercial loans, only a steady increase due to the growth of the country, the demand for the loanable capital at the disposal of the banks generally being in excess of the supply. In the government statement of July, 1920, commercial loans were reported at a trifle over $1,377,000,000 as against $1,385,000,000 in the following month and $1,014,-

000,000 in July, 1919, yet in the face of this constant increase, banks are accused of restricting their loans unduly. It is true they restrict unwise expansion in times of financial stress, and are always foresighted in preparing the country for troublesome times, but this action is of inestimable benefit to the country. Even under the serious conditions which prevailed in 1893, 1907, and 1903, and since the war, regular customers were not restricted in the use of their authorized lines of credit or reasonable renewals thereof. The banks did refuse to make advances for projects outside ordinary business requirements, such, for instance, as an unusually heavy purchase of raw material, not for the immediate needs of the business, but simply available at a bargain. New accounts at such a time are not encouraged, and all ventures other than those devoted to the creation and distribution of products are consistently refused assistance.

The slow and apparently placid increase of the loans, as shown by the monthly statements, is deceptive, for beneath the surface lies a seething mass of activity, inextricably interwoven. The continued existence of each kind of advance depends in great measure on the constant mobility of every other. Repayments of advances made by one class of industry are received in time to be lent to an entirely different business, possibly at the other end of the country, and so on. If lumber becomes unsalable from overproduction or other causes, the advances made for lumbering operations would not be liquidated in season, and the banks might find it difficult to satisfy the requirements of other industries, which generally make use of these funds as they are returned.

This will indicate how necessary it is for the banks to observe at all times one of the most important rules of sound banking, namely, that every loan made by a bank should rest on a foundation of salable merchandise or collectible debts. It is for this reason that loans on real estate have no place on the books of a commercial bank, whose profit and existence are dependent on the frequency of this "turn over," and the keen interest which bankers take in preventing overproduction in any line is thus justified. The average customer gauges his output from local or provincial experience, the banker from a national and international standpoint.

A concrete example may be of value in illustrating the circulation of credit attained thru the branch system. Take, for instance, a western farmer who borrows money from a bank in the beginning of the year in order to pay for seed and labor, and about the same time becomes indebted to the local store for supplies and the like. When he harvests his crop, in the ordinary course, he sells it to a grain buyer, who pays him by a check or order on the bank. This money is used by the farmer to discharge his debt to the bank and to the store; the balance, if he is a thrifty man, he deposits. The storekeeper remits his receipts from such payments to the wholesale houses in the East, and the wholesaler liquidates his indebtedness to his bank or to the manufacturer; the latter in turn pays his bank and buys more raw material. This is an instance of only one class of loan, but it will give some idea of the fluidity and interchangeability of credit which is possible thru the branch system. It might further be pointed out that the aggregate liquidation of loans by the farmers and correlative debtors enables the banks to finance the crops by making advances against warehouse receipts, etc., which are ultimately liquidated by drafts with bills of lading attached. This financial operation provides the basis for foreign exchange with which to pay for the raw material and other imports of the manufacturer and wholesaler. It is impossible fully to appreciate the far-reaching effect of even this simple payment of a farmer's debt. The discharge in any part of Canada of a debt of no matter what nature or size, is likely to be equally dynamic in its influence on the huge tho sensitive volume of loans.

16. *Establishing a line of credit.*—There are certain conditions covering the relation of Canadian banks with their borrowers which are invariably observed. One is, that no man can be a borrower from more than one bank, and it is only in the case of a very large account that this rule is broken, and then only by mutual agreement between the banks interested. The advantage of this "one bank" policy is obvious. The customer benefits from the fact that in being loyal to one bank he can rely upon the support of that bank at all times. The bank is also

thoroly in touch with his position and prospects, and is often able to give valuable advice. Another condition a Canadian bank insists on, is that a full statement of a customer's affairs should be submitted to it each year, and that as far as possible loans should be cleaned up at least once a year.

On the fulfilment of these conditions the bank on its part grants a customer what is called a line of credit, based on his estimated requirements, which is generally for a period of one year, during which time the customer is able to use as much or as little of the authorized credit as his business requires; providing, however, that he does not exceed the limit. A customer of a Canadian bank of good standing has therefore very little to worry about during the currency of his line of credit. He is not called upon to pay interest on more money than he is actually using, and he is, moreover, assured of the support of the bank in the operation of his legitimate business, no matter what the financial conditions may be.

The position of a bank customer in the United States is very different and not always so comfortable. National banks are restricted by law in the amount of loans they may make to any one firm or corporation, and large concerns are forced to seek loans all over the country. This practice is not to the advantage of the borrower; he is dependent on note brokers to dispose of his paper to various purchasers thruout the United States, to whom he is personally unknown. The paper must be met at maturity without fail. True, provision could be made by selling more paper, but if money is at all scarce even this resource is not available and, in consequence, solvent firms may be forced to the wall. The position is an unfortunate one for the borrower, not only because his finances are always in a state of uncertainty, but because the practice has a tendency to encourage over-borrowing in times of easy money, with consequent over-expansion. This evil is unlikely to happen to a man who has only one bank to deal with, as no trained banker would allow a customer to obtain more money from the bank than his business conditions warranted. A brake is just as necessary in business life for averting disaster, as it is in the mechanical world.

This method of financing naturally restricts the manufacturer and wholesale merchant to the making of one class of paper, their own single name notes, and consequently comparatively few settlements with their customers are effected by means of notes or drafts, the amounts due being carried in open account until the customer remits according to the terms of the sale. Of recent years, the business men of the United States have realized the value of trade bills in settling obligations, and an active educational campaign has been conducted by the credit associations and banks, with good results.

In Canada, however, open accounts are the exception, and practically every sale of goods is subject to settlement by draft or note. These notes and drafts are known as trade bills and are discounted freely by a bank and collected thru its various branches, the proceeds being applied in reduction of the customer's loans.

The Canadian borrower has therefore two methods of borrowing, loans and trade paper. Loans are made with or without security for the purpose of creating or purchasing goods. The goods when made or acquired are exchanged for cash, notes or the right to draw on the purchaser; the two latter are known as trade bills and, when discounted by a reputable firm, form the highest class of security a bank can have.

The discounting of trade paper is of benefit both to the bank and to the borrower. The latter changes a direct loan into an indirect or contingent liability, and is assured of the effective and prompt collection of the debt. The bank receives tangible evidence that its loan has been devoted to the production of goods, and that the goods have been disposed of to responsible merchants; furthermore, its position is strengthened by a second name and a definite date of payment.

17. *Branches and panics.*—It is apparent that the branch system not only gathers up money thruout the country, but distributes and varies the risk of the bank's investments. It does more than this, it distributes the risk of the deposits which, at times, is a very real risk. A run on a solvent bank is always more or less local in character and, tho quite capable of wrecking an individual bank, would not seriously affect the standing of a branch banking system. Not

only would the head office be able to send ample funds to pay off every deposit if necessary, but the branch itself would be in a position to allay the run by its ability to pay out its own notes; these would be taken readily by the depositors and, as a rule, assistance from the head office would not be required. Nothing will stop a run of this kind quicker than an apparent willingness and ability to meet all demands. Frequently, in such cases, the majority of the deposits are returned to the bank if it is willing to take them. Depositors who can be stampeded in this manner by a chance word or a rumor are not desirable, and the refusal to reopen a few of these accounts has a very salutary effect on a community. So unreasonable are panics of this nature that people have been known to withdraw money from a small city branch and deposit it in the main office of the same bank farther down the street, but occupying a more pretentious building. Such panics as these are disagreeable, but do not seriously affect a bank as a whole, and fortunately they seldom happen.

Even a serious loss by way of a bad loan would not affect the security of a branch depositor; no matter how small the branch, the depositor shares in the general security of the assets of the whole bank. The failure of a large customer might easily force a purely local bank to close its doors, but under the branch system the loss would be spread over the earnings of the whole system.

Altho the keenest competition exists among the banks in obtaining business at their various branches, and little or no intercourse occurs between the general managers in ordinary times, they are, as trained bankers, naturally in accord in interpreting the first signs of trouble on the financial horizon, and either in their several annual addresses or thru the press warn the public to retrench and prepare for the storm. All the annual reports of the banks issued at the end of 1906 and beginning of 1907 contained, in the addresses of the several general managers, serious warnings of troublesome times ahead, which unhappily materialized in October, 1907. Banks made themselves very unpopular in the early part of 1914 by their insistence on retrenchment in all lines of business activity, as they foresaw depression. The unexpected outbreak of war therefore found loans in process of satisfactory reduction and the banks in excellent position to face the strenuous times ahead.

Should a sudden emergency ever arise a few hours would suffice to bring the general managers of the eighteen banks to Montreal or Toronto. Their united counsel and experience would go far to ward off the anticipated trouble. In a few hours, if necessary, every branch in Canada from Dawson City to Halifax would act in unison. With a system capable of such control a general crisis or panic would be almost impossible.

Consider, too, the personnel of the general managers, who are men trained from their youth up to their profession. as only the branch system can train.

In their early years, moving from branch to branch thruout Canada, they became thoroly versed in local customs and environments, and in many cases they gained experience in foreign branches in England, the United States and elsewhere. As accountants and managers of large city branches they obtained a broad knowledge of national trade and finance until, as general managers, they are found not only directing the administration of their numerous branches, but also digesting and interpreting the reports of conditions received from the branches, scattered thruout the length and breadth of Canada. There are few things connected with the life of Canada that a banker can afford to leave unstudied. The weekly reports or news letters received from the branch managers deal with every variety of subject, from the price of staples to the death of a leading citizen. As a result, the bankers know more of the general conditions of Canada as a whole than anyone else. It has been said that the files of one of the larger banks contain more valuable and accurate information than can be found in any newspaper office.

18. *Interdependence of Bank Loans and Deposits.* Altho there is keen competition among banks to obtain deposits in order to increase their loans, it is not generally realized that loans are the antecedent and basis of deposits, and that banks as a whole create the funds which make deposits possible. The obtaining of deposits, which represent the proceeds of loans already in existence, enables a bank to protect and

increase its reserves. The reserves are protected to the amount by which the new deposit offsets customers' cheques presented by other banks through the Clearing House. If new deposits exceed these withdrawals, the reserves of the bank are thereby increased, as such balances are settled in Dominion notes or gold, and the bank in question can increase its loans accordingly. In other words if a bank gains $100,000 in reserves in this manner, it could increase its deposits $400,000 by making loans to that amount, twenty-five per cent of cash reserves being sufficient to maintain the amount of new deposit currency.

The principal business of a bank therefore consists of exchanging its own well-known and acceptable credit for that of the less known credit of its customers. In other words, a bank exchanges the evidences of its own indebtedness, which have a wide currency, for the evidences of indebtedness of its customers, which have a narrower or local currency and in addition will exchange its own credit for the evidences of indebtedness of other banks. The evidences of a bank's indebtedness received by a customer, whether in the shape of a deposit entry, a bank bill or a bank draft, can be transferred from one individual to another, and from one bank to another. It will be seen from the above that the transactions of a bank in actual money are comparatively insignificant, although a bank holds money in the shape of gold and legal tender sufficient at all times to meet its credit with the public as acceptable as money itself. As each bank, however, has about the same amount of claims against the other banks as they have against it, the actual amount of money required for the adjusting of the daily difference is, as a rule, approximately five per cent of the total amount cleared.

When a bank exchanges its credit, say, for $1,000, for that of a customer, it receives from the latter a promissory note as evidence of the indebtedness, and in so doing creates a credit balance on its books for the customer who is then at liberty to issue cheques against it. These cheques are deposited in other banks and paid in due course by the first bank. The deposits created in the other banks by these cheques are themselves distributed in their turn, and so on, and as long as the original loan is unpaid the credit or deposit currency it created forms part of the total deposits of the banks.

It is a fundamental principle of sound banking that credit as a rule should be granted to the production or marketing of goods; conversely it should be liquidated as the goods, etc., upon which the credit is based, enter into consumption, the borrower in the meantime having deposited cheques received from his customers for goods sold until sufficient has accumulated to cancel the debt, and in so doing the deposits and loans of the world are both decreased by that amount.

Take a concrete case of a customer of a bank "A" making a deposit of $5,000 made up as follows:

The customer's own rate.	$1,000	Loan
Cheques on bank "A,"...	1,200	Evidence of indebtedness on bank "A"
Cheques on banks "B," "C," "D," and "E"...	1,500	Evidence of indebtedness of other banks
Draft on New York.....	570	Foreign exchange
Draft on London £150 at par	730	Foreign exchange
	$5,000	

The effect of this deposit will be to increase the total deposits of bank "A" $3,800 ($5,000—$1,200 in cheques) offset on the asset side by an increase in the loans of $1,000, cheques on other banks $1,500, increase in the New York balance $570 and London balance £150. Drafts can be immediately drawn and sold against these two last items.

The following day the cheques on banks "B," "C," "D," and "E," $1,500, are presented thru the clearing house, and are offset by delivery by the other banks of say $3,500, consisting of cheques on bank "A" and the difference, $2,000, is settled by bank "A" in Dominion notes. After the clearing the assets of bank "A" are thus decreased by $500 cheques on other banks and by $2,000 in gold, offset by a decrease of $3,500 in deposits.

The deposit of $5,000 consisting of $1,000 newly created credit and $4,000 of the general volume of credit already in circulation, will be checked out and again distributed among the banks, continuing to circulate as deposit currency until such time as the original debts, from which the credit arose, are paid off by the cancellation of an equal amount of the circulating and outstanding volume of credit.

Banks not only serve as a clearing house for local credit transactions, but are ready to buy or sell evidence of indebtedness payable in other places on the same country or abroad—these generally assume the form of drafts. To this end the banks encourage the public to utilize their services for paying debts abroad, and in order that they may be able to do this, encourage people who have claims against others abroad to sell these claims to them so that they can thus offset sales against purchases. In this manner banks are both buyers and sellers of inland and foreign exchange.

Banks are therefore indispensable in the distribution and operation of credit under modern conditions, and it is most important in the study of banking and exchange to fully realize the interdependence of bank loans and bank deposits, not only nationally, but internationally, and that a credit once granted tends to swell the volume of the world's credits until such time as the relative loan on which it is based is liquidated.

The business level of credit is governed by the commercial needs of a country; it is adjusted between the banks through inland exchange and the local clearing houses, and tends always to correspond with the business level of the world's credit, adjusted through the international clearing houses. For this reason a loan granted by a bank in one country may eventually increase the deposits in another country, London, New York and other financial centres.

Funds advanced on an issue of bonds or on a mortgage do not materially affect the situation, as they practically result in a transfer of deposit currency from one person to another, and the same may either be used in whole or in part to liquidate an indebtedness previously incurred, or may be deposited and chequed out in the ordinary course of business.

19. *Clearing houses.*—Reference has been made to the service rendered by the banks in converting deferred payments of money, in the form of bills of exchange and promissory notes, into deposit currency. The deposits so credited are transferred from person to person, from bank to bank and from community to community, the banks aiding in this progressive assembling and distribution of deposit funds through the agency of their branches, correspondents and clearing houses. Clearing houses are a comparatively modern invention, but they are now indispensable units of the modern financial machinery and the conditions which they are intended to meet enter into every phase of financial business. The Supreme Court of Pennsylvania defines a clearing house as follows:

"It is an ingenious device to simplify and facilitate the work of the banks in reaching an adjustment and payment of the daily balances due to and from each other at one time and in one place each day. In practical operation it is a place where all the representatives of the banks in a given city meet and under the supervision of a competent committee or officer selected by the associated banks, settle their accounts with each other and make or receive payment of balances and so 'clear' the transactions of the day for which the settlement is made."

Inland exchange is a continuous and progressive series of "clearings." A bank acts as a clearing house between its own customers, the larger towns clear for the smaller towns in the same section and the financial centre of the country clears for the larger towns and at the same time adjusts international balances between this country and other countries.

If there is only one bank in a town it acts as a clearing house between its customers by transferring amounts from one account to another. If there are two banks in a place they offset the cheques drawn on each other and adjust the difference by a draft drawn on the nearest centre, if there are three banks it will involve three settlements, if four banks six settlements, while eight banks would involve twenty-eight separate settlements and the work would be greatly simplified and lessened by the establishment of a local clearing house which would operate as follows:

Each morning representatives of the eight banks meet under the supervision of a competent officer, and each bank delivers seven parcels of cheques drawn on other banks and receives seven parcels of cheques drawn on itself. The difference between the total deliveries and receipts of each bank is adjusted in one amount, paid to or received from the clearing house.

20. *General review.*—A study of the Canadian banking system along the above lines will demonstrate clearly why it has been accorded such a high place among the banking systems of the world, not only on account of the equable distribution of loanable funds thru the branch system, but also on account of the absolute safety of the note issue and its elasticity in meeting every need of national life and commerce. The uniform reciprocal payment of each other's notes at par by the banks all over the Dominion, followed by prompt redemption, renders forced and unhealthy inflation an impossibility, while the automatic expansion of the circulation whenever required or called for by the exigencies of commerce and agriculture renders it peculiarly adapted to the needs of a young and growing country like Canada.

Dr. Joseph French Johnson sums up the main advantages of the Canadian system of branch banking as follows:

1. Large capital behind each institution. No matter how small the branch the customers share in the security which a large capital offers.

2. Unity of policy on the part of the leading banks during a stringency, in contrast to the playing at cross purposes which, in the panic of 1893, distinguished the action of the national banks in the central reserve cities of the United States against the smaller country banks. In 1907, if the country banks had been branches of the large city banks, they would not have withdrawn funds from those banks when they were so badly needed, and the crisis would not have been so severe.

3. Power to equip every branch with ample reserves for

maintaining commercial credit by means of note issues. It is impossible in Canada for the business needs of any community, no matter how remote, to outstrip the banking facilities, as is often the case with us. The resources of the branch bank are quickly and indefinitely extended. Moreover, when the need for additional facilities has passed, the business of the bank can ~~control~~ contract accordingly without loss to anyone.

4. Uniformity of interest thruout the whole country which does not vary more than one or two per cent between the large cities in the east and the newer towns and rapidly expanding cities of the west. In the absence of competition the necessity of depending upon small local banks for accommodation requires the business men of western towns in the United States to pay monopoly rates for the use of capital.

5. Expert supervision by the central office prevents bad banking The boards of directors of the large banks are responsible for all the branches and they are therefore forced to put into practice a method of examination and supervision which is much more effective than government examination in the United States

6. Branches can be maintained in localities where the profit of the business would not justify the establishment of a separate bank with independent capital. The city banks can establish branches without any investment in additional capital. Branches can be established where the business is so small as to justify simply the employment of a few clerks in a rented office.

REVIEW

Describe the various forms of currency used in Canada. What currency is legal tender?

What is meant by elasticity in currency? How does the Canadian system of note issue provide for this?

What situation proved the excellence of the Canadian banking system? How?

Why does the branch bank system work particularly well in Canada?

CHAPTER VI

ANALYSIS OF A BANK STATEMENT

1. *Bank statements.*—The Bank Act requires the banks to furnish the government with monthly statements of their assets and liabilities, and in addition to these, an annual statement to the shareholders. The latter differs only slightly in detail from the monthly statements, and is submitted to the shareholders at the annual general meeting, accompanied by the profit-and-loss statement and the report of the auditors. The annual reports of the several banks appear at various dates during the year, principally during the winter months. The monthly and annual statements are published in the various financial and other papers and are subjected to the closest scrutiny and analysis both by the press and the banks themselves.

The totals of the combined monthly statements of the banks as published by the government are of particular interest, as the figures generally afford a very fair barometer of the financial condition of the country.

To the average man a bank statement has no more than a passing interest. Even if he goes so far as to compare the statement of one bank with another, the bare figures tell him very little more than that one

STATEMENT OF THE PERCENTAGE BANK OF CANADA

Liabilities	Percentage to Total Liability to Public, 1920		Percentage to Total Liability to Public, 1912	
Notes of Bank in Circulation		8.28		6.54
Balance due Prov. and Dom. Governments	9.39		1.25	
Demand Deposits	25.57		23.33	
Deposits Payable after Notice	37.64		59.26	
Deposits elsewhere than in Canada	14.89	87.49	6.90	90.74
Bills Payable		.33		.00
Due to other Banks in Canada		.24		.41
Due to British Banks		.13		.75
Due to Foreign Banks		1.31		1.56
Letters of Credit		2.22		.00
Total Liability to the Public		100.00		100.00
Capital Paid up	3.71		7.16	
Reserve Fund	4.03		5.74	
Undivided Profits	.64	8.38	.33	13.23
		108.38		113.23

Assets	Percentage to Total Liability to Public, 1920		Percentage to Total Liability to Public, 1912	
Specie and Dominion Notes		11.97		12.61
Central Gold Reserves		4.93		.00
Cir. Redemption Fund		.19		.32
Notes and Cheques on other Banks		5.68		4.03
Due from Canadian Banks		.01		.61
Due from British Banks		.02		.96
Due from Foreign Banks		2.98		2.17
Total Quick Assets		25.78		20.70
Dom. and Prov. Government Securities	10.30		2.42	
Municipal Bonds, etc.	8.47		3.16	
Railway and other Bonds and Stocks	2.02	20.79	3.02	8.60
Call Loans in Canada	2.75		4.03	
Call Loans elsewhere	9.28	12.03	6.13	10.16
Total Liquid Assets		58.60		39.46
Current Loans		45.93		71.31
Customers' Liability *re* Letters of Credit		2.22		.00
Overdue Debts		.07		.12
Real Estate other than Bank Premises	.14		.13	
Mortgages	.01		.18	
Bank Premises	1.41	1.56	2.03	2.34
		103.38		113.23

The above percentages are based on figures obtained from the combined annual reports of several Canadian banks, and refer to no particular bank.

FIGURE 4

bank has larger deposits or loans than the other, but as to the standing or earning power of the banks in question, he can form but a faint idea until he has compared them on a common percentage basis, say, to total assets. A full understanding of a statement of a bank forms a very good introduction to the actual practice of the business; and in order to present the leading features in the most comprehensive form the statement[1] on page 101 (Figure 4) has been prepared. This is based on the annual statements of several banks for the year 1919, with the amounts under the various headings reduced to a percentage to total liability to the public. For comparison, similar percentages for the year 1912 are given. The several headings will be considered briefly in detail, and should be studied with special reference as to their relation, the one with the other.

A bank statement is primarily intended to show the distribution of the assets of a bank and to whom they ultimately belong, the public or the shareholders. The bank occupies a dual relation to the public; it is, on the one hand, a buyer of credit and, on the other, a seller.[2] The prime qualification for successful banking is so to command the public confidence that the public will deposit its money freely and continuously. The liabilities of a bank to the public are

1 This statement should also be compared with the percentage of the combined monthly statements of all the Canadian banks as reported to the government for the month of July, 1920, Figure 2.

2 See Sec. 18, Chapter V. Interdependence of loans and deposits.

therefore of the most vital importance to its existence and will be considered first.

These may be roughly divided into circulation (8.28%), sundry liabilities (4.93%), and deposits (87.49%). Although the ratio of the latter remains practically the same (90.74% in 1912), considerable change has taken place in the percentages of the various classifications. These are referred to below.

2. *Deposits payable after notice.*—A reference to the statement will show that nearly 38 per cent of the liabilities to the public consist of interest-bearing deposits or, as they are sometimes called, time deposits or savings bank deposits. They form the largest individual item in the statement with the exception of current loans. In 1912 these deposits formed nearly 60% of the total liability to the public. This marked difference is due principally to war and exchange conditions, and is offset by increases in the amounts due the Dominion Government and foreign countries. Time deposits are so called because they are deposits made in the savings bank department of a bank and under the rules of the department are subject to a withdrawal notice of ten or fifteen days. Practically, they are payable on demand, as no bank now makes a practice of exacting the required notice, altho the majority still retain a clause to that effect in their pass books. All these deposits bear interest at the rate of three per cent compounded semi-annually.

The chief difficulty a bank experiences in this kind of deposit lies in the fact that a certain class of the public is inclined to look upon a savings bank account as a convenience as well as an investment; the two are not compatible. A time deposit requires a small reserve and a minimum of bookkeeping and a three per cent rate leaves a margin of profit to the bank, but to give three per cent on an account subject to frequent checking is another matter and would be likely to result in an expense to the bank rather than a profit. In fact, of late years many of the savings bank deposits, thru competition, have been allowed to develop into ordinary checking accounts.

Theory as well as experience in Canada has shown that no bank can afford to pay a higher rate than three per cent without seriously affecting its position. In fact an increase of even one-half or one per cent would change the present net profits of the majority of the banks into a loss.[1] Deposits bought too dearly must be fully employed because interest and dividends must be earned in some way. Competition prevents a bank from lending money to legitimate enterprises at a higher rate than the market rate; consequently a bank paying a high rate for its deposits is forced to invest its money in risky undertakings, or else to maintain inadequate reserves, both very dangerous and undesirable expedients.

Fortunately, the bulk of the savings bank depositors are quite content to use their savings bank accounts for the purpose intended—a depositing place

[1] See Section 2, also Chapter on Bank Cost Accounting.

for their surplus money. Each person who keeps a bank account does so for his own convenience, but the result is an enormous control of credit placed at the disposal of the industries of the country thru the agency of the banks and their branches. In fact without these deposits banks could render but little assistance to the trade and commerce of the country. The steadiness of these deposits, the fact that by the law of average they can be relied upon to remain fairly constant in amount and that, except in very stringent times, they are constantly increasing, is the basis of the commercial credit system of Canada.

3. *Demand deposits.*—Demand deposits represent amounts due to individuals and firms payable on demand. No interest is paid on these accounts except in special cases where a large dormant balance is kept which could otherwise be transferred to the savings bank department. The average current accounts are frequently run at a loss, and were it not for the collateral profits accruing from the connection in the shape of exchange, discount and the like, the burden of operating them would be serious. The average cost of carrying a small account has been variously estimated at from $20 to $30 per annum. To cover this expense a full balance of at least $500 is necessary.

In order to prevent the abuse of the checking privilege some of the banks make a nominal charge for carrying small checking accounts, but it is a question even then if the bank comes out ahead.

The ratio of total deposits to the capital and reserve of the average bank is so large that even a small increase in the interest rate or in the expense of operating the deposits will materially affect the earnings on capital, unless, as has already been pointed out, the question of maintaining adequate reserves is neglected. In a lecture on "Interdependence of Trade and Banking" George H. Pownall, an English banker, in referring to the question of banking profits, says:

> Banking would not be possible if its present lines were seriously changed. We have to bear in mind that the business of banking, like every other kind of business of long standing, has evolved itself by daily-accumulating experience. I believe that depositors cannot expect a greater return than they now obtain, unless there were some general change in the supply of, and the demand for, loanable capital. Bankers do not take in deposit money as an investment for the depositor. The money comes in at the will of its owner, without notice, and is withdrawn without notice. That consideration governs the employment by bankers of their deposit money. They have individually to judge from the circumstances of their particular business what percentage of cash to their total liabilities they need to keep in their tills, what percentage of cash they shall keep unemployed to insure the public confidence in the stability of their institution, and what percentage of their liabilities to the public shall be represented by first-class securities, and first-class securities so written down in price that nothing but an extraordinary public catastrophe shall reduce their selling price below the figures at which they appear on the balance-sheet, and so produce an apparent deficiency in the assets of the bank. To keep money unemployed is to lessen earning power; to hold first-class securities is to obtain less than the average rate of return on money employed in loans,

and to write them down to a safe level is a form of insurance that expert opinion demands of a banker.

It is not only from within that these matters have to be looked at, it is also from without. There is a large class of the public perfectly able to reckon up the safety or insecurity indicated by the broad lines of a bank balance-sheet, and, in the long run, the strongest institutions get the deposits. Paradoxical as it may seem, a banker's balance-sheet must exhibit an ability to pay any proportion of the banker's liabilities likely to be called for by nervous people in times of stress, not merely because the call for repayment needs to be faced, but also because to exhibit strength is to discipline people to make the demand.

4. *Deposits elsewhere.*—These amount to 14.89% and represent deposits by individuals and firms made in branches outside of Canada. Part of these deposits in all probability bear interest. Combining them with the deposits maintained by foreign banks gives a total of over 16%, representing funds supplied by depositors outside of Canada. An examination of the asset side of the statement shows that the greater part of this amount is invested as a quick asset in call loans outside of Canada and on deposit with foreign banks. This question will be fully considered in connection with call loans.

5. *Due banks in Canada.*—Owing to the fact that practically every Canadian bank is represented by branches in the redemption centers and other large towns, there is no necessity for it to maintain balances with other banks for the protection of its interests at those points, and any balances which may be due between banks in Canada are merely as matters of con-

venience in connection with collection arrangements.

6. *Due to banks in foreign countries.*—Under this heading are included all amounts due to foreign correspondents and represent balances which are maintained by banks of Great Britain, United States, Europe and elsewhere which have business relations with Canada.

7. *Dominion and provincial governments.*—The branches of the banks act as depositaries of the Dominion and provincial governments, and transfer funds received at their various branches to Ottawa or to the several provincial capitals. All customs, internal revenue and Post Office receipts, including the deposits of the Postal Savings Bank, are deposited by the federal officers in the local branches of the various banks thruout Canada, and are transmitted by them to Ottawa for the credit of the government. Government cheques of every description, including those issued on account of withdrawals from the Postal Savings Bank, are, by the Bank Act, payable without charge at any branch of any bank in Canada.

Altho the collection and disbursement of the national revenues involve a great deal of work, it is done willingly by the banks, not only in a way, as a return for the note issue privilege, but also as an appreciation of the practical and economical manner in which the government handles its revenues and funds. So efficiently is this done thru the banks that no disturbance is ever made in business or financial circles by the movement of government moneys, notwithstanding their very large aggregate. All revenues received are left with the banks for commercial use until ultimately disbursed by the government. There is no wasteful piling up of gold in government vaults; every cent is allowed to do its share in the economic development of the country until wanted.

The net balance due to the government may be mobile, and at times comparatively small, but the principle is sound and works well in every respect. It would be almost impossible to devise a scheme for the collection and disbursement of government revenues that would work more smoothly or efficiently.

Canada in her scientific administration of government funds differs from almost every other country. The noticeable increase in the percentage of 1919 represents an unexpanded portion of the last Victory Loan, and probably some transactions effected under the Finance Act.

The balances of the provincial governments consist principally of deposits in connection with the Inland Revenue Department and judiciary accounts. The balances due the Dominion and provincial governments are privileged claims on the assets of a bank and rank above those of other depositors.

8. *Circulation*: The nature of this liability has been fully explained in Chapter V. In comparing the two years, regard must be given to the fact that in 1912 the central gold reserves were not in operation, and consequently a bank was obliged to keep a safe margin between the actual amount of its circulation and the

legal limit of paid up capital. No bank, especially one with numerous branches, would feel safe in increasing its circulation over this margin except during the period of emergency currency (September 1st to February 28th).

The circulation in 1920 stood at 8.28%, of which amount 3.71% is issued on the basis of paid up capital leaving 4.57% to be covered, dollar for dollar, by the deposit in the central gold reserves, which in this case amounts to 4.93%. The excess, .36%, is available as part of the general cash reserves of bank, and at the same time provides cover for any sudden rise in the circulation.

Emergency currency could also be issued to the extent of 1.16%, so the total possible circulation would be 9.80% as against the 8.28% shown in the statement. The circulation issued as emergency currency is taxed 5% for the time it is outstanding. Any circulation, therefore, issued by a bank in excess of its paid up capital, involves a loss.

In addition to the protection given to the noteholders by the general five per cent redemption fund, the statement shows that circulation uncovered by the amount deposited in the central gold reserves, namely, 3.35%, is protected by the total assets of the bank 108.38%, and the double liability of the shareholders 3.71%, 112.09% in all, or practically $167 for every five dollars in circulation.

9. *Capital and reserve.*—The difference between the amount due the public and the total assets 8.38%

represents the proprietors' or shareholders' investment. The latter consists of capital, \$6.33, and reserve and undivided profits, \$5.36. A reference to the profit-and-loss sheet on page 129 shows that the dividends declared were equal to 12.40% of the capital, or 6.07% on the capital and reserve. The net profit earned on capital and reserve is 9.05% or, as it is generally published, 19% on the paid-up capital. The method of basing earnings on the percentages to paid-up capital is a misleading one, and should be abandoned by the banks and financial papers or used only in conjunction with the percentage on capital and reserve. To base earnings on capital not only gives an erroneous idea to the public of the earning powers of banks, but does not form a fair method of comparison.

In case of the insolvency of a bank the shareholders are liable to be called upon for an amount equal to the par value of their shares.

10. *Specie and Dominion notes.*—Under this heading are included not only the gold and large legal tender held by the bank for its cash reserve and clearing house settlements, but it includes also the till and change money at the various branches. The latter, however, forms a very small proportion of the whole.

The only reference made by the Bank Act to a cash reserve is in connection with the requirement that at least 40 per cent of the cash reserve must consist of Dominion notes. This clause was introduced into the Bank Act in the early days of Confederation and was frankly intended as a forced loan from the banks. It has been retained at each subsequent revision, although the reason for the clause has long since disappeared and its continuation is not in the best interests of the country. Apart from this condition it is left entirely to the judgment of the individual banks themselves to fix their own cash reserves, and the experience so far has fully borne out the wisdom of non-interference in this connection on the part of the government. Considering that practically all the till money is in the form of a bank's own notes, the average cash reserve maintained by the banks of about 10 per cent to 12 per cent has proved fully adequate at all times. Some banks maintain a higher and some a slightly lower rate than the above according to their circumstances or requirements, the ratio varying with the same bank at different times. The daily redemption of notes and checks thru the clearings all over Canada acts as a constant check to any tendency on the part of a bank to lower its reserve below a certain limit.

11. *Notes and checks of other banks.*—This amount represents notes and checks of other banks in process of clearing. These have been deposited by customers during the day, and in the ordinary course are presented and redeemed thru the "clearing" the following morning. As the customer is given credit the same day and the bank does not receive returns until the following day, this amount represents a loss of one day's interest to the banks and forms a very consider-

able item in the course of a year. The amount outstanding under this heading for all the banks on July 31, 1920, was over $161,000,000, representing a steady loan to the public for that amount without interest, as this can be considered an average. The note circulation at the same date was $231,000,000, or, deducting the amount on deposit in the Central Gold Reserves, $131,000,000. In other words, the amount of these items exceeds the note circulation of the banks by $31,000,000. In addition to this the amount of checks in transit between the branches of the different banks themselves would run considerably over $100,000,000.

12. *Deposits with other banks.*—These amounts represent the balances maintained in the United States, Great Britain and elsewhere in connection with exchange operations, and make also a very useful way of carrying a certain proportion of the bank's reserve. These balances combined with specie, Dominion notes and the notes and checks of other banks form 25.78% of the bank's total assets, and are generally known as quick assets. With the exception of a few of the bank accounts, on which a low rate of interest is sometimes obtained, the quick assets do not earn interest.

13. *Securities.*—The securities held amount to 20.79% of the total assets and consist of municipal bonds and other first-class investments. The banks are not restricted in their choice of this class of security, and may purchase not only government, pro-

vincial and municipal bonds, but also the bonds of domestic and foreign railways and industrial corporations. Banks look upon these securities as a kind of secondary reserve, and include them with call loans among their liquid assets. The marked increase in this asset is represented principally by Victory bonds and other government and municipal securities.

14. *Call loans in Canada.*—Call loans in Canada represent advances made to brokers and other customers, principally the former, on the security of first-class stocks and bonds, with an average margin of some twenty points below the market value of the stock and, if loaned conservatively and watched carefully, form a safe and remunerative asset.

Call loans in Canada are not call loans in the strict acceptance of the word. The securities given as collateral have, as a rule, only a limited market principally confined to Canada. Comparatively few of them are listed on the stock exchanges of New York and London, and they consequently cannot be looked upon as a means of increasing the cash reserve of the country in case of emergency. An individual bank, in ordinary times, can, of course, reduce its call loans in Canada at any time for its own purpose, the brokers simply borrowing from another bank to meet the call, but in a general emergency a prompt response to a call by a considerable number of banks could not be relied upon.

Under these circumstances the rate of interest charged on these loans is considerably higher than that obtaining on strictly call loans in New York and London, and is only slightly lower than the rate charged on commercial loans, seldom falling below five per cent. In times of financial stringency the rate on call loans is generally higher than the commercial rate, which remains practically unchanged.

The Canadian custom of requiring a man to confine his borrowing to one bank—the one-bank policy as it is called—does not apply to brokers who from the nature of their business borrow where they can, the loans depending entirely on the securities pledged, rather than on the financial standing of the borrower. A broker is therefore a customer of one bank but a borrower from many. These latter naturally look after their own commercial customers first, and the broker, not being a regular customer, is of only secondary consideration, and he is loaned any surplus money of the bank after the requirements of the commercial and other customers have been met.

Banks are frequently accused of encouraging speculation on the stock market at the expense of their commercial customers, but this is certainly far from the case, as will be vouched for by any broker.

15. *Call loans elsewhere.*—The call loans carried by certain of the larger banks in New York and London subject them to a great deal of undeserved criticism, as it is a common belief on the part of the public and the average newspaper man that the Canadian banks lend money in New York because of the higher rates obtainable there. Such criticism betrays a total ignorance of the nature of the Canadian bank re-

serve for, if these call loans were not maintained, the Canadian borrower would be no better off than now. The banks would have no alternative but to carry the amount in gold in their own vaults. This would not only mean a loss of earning power to the banks, but would also cripple them in the foreign exchange and other facilities which they now offer the public.

If these critics would take the trouble to examine the government statement and ascertain the *net* amount of Canadian money which is invested in call loans outside of Canada, they would doubtless be surprised at the results.

Take for instance the foreign loans in the government statement for the month ended July 31, 1920:

Assets:		
Balance due by banks in the United Kingdom........	$15,613,645	
Balances due by foreign banks	63,162,936	
Call loans elsewhere than in Canada	203,045,209	
Current loans elsewhere than in Canada	190,914,052	
		$472,735,842
Liabilities:		
Due depositors elsewhere than in Canada.........	$348,008,545	
Due banks in United Kingdom	6,837,914	
Due foreign banks........	38,104,212	
	$392,950,671	
Net amount supplied by Canada	79,785,171	
		$472,735,842

The critic would point out that Canadian banks had over $473,000,000 of their assets in foreign loans and bank-balances, and that this should be loaned to Canadian borrowers. They seldom look at the other side of the return which shows that over $393,000,000 of this amount represents outside capital on deposit in the banks, leaving only $80,000,000 as the actual amount supplied by Canadian banks toward a very important part of their reserve. This is only 2.60 per cent of the total assets, an insignificant amount compared with the real benefits which it creates.

As regards earning a higher rate of interest in the foreign call markets, the argument is fallacious. The rate for call loans in Canada is seldom below five per cent, and while the call loan rate in New York may fluctuate widely, ranging from 2 per cent in times of redundancy up to such extreme figures as 20 per cent when money is extremely scarce, the Canadian banks cannot place any dependence in an extra earning power for funds so utilized. From the gross income of such call loans in New York there must be deducted the heavy state tax on loans of foreign corporations; this subtraction reduced the net rate received by the Canadian banks to something between $2\frac{1}{4}$ per cent and 3 per cent. At this rate it would certainly be to the advantage of the banks to confine themselves entirely to Canadian call loans or even place money on deposit with one another at three per cent. The banks, however, fully realize that safety must be considered before profit, and that the investment in outside call loans provides the best form of reserve, next to the actual gold in their vaults.

New York is one of the international money markets of the world to which funds flow freely from abroad. Gold can be obtained there at any time. The Canadian banks have on numerous occasions tested their ability to liquidate loans in New York and bring them to Canada in the shape of gold. New York is within half a day's journey from Montreal or Toronto, and to all intents and purposes is just as convenient as if the gold were kept in Montreal or Toronto.

Sir Edmund Walker, in an interesting article in the *Monetary Times* on this subject, concludes with the following example of the actual working of this form of reserve during the panic of 1907:

That the banks drew freely upon their funds out of Canada to meet the requirements of their Canadian business was very conclusively demonstrated at the time of the last United States panic. According to the Government Bank Statement of September 30, preceding, the position as regards the outside accounts of the banks was as follows:

Call loans outside Canada.........	$63,158,601
Current loans outside Canada.....	25,794,092
	$88,952,693
Deposits and balances due outside Canada	76,178,950
Net amount employed outside Canada	$12,773,743

The panic in the United States may be said to have commenced in October, 1907, and at November 30, later, the position of the Canadian banks as regards their outside accounts had changed to the following:

Call loans outside Canada.........	$41,198,293
Current loans outside Canada.....	23,576,315
	$64,774,608
Deposits and balances due outside Canada	67,616,113
Net balance *owing by* Canadian banks outside Canada................	$2,841,505

The tight money conditions which existed in Canada at the end of 1907 and the early part of 1908, led in all parts of the country to a clamor against the banks, who were accused of lending in New York, moneys gathered from their Canadian customers and needed in Canada. But it will be seen from the above figures that during a period when call money commanded very high rates in New York, the Canadian banks in less than two months reduced their call loans outside of Canada by $22,000,000 and that by the end of November, instead of having Canadian funds employed outside Canada, the balance was actually the other way to the extent of $2,841,000, a condition of affairs which continued several months into 1908.

In the payment of its debts due abroad or in selling exchange against commodities shipped by Canada, New York is the market where all such transactions must be settled and, therefore, ready money to be available in the operations of a Canadian Bank is, in the majority of cases, needed in New York.

A careful examination of the evidence must make the following clear to any intelligent person:

1. That the banks lend money in New York at a much lower average rate than loans produce in Canada;

2. That the high rates of interest so often referred to occur only at rare occasions coincident with panic, and do

not materially affect the average rate earned; and that at the time of such high rates the Canadian banks are almost always withdrawing money from New York instead of sending it there.

3. It is the power to withdraw money at such times which enables the Canadian bankers to support their customers, and it is largely because of this power that, altho the financial history of the United States is marked with frequent panics, no financial panic has taken place in Canada in recent times.

4. The object of the loans in the United States, therefore, is not to enlarge the profits of the Canadian banks but to enable them to do justice to their customers in time of stress. Such loans are an evidence of caution and wisdom in the interest of Canada and the policy should be the subject of praise by critics of Canadian banks and not of dispraise.[1]

16. *Reserves.*—Including call loans and securities the average reserve maintained by the Canadian banks lies between 35 per cent and 40 per cent of the total assets, of which about 10 per cent is in cash and Dominion notes, 10 per cent in amounts due from other banks, and the balance in securities and call loans. The banking conditions are so varied in the different sections of the country and in different institutions that it would be impossible to establish a fixed legal reserve which would suit all conditions and seasons. Past experiences have demonstrated that the question may be left safely with the individual banks themselves. The cash reserve of the Canadian banks compares favorably with the general average of the national banks of the United States. The statement

[1] *Monetary Times,* Toronto, Jan. 6, 1912.

under review shows quick assets of 25.78% and liquid assets of 58.60%, a very satisfactory condition.

The fixed legal reserve of the national banks of the United States has been compared to certain beds in a hospital which were always reserved for emergency, and on the occasion of a great disaster the superintendent refused to permit the beds to be used, asserting that they were to be reserved for emergencies. To establish a *legal* reserve means that when a bank uses its reserve for what it is intended, it breaks the law and becomes subject to severe penalties. Altho there is no law or understanding on the subject in Canada it is generally conceded that the total quick assets of a bank should not be allowed to fall below 15 per cent, of which at least eight per cent shall be in cash and the balance in notes and checks of other banks, and in bank balances. In the statement under consideration it will be noticed that the quick assets amount to 25.78 per cent and liquid assets to 58.60 per cent.

With the establishment of the central gold reserves, certain new phases will arise in connection with the computation of the cash and other reserves. This feature has been very clearly explained in an article published in the *Financial Times,* Montreal, August 16, 1913, which reads as follows:

> That the new system will necessitate a somewhat different method of computing the strength or weakness of a bank in point of reserves is evident. Or rather, while the method will remain the same, the standard will have to be adjusted.

The gold deposited in the Central Reserve cannot, it is plain, be regarded as an available cash reserve, except to the extent to which there is no currency issued against it. Gold which is being employed as the basis of currency, under a law which requires the holding of a full dollar in specie for every dollar of the corresponding notes, is not an asset at all; but neither, on the other hand, are the notes of liability. The issue of notes against deposited gold, therefore, decreases the amount of cash assets, but does not increase the amount of liabilities. But the process of issuing additional currency implies the receipt by the bank of something with which that currency is purchased by the person who takes it out. So far as concerns the special additional currency taken out in the autumn and returned before spring—which is the only class of circulation to which the Gold Reserve clauses will at present apply, since the ordinary issue power of the banks up to the limit of their capital, without gold deposit will for a good many years suffice to look after the all-the-year-round requirements of the nation—practically all of it is taken from the banks in exchange for grain receipts, drafts on grain shipments, and similar high-grade, short-term, readily negotiable securities. These securities have in themselves a certain value as reserve. They are not to be indiscriminately ranked with the ordinary commercial loan which forms the bulk of the all-the-year-round business of the banks, for they are based upon a commodity which is at all times salable, and they possess a negotiable value far in excess of that of ordinary commercial paper. In addition to this, they will be steadily disposed of by the banks in the international money market, in proportion to the speed with which the crop moves to seaboard; and if money is tight and reserves low it is in the power of the banks to exert much pressure to get the crops moved rapidly—as they doubtless will do this season. So that while there will be an apparent reduction in the reserve strength of many if not all the banks when grain payments commence, it will be much more apparent than real; and the gold which is taken from the banks' control to form a basis for the extra currency can in case of need be replaced without any great difficulty or sacrifice.

17. *Current loans.*—Current loans form the largest individual item in the statement, and consequently represent the bulk of a bank's investment. This is an asset which requires the most careful and unremitting attention on the part of the branch manager and the head office.

Current loans can be broadly divided into advances to customers and bills and notes maturing. The latter are the more desirable because they are principally composed of trade bills, with a currency of from sixty to ninety days, and as a rule can be relied upon to be retired at maturity. A good portfolio of bills is no mean factor as a part of the reserve. Canadian banks as a rule refuse to take longer term paper than that of three or four months' currency; in fact the average currency of a good bill file should not exceed six weeks, which would mean a steady flow of money coming in every day, even if only 50 per cent of the items maturing were paid in full.[1]

Advances to customers, however, cannot be relied on to any such extent. They may be divided into four classes:

[1] An interesting calculation may be made in any office by rebating interest on the daily total of the maturing notes and bills in the diary. The total thus arrived at will show the amount that would have to be rebated supposing all the notes were paid on the day selected. Taking this total rebate, ascertain for how many days it would pay interest on the total amount of unmatured time items. The number of days represents the average currency of the bill file. The actual results in one branch varied between 41 and 45 days' currency.

(a) Advances made to customers on the security of produce and other merchandise;

(b) Advances made to customers on stocks, bonds, notes and other collaterals;

(c) Advances made to customers on notes other than trade bills; and

(d) Advances made to customers on single name paper.

The first two call for very little comment, and, if well margined, form a desirable asset. The third class, altho secured by two or more names, is not so desirable from a banker's point of view, as it may comprise a certain amount of accommodation paper. Advances to customers by means of single name notes are less objectionable, providing the customer's statement shows a sufficient margin of quick assets to warrant the loan, and that there is a definite understanding between the bank and the customer as to the destination of the loan, and when and how the advance is to be paid. Occasionally this latter class of advance is made by means of overdraft. This, however, is a practice that should not be encouraged as it is objectionable for many reasons which will be given later.[1]

It is the two latter classes of notes which give the most anxiety and trouble to the banker. Unless great care is taken, the bank is apt to become a partner, as it were, in more or less undesirable undertakings. It is here we find the dead loans, safe enough no

[1] See Section 10, Chapter VII.

doubt so far as ultimate payment is concerned, but still not banking transactions.

Advances are made to business firms and others that are in their way more or less permanent, sometimes consciously so, sometimes made so by force of circumstances. How can payment of such loans be obtained within a reasonable time? Or in case of failure what can the bank do with the wornout works or the old-fashioned mill? It finds itself a partner, frequently principal partner, in the business.

It is therefore most necessary for a bank to avoid advances of this nature. It should endeavor to keep its loans in as liquid a condition as possible, and in reasonable proportion to its deposits.

Leroy-Boileau, in his "Traite d'Economie Politique," says:

> Banks obtain their resources generally from the most mobile part of a country's capital—from funds scarcely constituted, destined for an investment whose character has not been determined or for consumption slightly postponed. In view of this origin of the larger part of banking resources, it follows that the capital lent by banks ought always to remain in the condition of circulating capital, easily convertible into money, and should not be transformed into fixed and inconvertible capital. *Banks are instituted to make capital circulate, not to lock it up.*

18. *Overdue debts.*—These call for very little comment; the greater portion consists of notes which are overdue owing to temporary delays in settlement. Farmers are notorious delinquents in this respect.

They have, however, a good excuse, particularly in the West, owing to the distances they generally live from the bank. There is not the same excuse, however, for ordinary business paper being overdue, and the same leniency is not extended to a business man, whose credit is seriously affected if he allows his paper to frequent the overdue file. A portion of the overdue consists of doubtful debts for which full provision has been made.

19. *Real estate.*—The law is very strict as to banks holding real estate other than that required for their own premises, nor can they lend on mortgages. They may, however, take a mortgage as additional security for a debt already incurred, and in case of foreclosure they are allowed to bid in the property, but cannot hold it over a certain length of time. Real estate other than bank premises, in the statement, represents lands which have been acquired in this manner and bought in by the bank in its effort to improve the position of a doubtful or a bad debt. Banks naturally try to get rid of property thus acquired as quickly as possible and, in making sales, frequently sell for part cash and accept security for the balance in the shape of a mortgage. These are shown in the statement as "mortgages on real estate sold."

20. *Bank premises.*—The Bank Act permits banks to own real estate and erect buildings for the purposes of their business. It has always been a question as to whether banks have the right to erect a building and rent any part not required for banking purposes.

The question is not a serious one and should be left to the banks themselves.

21. *Profit and loss statement of a bank.*—A study of the profit and loss statement of the various Canadian banks for the past years shows very conclusively that, notwithstanding the large increase in the amount of deposits and the volume of business transacted, the profits have not kept pace with the continuous increase in operating expenses, and the average net earnings on assets during the last decade has dropped from 1.28 per cent to .75 per cent. Banks, in common with all other business concerns, have had to pay out more in salaries, rents and other expenses, yet it is seldom realized that banking charges to the public have not been increased. On the contrary, they have by force of competition and other causes been considerably reduced. The table on page 117 shows the percentage of net earnings, etc., of nine of the Canadian banks for the year 1919. It affords several interesting comparisons and demonstrates that the earnings of Canadian banks are by no means commensurate with the risk and work. The average for 1919 is shown in comparison with 1912 at the foot of the table.

Column No. 1 will assist in giving the reader some idea of the proportion of capital and reserve to total deposits or, if the reserve ratio is required, it will be found by dividing this percentage into 100; thus, the deposits of bank No. 1 are eleven times its capital and reserve.

The second column gives the proportion of the total assets represented by interest deposits, and shows what a very important part the interest-bearing deposits take in the existence of a bank and how easily a slight increase in interest would materially affect the net profits.

The third column gives the net profits earned on the total assets of the banks. Considering the large amount of the turnover during the year, and the double liability of the shareholders, these figures constitute a very small return for the amount of work done and the risk taken.

Column No. 5 shows the percentage of net profit to capital, and is the method usually adopted by banks and financial papers in commenting upon the profit and loss sheet of a bank. As it shows the interest on only a part of the liability to the shareholder this percentage affords no useful information, unless used in conjunction with the figures given in column No. 6. This gives the percentage of net profits to capital and reserve and shows the true net earnings on the proprietors' capital before any dividends have been declared or amounts written off.

Column No. 7 gives the percentage of net earnings before any dividends have been declared or amounts written off. These last two columns will show where the market value exceeds the book value or vice versa.

Column No. 8 gives the actual dividends paid. It will be noted that some of the banks prefer to give their shareholders an increased return on their invest-

ANALYSIS OF NET PROFITS OF NINE CANADIAN BANKS

1		2	3	4	5	6	7	8	9	10	11
			Percentage of Net Profits to[2]					Dividends		Stock	
No.	Percentage of Capital and Reserve to Total Deposits	Percentage of Interest Deposits to Total Assets	Total Assets	Assets after Allowing 6% on Capital, etc.[1]	Capital	Capital, etc.[1]	Market Price of Stock	Paid	Yield on Market Price	Market Price	Book Value
1.	8.90	57.30	.57	.11	15.62	7.43	7.51	12%	5.77	208	210
2.	14.93	53.03	.77	.05	18.92	6.46	6.92	16%	5.86	273	293
3.	12.54	49.19	.83	.19	18.20	7.72	9.36	12%	6.15	195	239
4.	10.30	57.92	.81	.29	19.11	9.40	10.06	12%	6.32	190	203
5.	14.26	57.73	.78	.12	14.02	7.03	9.05	9%	5.80	155	200
6.	7.46	50.43	.61	.21	19.50	9.30	9.83	12%	6.06	198	210
7.	11.50	51.79	.81	.25	19.50	8.66	9.51	12 ± 1	6.34	205	225
8.	14.70	56.65	.97	.25	17.91	8.04	9.14	12	6.12	196	222
9.	7.71	48.62	.61	.22	19.21	9.30	8.88	12 ± 2	6.48	216	206
Average 1919	11.37	53.62	.75	.18	18.00	8.16	9.00	12.44	6.10	204	223
Average 1912	19.50	58.41	1.28	.33	21.00	8.26	7.00	11.70	5.48	213	209

[1] Capital reserve and undivided profits
[2] Less war taxes

FIGURE 5

ment in the shape of a bonus, rather than an increase in the dividend rate. It is evident from this that banks are unwilling to make a permanent increase in their dividends in case they might not be able to maintain it, owing to the very narrow margin of profit on which they have to work.

Column No. 9 shows the yield on the market price of the stock on the basis of the figures given in column 10.

22. *Interest on deposits.*—From time to time it is advanced in the public press and elsewhere that the banks should pay a higher rate on their deposits than three per cent, especially in view of the fact that they are getting six and seven per cent for their money. Tho nearly the whole of a bank's gross revenue is derived from interest on its loans, the net profit is necessarily governed by the difference between the deposit and lending rates which, in Canada as in all other countries, bear a fixed ratio to each other, firmly established by both theory and experience. Any attempt to deviate from this fundamental rule of correlation, either by raising the deposit rate, or unduly lowering the lending rate, can lead to but one end, as many banks have found to their cost. The average difference between the deposit and loaning rate of Canadian banks is three per cent, and any increase in the former must be accompanied by a corresponding increase in the latter.

That this is no arbitrary ruling can be conclusively proved by examining the profit-and-loss statement of any bank on a basis of giving a fair return to the shareholder for his investment, it being first conceded that every business should pay interest upon the capital actually invested in it at a rate determined by the risk or responsibility incurred in the business. This is a practice that no business man will question, and there is no reason why the banking business should be excepted from its application.

No man is willing to invest his money in an active business which involves responsibility and the meeting of keen competition, unless he thinks there is the probability of more than an ordinary return in interest. Banking business is certainly not free from such competition, risks and responsibilities, and unless a bank can make a reasonable profit upon its proprietors' investment, the shareholders might as well put the bank into liquidation and invest their capital where it will be free from risks of this nature. In making such an apportionment from banking profits for capital invested, six per cent should be considered a very reasonable rate to accord to shareholders for the use of their money, and after deducting that amount from the net profits of the bank the remainder represents the compensation for banking services and the like. The application of this principle to the annual profit and loss sheets of ten banks given on page 117 demonstrates very graphically how impossible it would be for any of these banks to pay a higher rate than three per cent on their deposits without increasing their lending rate accordingly.

Column 4 in the table on page 129 shows the amount of profit remaining after deducting six per cent on the capital and reserve of the different banks. A comparison of these figures with those given in the second column will show that not one bank would have sufficient profit left to increase the rate on its interest deposits one per cent or even half of one per cent. The majority could increase their rate on deposits to $3\frac{1}{4}\%$ but would have practically nothing left for even ordinary appropriations for reserve, depreciation and the like.

23. *Profits of the "Percentage Bank."*—Referring to the statement of the "Percentage Bank" given on page 101 the following profit and loss sheet of that bank may prove of interest:

	Per cent of total liability to the public	
	1920	1912
Dividends paid	.47	.72
Written off Bank Premises, etc.	.11	.15
Transferred to Rest Account	.04	.16
Transferred to Pension Fund	.02	.02
War Taxes, etc.	.03	
Balance carried forward to Undivided Profits	.03	.33
Net Profits for Year	.70	1.38

The net profit is found after paying all the current expenses of the bank for the year, and providing for any loss from bad or doubtful debts. The shareholders do not by any means get the whole of the net profits, only a little over 65 per cent of the amount being paid in dividends equal to 12.40 per cent on the capital or 6.07 per cent on the capital and reserve combined. Of the balance about 15 per cent is applied to writing off bank premises account, 6 per cent is transferred to reserve or rest account, a small amount to the pension fund of the bank, and 4 per cent is carried forward as undivided profits.

24. *Depreciation of premises.*—It is a sound theory in business that no plant or building should be carried at cost on the books of an institution for any great length of time, but that each year a certain amount should be written off for depreciation. This practice is followed by all well-managed banks. It must be remembered in this connection that no matter how suitable a building may be for banking purposes, it would not be very suitable for any other business and at a forced sale might not realize much more than the value of the land. Roughly, the depreciation in the statement under discussion amounts to three per cent of the bank premises and absorbs 15 per cent of the net profits.

25. *Reserve fund.*—The rest, or reserve, fund of a bank is now looked upon in the light of a greater margin of safety to the depositors, and the aim of every bank is evidently to make the reserve fund equal to the capital. The original purpose of the rest fund was to accumulate the surplus profits of good years for use in leaner years to maintain dividends and the like, if necessary. Today, however, any impairment of the rest fund would be considered almost as serious a step as the wiping out of part of the capital itself.

The original intention of the rest fund is now fulfilled by the maintenance of a larger amount in undivided profits, which serves exactly the same purpose.

The rest account in a Canadian bank may therefore be considered as intended for the protection of the shareholders.

In the present instance about 4 per cent of the net profits is used to increase the reserve, making the latter nearly 110 per cent of the capital.

26. *Gross profits.*—It has already been pointed out that the greater portion of a bank's profits is derived from the difference between the interest on its deposits and its loans. The gross profit, therefore, can be found roughly by a study of the interest-bearing assets of a bank and it may be safely assumed that even in the best of years a bank can seldom make more than between five and six per cent gross on its total assets; that is, inclusive of exchange and all other profits.

So many features enter into expense distribution and the gross earnings of banks that it is impossible to establish any criterion. Some of the English banks publish the amount of their expenses, but this serves no useful purpose unless other data are also furnished. The fact remains that Canadian banks are confronted with a very serious and steady diminution in net profits owing to competition on the one hand, and constantly increasing operating expenses and taxation on the other. This situation must be met either by increasing the charges or decreasing the expenses. The former is a last resort and there remains the necessity for a systematic study of costs with a view to reducing expenses and eliminating accounts or transactions which have hitherto been a source of loss.

REVIEW

What is a bank statement primarily intended to show?

Why is it unwise for both the bank and the public to allow savings deposits to be used as checking accounts?

In what sense are call loans in Canada not call loans in the strict acceptance of the word?

How will the central gold reserve affect the standard of computing the strength of a bank in point of reserves?

How may a bank's gross profits be determined?

PART II

BANKING PRACTICE

BANKING PRACTICE

CHAPTER I

HEAD OFFICE

1. *Directors.*—The nominal executives of a bank are the president and board of directors, who are responsible not only to the shareholders but to the government for the true and faithful administration of the bank's affairs. In practice, however, the actual work of administration has to be entrusted to the general manager and his staff. The work of the directors is rather of an advisory and supervisory nature. That this supervision, however, should not be of a perfunctory character is demanded in no uncertain terms, both by the Bank Act and by public opinion.

The president, as chairman of the board of directors, occupies the most prominent position in the bank, especially in the eyes of the public, and should always be a man who can command public attention and respect. In virtue of his position the president is obliged to devote more of his time to the affairs of the bank than his brother directors; upon him devolves the checking and signing of the bank returns and other official documents. Daily, in conjunction with the general manager, he must review the position and general policy of the bank.

Of recent years the public has demanded "directors who direct." No man should, therefore, accept a position on the board of a bank unless he is prepared not only to attend the meetings regularly, but also to take sufficient time to become acquainted with banking in general and the affairs of his own bank in particular. In other respects a director should be a man of outstanding qualifications, especially as regards character and influence in the community; he should also be a man of large business affairs and a good judge of men.

The principal duty of the directors at ordinary board meetings is to discuss with the general manager and authorize all credits and loans which exceed a certain amount. This amount or limit is set by the directors themselves, as it would be physically impossible for the board to deal with all the loans made by a bank. The majority of these can safely be left to the judgment of the general manager, leaving the large and important accounts for the careful consideration of the board.

There are, of course, some losses in small loans. But the supervision of the directors would not avert them, and the average is never high enough to be serious. It is the larger loans which call for the constant and careful attention of the directors. Experience shows that bank failures arise invariably from losses made by the failure of a small number of large accounts, and never from any trouble caused by the small accounts. The limit varies from $1,000, in a small bank, to $5,000 or $10,000 in a large bank. In setting the amount, the directors are guided by their opinion of and confidence in the general manager and his staff, as well as by the volume of applications calling for consideration.

Board meetings are held once a week and a financial statement of the affairs of the bank as well as a report on all important transactions that have taken place since the last meeting is placed before them. In some banks a list of the smaller loans authorized by the general manager during the week is submitted and initialed by the directors after reading. The duties and responsibilities of the president and directors are outlined in the Bank Act, to which reference is made in Chapter III, Part I of this Text.

2. *General manager.*—The general manager occupies the most important position in the bank. To attain that rank a man must not only be a professional banker by training and instinct, but must possess other outstanding qualifications. His duties are numerous and the responsibility heavy. To assist the general manager in his work of supervision and control, there is a head office staff of highly trained men. If the bank is large, an assistant general manager is generally appointed to assist the general manager, and to a certain degree share some of the responsibility.

The following officers are generally found on the head office staff of a bank:

An assistant general manager
A superintendent of branches
A chief inspector and officers under him
A secretary and staff
A chief accountant and staff.

3. *Superintendent of branches.*—This officer, in conjunction with the inspection department, exercises a strict supervision over all branch loans, not only by a careful study of the branch returns, but also by examining and passing on all the applications for credit submitted by the branches. He prepares for the board of directors, with his recommendation, all applications for credit which are large or important enough to be brought before them, and assists the general manager in the disposition of the less important applications. Altho the greater part of the superintendent's work consists in dealing with the branch loans, he has many other duties to perform in connection with his position, and is in frequent consultation with the general manager regarding the policy and position of the bank. The office is a most important one and calls for special qualifications and training.

In a large bank with numerous branches, it would be physically impossible for one man to review the work of the whole bank in this manner, and many of the banks divide their branches into provinces or districts under the charge of district superintendents. As each of these officers has from fifty to one hundred branches to look after, the position of district or provincial superintendent is also an important one.

In a small bank the offices of superintendent of branches and chief inspector are often merged into one, and the work is conducted by the general manager and inspector. In the larger banks, however, the loans can only be comprehensively dealt with by a process of sifting and elimination, according to size and importance. All loans, irrespective of amount, are subject to constant supervision both in returns of the branch and by regular inspections. In the granting of these loans, however, conditions vary according to amount. Every branch manager is accorded a limit up to which he may lend without direct reference to the head office, the amount varying with the size and importance of the branch. For all amounts over this limit, the application, with full particulars and statements, must be sent to the superintendent of the district and a copy of the correspondence to the head office. The district superintendent in his turn has a limit to the amount he can authorize. If a prospective loan is larger than he can deal with, he writes to the head office, recommending the application or otherwise, the head office already being in possession of the particulars. At the head office the application is dealt with by the superintendent in the usual way, and either authorized forthwith by the general manager or referred to the board.

4. *Chief inspector.*—As has been indicated, in some banks this office is combined with that of the superintendent, the work being so intimately connected. The chief inspector gives special attention to the auditing and inspection of the branches and sees that every branch is inspected at irregular intervals at least once a year. As a rule he personally conducts the inspection of the larger branches and supervises and directs the other inspectors in their examination of the rest of the branches. An inspection consists of two kinds of examinations, namely, verification and valuation. The first is called the audit or routine inspection, and consists of auditing and balancing the books of a branch and ascertaining the existence of all the assets called for by the books. Attention is also given to the general routine work of the office with a view to ascertaining if instructions from the head office are faithfully observed. This is the first stage of the inspection, and is made by routine inspectors or officers.

The second stage, or inspection proper, is made by a senior inspector and consists of a thoro analysis and valuation of the loans and other assets of the branch. This is not necessarily made at the same time as the audit, but the inspector visits the branch as soon as possible afterward and discusses every account exhaustively with the manager. On his return to the head office he embodies his criticisms in the official correspondence with the branch.

The chief inspector generally has in his charge all matters pertaining to bookkeeping methods, disposition of the junior staff, stationery forms, bank premises, furniture, etc. Of course he can delegate any of these to the care of one of the inspectors.

5. *Secretary.*—One of the most useful officers in the head office is an efficient secretary with initiative, tact and a good memory. The secretary forms the connecting link between the different departments, and thru his hands passes all the correspondence received or despatched by the head office. He is therefore in touch with any question that may be under discussion with any of the branches, and if possessed of a good memory is frequently able to refer the general manager or inspectors to similar instances that have occurred in the past at other branches. The secretary generally has charge of the bank advertising, and deals with all minor matters that do not fall within the province of the other departments.

The general diary of the bank is kept by the secretary, who sees that all the returns called for by the Bank Act are promptly dispatched, dividends and meetings duly advertised, and any court or legal business looked after by the officer appointed to appear.

6. *Chief accountant.*—This officer, tho seldom heard of by the public, fills a most important place in the bank, as he is required by the Bank Act to join with the president and general manager in certifying to the correctness of the returns made to the government. It is his duty to combine the branch balance

sheets so as to show the position of the bank as a whole, and submit a true copy to the directors every week, to the government every month and to the shareholders every year. The stock ledger and transfer book are under his charge, as are also all special accounts such as the pension and guarantee funds of the bank.

It will be gathered from the above that not only is the general manager himself thoroly in touch with the affairs of the bank, but he has also a highly efficient staff about him, all able to make helpful suggestions and if necessary to take the initiative in any matter. Each has his own well-defined duties, yet is able to assume any other work if called upon, and all are imbued with one common aim, the well-being of the bank.

REVIEW

What are the principal duties of a bank director?

What are the duties of the superintendent of branches? How does he regulate loans made at the branches?

In what respects is the secretary one of the most useful officers of the head office?

What are the duties of the chief accountant?

CHAPTER II

HEAD OFFICE RECORDS

1. *Head office bookkeeping.*—A distinction must be made between the head office and the main office of a bank. By head office is always meant the executive office of the bank, while the main office, tho generally in the same building, is simply a branch office. Notwithstanding its size and importance, its relations to head office are exactly the same as the most distant branch so far as routine matters and operations are concerned. Its business, like that of other branches, is with the public. The head office, on the other hand, transacts no actual business with the public, and its bookkeeping consists principally of combining and analyzing the statements sent in from the various branches. Practically all this work is done in the chief accountant's department. The machinery, however, is suprisingly simple considering the work it accomplishes.

The immediate books of the head office consist of a general ledger, a cash book, a correspondents' ledger with controlling account in the general ledger, and the stock transfer books.

2. *General ledger.*—The head office general ledger contains accounts for all the assets and liabilities of the bank which are not included in the branch

statements: such as capital, surplus, undivided profits, head office investments, general expense account and the like.

At the end of each month every branch sends in an exact balance sheet of its general ledger. These statements are all summarized in specially ruled books or sheets under the various headings of the accounts, and, when combined with the balance sheet of the head office general ledger, give the complete statement of the bank's business required by the Bank Act.

Attention is called to the fact that after allowing for the amount due to or from the head office itself, the combined debit and credit balances of all branch clearing accounts (Pages 177–179) will exactly offset each other with the exception of the items in transit. These outstanding items are analyzed and allotted to their several destinations or accounts, and there is consequently no branch clearings account balance shown in either the government report or the annual reports.

3. *Correspondents' ledgers.*—Every bank finds it necessary, for exchange and other purposes, to carry accounts with correspondents in Great Britain, the United States and other parts of the world. For simplicity and directness of accounting some of these accounts are frequently carried at the head office, and the various debits and credits from the branches are passed thru the branch clearings account as later explained (Section 18, Chapter IV). As the entries

reach the head office they are posted direct from the slips to the several bank accounts in a special ledger. Statements of the accounts are received from the various correspondents weekly, and in many cases daily, and the accounts are kept in constant adjustment—any item outstanding an undue length of time being made the subject of immediate inquiry.

4. *Statistical books.*—Apart from the shareholders' ledger and the stock transfer books which, for convenience to the public, are generally kept in the main office, all the books used in the head office are principally of a statistical or analytical nature. The profit and loss returns from the different branches are all carefully analyzed in relation to the amount of business done and the capital employed. Daily circulation returns are compiled, and a close watch kept on the movement of the bank's liquid assets. Special funds, in connection with guarantees, pensions and the like, are also administered from this department.

5. *Branch clearings.*—The checking of the branch clearings statements received from the branches is also in charge of the chief accountant. The method is very simple. An ordinary filing clip is kept for each branch; when a statement is received, the entries are ticked off as far as possible against the entries on other branch statements, and it is then filed on its clip to await delayed corresponding entries. As the entries on each sheet are completely marked off, a diagonal line is drawn across the statement, and whenever a

balance is struck by the department these dead sheets are filed away in bundles. Some banks arrange the clips in alphabetical order, but the best way is to arrange them first by provinces, as naturally the majority of the entries are between branches in the same province. The checking is also more concentrated under the latter system.

6. *Stock books, etc.*—In the shareholders' or stock ledger an account is kept with each shareholder in which are recorded all shares bought and sold. The amounts entered in the account represent the par value of the shares, and the sum of all the balances in this ledger will equal the amount of the paid-up capital of the bank.

The shares of a bank are transferable only on the books of the bank; these are known as "Transfer Books." Each page of the transfer book is in the form of a legal document by which one person agrees to transfer a certain number of shares standing in his name to another person who agrees to accept the shares. The transfer must be executed by both parties in person or by a properly executed power of attorney appointing some one to act for them. The entries in the stock ledger are made direct from the transfer book.

The other books used in the stock department are a "Register of Stock Certificates Issued" and a "Dividend Register." The stock certificates issued are not transferable and need not be presented when a transfer is made.

Dividends are usually paid quarterly by check to shareholders of record on certain dates, and the dividend register is simply a record of the payees and amounts of checks issued.

A bank may keep transfer registers in other provinces than that in which the head office is situated. The books consist of a stock ledger (a duplicate being kept at the head office), in which is kept the accounts of shareholders residing within the province, a transfer book and a register of stock certificates issued. The head office is advised regularly of all transfers made, and altho certificates are issued at the branch office, all dividend checks are issued at the head office.

7. *Circulation records.*—An important duty of the chief accountant is to watch the circulation closely and see that an overissue does not occur. Reports are received daily from the larger branches as to the amount of notes on hand, and weekly from the smaller branches, and from these the exact position of the note issue is determined.

Altho a bank, under ordinary circumstances, can issue notes only to the amount of its paid-up capital, the invariable practice is to carry a large supply of circulation in the tills of the branches thruout the country so as to be ready to meet, without delay, the requirements for circulation at any point. A bank, for instance, with a paid-up capital of $3,000,000 would probably have at least $5,000,000 at the credit of bank note account in the head office general ledger.

Part of this amount would be represented by notes on hand in the head office, part by notes in the branch tills, and the balance would represent the amount of circulation outstanding.

At credit bank note account....		$5,000,000
Less:		
Unsigned notes...........	$500,000	
Soiled and mutilated notes awaiting destruction.....	400,000	
Notes held in the tills of the branches	1,400,000	
	$2,300,000	2,300,000
Total amount of outstanding circulation in the hands of the public		$2,700,000

This leaves a margin of $300,000 unissued, the difference between authorized and actual circulation.

Changes in bank note account are infrequent and occur only when notes received from the engraver are credited, or when a debit entry is made of the amount of mutilated bills destroyed by the directors.

Soiled and mutilated notes are counted and burned by the directors whenever a sufficient quantity has accumulated. A special furnace is used for this purpose, and as soon as the bills are counted they are placed in the furnace by the directors, where they are rapidly consumed. A statement showing the amount and denomination of the notes destroyed is then signed by the directors to be attached to the monthly circulation return.

In the note circulation register, a complete record of the various issues is kept, as well as of all the denominations of the notes themselves.

8. *Returns to head office.*—Every branch sends to the head office a number of statements and returns. These statements go under different names in the various banks tho they vary but little in their intention and in the information conveyed. It is most important that all returns should be carefully prepared and legibly written by the branch. An error in any one of them is serious; it involves the head office in a great deal of unnecessary work in locating the difference and, obviously, is a serious reflection on the ability of the officers whose signatures attest the correctness of the figures. The principal statements are as follows:

9. *Branch clearings statement (daily).*—The branch clearing statement is forwarded to the head office as soon as the cash book for the previous business day has been checked. It is signed by the cash-book clerk and checked in every particular by the accountant, who also signs in attestation of its correctness.

10. *Financial statement.*—This is forwarded daily by the larger, and weekly by the smaller branches. It is practically a balance sheet of the branch general ledger, either in exact figures or approximately in even thousands. It is important that this statement should be despatched promptly, as the data are

necessary to the chief accountant in arriving at the amount of circulation outstanding and the general movements of the bank's assets and liabilities. A complete balance sheet is rendered on the last day of the month.

11. *Discount report.*—In some banks this is sent in daily, and in some weekly. If sent in daily, it generally takes the form of a carbon copy of the discount register, with the manager's comments or explanations of the different transactions. If a weekly statement, only transactions above a certain amount are reported. The limit varies with the importance of the branch. All overdrafts, no matter how small, are reported with explanations. All liability accounts in the branch which are out of order in any way, either by the expiration of the credit or for other reasons, are listed in each report until they have been adjusted to conform to head office requirements.

12. *Cash item account.*—This return is made up at least once a month and gives the outstanding sight drafts and other cash items with the date of origin and domicile. A special report should be given on any item which appears to be too long outstanding, thus anticipating inquiries from the head office.

13. *Balance sheet.*—This is made up to the close of business on the last day of the month, and mailed to the head office not later than the following business day. It is an exact statement of the general ledger of the branch, and is used by the head office in com-

piling the general statement of the bank, or monthly return to the government, as it is generally called.

14. *Overdue bills.*—This statement is required at least once a month, and gives a list of all overdue loans and discounts. It should be the ambition of every manager to keep this list down to a low point, if not entirely to eliminate it. Any name which appears frequently in this list should be avoided; it shows a lack of business honor, or something worse.

15. *Monthly liability return.*—This return gives a list of all the liability accounts on the books of the branch over a certain amount with all necessary particulars regarding security, etc. Some banks require the monthly liability return to contain the name of, and amount, no matter how small, due by every obligant.

16. *Sundry returns.*—Statements of the expense account of each branch, accompanied by the relative vouchers, are sent every month to the head office. The closing of the books at the end of the bank's fiscal year calls for a number of returns for statistical and other purposes, such as the profit and loss statement, the report on bank premises, the bad and doubtful debts return, and the like. In addition to these, special reports on various subjects may be called for from time to time by the head office.

17. *Weekly report on business.*—In discussing the Canadian banking system, frequent reference is made to the very full knowledge possessed by the general managers as to the condition and requirements of

the country as a whole. This information is acquired thru two separate channels: the weekly financial statement and the weekly report on business. The weekly financial statement from the different branches shows the fluctuation of the circulation, loans, deposits, etc., thruout the country, and forms an excellent financial barometer of business conditions. The information in these statements is supplemented by weekly or fortnightly letters from the branch managers which, as a rule, cover the ground most thoroly, and give a variety of interesting and useful facts. Among other things with which the letter deals may be mentioned the following:

(a) Particulars as to prices and movements of staple commodities such as grain, flour, cattle, dairy produce, lumber, etc.;

(b) Acreage, condition and prospects of crops, etc.;

(c) Farm sales and other real estate transactions:

(d) The conditions of trade locally, scarcity or otherwise of money, general financial and commercial news;

(e) Business failures or indications of beginnings of unsoundness in local firms, whether customers or not;

(f) Local rates for money, domestic and foreign exchange, etc.

It is easily seen that no press association or mercantile agency could possibly give the intimate information as to the country's condition thus afforded the general managers thru the branches. By means of information thus regularly afforded, Canadian banks are able to see the coming financial clouds six months or even a year before they appear on the commercial horizon, and thus not only to take the necessary steps to prepare themselves for trouble, but also, in the annual reports of the bank, to warn their customers and the public generally of the approaching storm.

18. *Records of routine work.*—At the end of each month there is forwarded to the head office a certificate signed by the manager and accountant, which certifies to the following:

That all the general statements and work of the office have been completed and verified for the month;

That all the overdrafts shown in the deposit ledger during the month were authorized by the manager;

That the liabilities of customers as shown in the liability ledger are correct;

That all interest computations in the discount and ledger departments have been independently verified by a second and competent officer;

That all insurance held is in force;

That the time-lock is running correctly and the combination locks are in satisfactory condition;

That the cash items account was drawn off, and that all outstanding items are satisfactory;

That the current deposit ledger, savings bank, and liability ledger balances were drawn off and found to be correct;

That the notes, bills, and collaterals were inventoried and balanced;

That the collection register has been regularly checked, and that there were no unsatisfactory outstanding items;

That goods pledged or warehoused have been examined and found correct;

That the draft account has been balanced.

The dates on which these several balances were arrived at are given, as well as the initials of the officer who made the check.

It is essential that a complete record of daily routine work, etc., should be maintained, and some banks require monthly reports from their branches giving the initials of the officers who fulfill the various duties each day. Even if this report is not required by the head office it is advisable to keep a systematic record in the office.

REVIEW

What accounts are kept at the head office of a bank?

Who keeps the circulation records of the bank?

Who makes up the branch clearing statement? How often is it sent to the head office?

Thru what channels does the general manager get complete information about the branches?

How is the routine work reported to the head office?

CHAPTER III

THE BRANCH STAFF

1. *Manager.*—The directors are obliged to rely on the general manager to a great extent for the competent administration of the bank's affairs, and he, in his turn, has to look to the branch managers and their staff for an efficient and loyal discharge of duties, for on the staff, more than on any other factor, depends the success of the bank.

The making of loans is a corollary of having the money to lend, and consequently the most important work of a manager is to attract and accumulate deposits by giving a satisfactory and effcient service to customers and the public at large. There is no difficulty about making loans; the difficulty is to know when to refuse to make them. The head office can always assist in the decision, but the manager has only the general standing of the bank and his own efforts to rely on for obtaining deposits. The value of a good lending branch is not denied, nor the fact that loans frequently create deposits; but banking essentials should be considered in their proper sequence; first, deposits, then loans. No bank would open a branch simply to make loans; deposits or other collateral advantages must be present or in prospect.

That the loans at a branch may exceed the deposits does not alter the principle.

To attract deposits, personality, efficient service and a knowledge of human nature are necessary, but the lending of money, in addition, calls for a high degree of tact, ability and technical training. In small transactions the manager exercises his own discretion, within certain limits established by the head office for each branch or manager. Loans exceeding this amount must first be submitted to the general manager for authorization. The requisites of a good loan will be dealt with in another chapter.

The manager has many other duties and responsibilities besides obtaining deposits and making loans. He is expected to give constant and vigilant supervision to every part of the business of his office, and to the general deportment of his staff. The fact that he is permitted by the head office to delegate a certain portion of this work to the accountant or other senior officer does not relieve him of the responsibility for anything that goes wrong.

Except at the small offices the manager is not expected to do any of the routine work of entering or posting, but he has a good deal of work to do in connection with the checking of the day's work.

2. *Daily work.*—A manager will find it of great advantage to himself and his staff to reach the office a little before nine. Not only can more work be done between nine and ten o'clock than in any other

two hours of the day, but the manager's punctuality insures a like quality in the staff.

All checking in the office should be accomplished before ten o'clock in the morning.

The manager is then prepared to receive and interview customers, and his desk should be so placed that he can see all who enter the office. Both the manager and the accountant should be constantly on the alert to see that every customer receives prompt attention.

During the day the manager's time is fully occupied with preparing applications for credit, general correspondence and interviews with customers. Much of the manager's time is frequently wasted by customers, and offenders in this respect should be tactfully broken of the habit. Every minute of the manager's time costs money to the bank—a fact frequently overlooked by both the customer and the manager himself. The staff of a Canadian bank are designated generally as officers, irrespective of rank.

3. *Accountant.*—The position of accountant is a responsible one. As lieutenant or deputy of the manager he is frequently called upon to assume charge of the office whenever it may be necessary for the manager to be absent, to which end he should be thoroly acquainted with the discounts and general business of the office. A great part of an accountant's duties consists in relieving the manager of the work (but not the responsibility) of looking after the routine and general supervision of the office.

With the concurrence of the manager he apportions the work among the staff, clearly defining the duties of each officer, sees that prompt and becoming attention is given to the public, devotes such direction and teaching to his subordinates as they may require, and insures that all work is punctually performed, and none permitted to fall into arrears.

The accountant is generally expected to check all statements and returns, to see that nothing has been omitted, and to sign or initial them in attestation of their correctness, prior to handing them to the manager for completion.

The accountant jointly with the manager has control of the treasury cash and other valuables of the branch. He is also responsible for the safe-keeping of all engraved forms, such as drafts, money orders, and the like.

4. *Teller.*—A great deal of responsibility is attached to the position of the officer who has charge of the cash, and known as teller. His principal duties are the receiving of deposits and the payment of checks. This work requires great care in order to avoid a loss to himself or to the bank. In most banks the tellers are required to make good all shortages in the cash. When cash is over, however, the amount is credited to an account in the deposit ledger called "cash over account."

In a small office the duties of paying and receiving teller are fulfilled by one man; in larger offices, however, the work is performed by two or more tellers, and a distinct division is made between the work of receiving and paying.

The teller must scrutinize closely all checks and cash items which are included in the deposit in order to see that they are properly indorsed and in form as to dates, amounts, etc. The total is then entered in the teller's blotter, and the slip is handed to the ledger-keeper who posts the deposit in the ledger and enters it in the customer's pass book.

The only book kept by the teller is the blotter in which all debits and credits passing thru his hands are entered. It has various columns, in which the entries are so distributed that the totals can be used by the different departments in proving the day's work. At the close of the day's business the cash is balanced and the details of the various denominations are entered in the space provided for the purpose in the teller's balance book.

5. *Ledger-keeper.*—A good ledger-keeper should be accurate, quick and a good writer. Accuracy is the most important qualification, as errors in posting or in extending the balance of an account might result in a loss to the bank.

A ledger-keeper should be thoroly familiar with the signatures of the bank's customers, and be constantly on the alert to detect forgeries and other irregularities.

When opening a new account care should be taken to record in the ledger all the necessary particulars. In the case of accounts with partnerships, societies, corporations, etc., both the manager and ledger-keeper should see that the necessary authorization and other documents are lodged with the bank.

Particular care must be taken, when "marking" or accepting checks, to see that they are not written in such a way that they can subsequently be changed to a larger amount. If there is any space left on either side of the written amount, it should be filled in with a heavy stroke of the pen.

6. *Collection clerk.*—The collection department is considered one of the most important in connection with the business of the bank, and the clerk in charge of this work must be careful and methodical in his work, and constantly on the alert, to see that all the details in connection with each item passing thru his hands are promptly and carefully looked after.

At most branches of the bank the larger part of the items received for collection come thru the mails from other branches and correspondents, and the majority of these are drafts on local merchants which require to be presented for acceptance. The instructions which accompany these items must be noted and carefully followed. Items which are to be protested for non-acceptance or non-payment require special attention, as the bank could be held responsible for any loss if the instructions are not carried out to the letter.

As the bank should not hold a collection unaccepted more than two days if the drawee resides in town, or over five days if he resides out of town, it is necessary to obtain the acceptance without delay or return the item with or without protest, as the case may be. It is, of course, to the interest of the bank as well as of the drawer to get all items accepted if possible. Drafts with documents attached, such as bills of lading, also require special attention, and the instructions regarding each must be carefully observed.

The work in connection with drafts issued on other branches or correspondents in payment for collections, as well as with drafts and money orders sold to customers, is generally performed by the collection clerk.

7. *Discount clerk.*—It is the duty of the discount clerk to look after the work in connection with all notes and bills discounted. Each note and bill should first be initialed by the manager, and then passed by the latter direct to the discount clerk, who should see that each item is in proper form as regards terms, date, indorsement, and the like, before entering it in the discount register. The interest is then reckoned and the proceeds credited to the customer's account thru the discount blotter. In the case of a "petty loan" a voucher is issued on which the proceeds may be drawn in cash. All interest computations should be checked by a second officer to insure correctness. Exchange on bills payable at outside points must also be deducted.

8. *The junior.*—The duties of the junior, as the

beginner is called, vary according to the size of the office. At a small country branch he will have charge of the collections, cash book, supplementary cash book, outgoing mail, besides various other duties which in a large office are performed by the messenger or porter. In a large office where there are several tellers, ledger-keepers, etc., his duties may consist of only one line of work. He may be one among several in charge of the supplementary cash books, and do nothing else all day than entering up deposits and checks; or he may do similar entry work in various other departments.

REVIEW

Describe the duties of the branch bank manager. What are the duties of the teller? Of the ledger keeper?

For what work is the discount clerk responsible?

What experience does the junior in a small branch receive?

CHAPTER IV

BRANCH BOOKS AND RECORDS

1. *Bank accounting.*—The tendency of modern accounting is to adapt the books to a business, rather than the business to the books, and this practice is particularly noticeable in bank bookkeeping. Systems and devices may differ among banks, and even between branches of the same bank, but the basic principles are the same. Once a clear understanding of bank bookkeeping in general is obtained, there will be found little or no difficulty in mastering any of the methods or systems in use by Canadian banks.

To grasp thoroly all the underlying principles of bank accounting, it is necessary to bear in mind that practically everything handled by a bank, in the ordinary course of its business, is either money itself, or a written claim or right to money. Consequently the cash book in a bank is the principal book, and thru its pages must pass a record of every transaction made by the bank, either in detail or as a total from a supplementary book. Thus the cash book gives a bird's-eye view each day of all the work of the bank. Some banks still use, in addition to the cash book, a modified form of the old-fashioned journal, but it is preferable to make the cash book the only posting medium of the general ledger.

It would be quite possible for a newly-opened branch to conduct its business for the first six months or so with the aid of a cash book and a ledger, which would serve for all accounts. A collection register would, however, soon be necessary.

As the business grew it would be found convenient to have a special ledger for individual accounts, with the control or key account carried in the original ledger, and to have the checks and deposits entered in a supplementary cash book, with only the totals entered in the general cash book. Similarly, it would be found necessary in time to open up a discount register and a liability ledger to look after the increased number of loans.

As the volume of business increases, the deposit ledger is capable of being indefinitely subdivided, either alphabetically or numerically. Generally, the ordinary deposit ledger is divided alphabetically and the savings bank ledger numerically.

From the above it will be noticed that bank bookkeeping, altho based primarily on the cash book and ledger, is susceptible of indefinite expansion in any direction to meet increased volume of business or other local exigencies.

2. *Books of a branch.*—The books in use at even a moderately sized office generally include those given in the following list:

Books of Original Entry

	Cash Book.
Figure 6.	Cash Book, supplementary.
7.	Discount Register.
8.	Discount Blotter.
9.	Discount Diary, local bills.
10–11.	Discount Diary, remitted bills.
12–13.	Draft Register.
14–15.	Checks Remitted Register.
16.	Sight Item Register.
17.	Remittance Book ("Red" book).
18.	Branch Clearings Statement.

Teller's Books

	Teller's Blotter.
Figure 21.	Teller's Cash Statement.
	Money Parcels Received.
	Money Parcels Despatched.

Books of Summary

	General Ledger.
Figure 23.	Deposit Ledger.
24.	Savings Deposit Ledger.
25.	Liability Ledger.
26.	Blue Books (Trade Paper).

Fiduciary Books

Figure 27.	Collection Register.
	Collection Diary
28.	Collateral Register.
	Securities Register.

Statistical Books, etc.

General Statement Book.
Financial Statement Book.
Letters Received Register.
Postage or Letters Despatched Book.
Past Due Bill Register.
Warehouse Receipt or Produce Book.
Pro Forma Stationery Book.

Register of Powers of Attorney.
Register of Waivers, Etc.
Overdraft Register.
Expense Book.
Discrepancy Book.
Treasury Book.

This list may appear formidable but it is intentionally comprehensive. A small branch would require only half this number; the fewer books used in an office the better. New books or sub-divisions of books should be introduced only when the work on the original book becomes congested. A ledger, for instance, should be subdivided only when the posting and references become too heavy for one clerk to do, and when, in consequence, the work of the office is delayed. Method, simplicity and concentration are the foundations of an efficiently managed office.

Books should be uniform in size as far as possible; thickness and weight should be avoided. Two or three standard sizes should be established and complied with. Uniformity in size and position of post holes is particularly advantageous in the loose-leaf system, as the binders are then not only interchangeable, but one binder can be used for several different forms.

Attention should be paid to the ruling, with a view to uniformity. One inch and a quarter is ample width for the average money column, with a hair line dividing the thousands—allow five-sixteenths of an inch for the cents and, say, seven-sixteenths for the thousands. One-half to three-quarters of an inch is sufficient for discount, exchange, date columns, etc. As regards the width between the horizontal lines, one-quarter of an inch is a good average. In books where the entries are extended across a number of columns, every fifth horizontal line should be of a color different from the regular ruling, to serve as a guide line. Books or forms intended for use with an adding machine, if ruled, should be spaced according to the mechanical spacing of the machines used.

In the sample forms given in this chapter no attempt is made to preserve the correct proportion of the various columns; to do so would occupy too much space. These forms have no particular claim to merit except that they have been in satisfactory use for years in different banks. They are general rather than specific, and will, it is hoped, be suggestive as well as directly useful.

3. *Loose-leaf accounting.*—The vast increase in the number and volume of commercial transactions during the past twenty years has made the use of loose-leaf ledgers and other books a practical necessity in modern accounting. In Canadian banks, particularly, the system has been in successful operation for many years. The principal objection urged against loose-leaf ledgers—the question of their validity in a court of law—appears to have died a natural death. The courts rule so plainly and the logic is so clear, that it is the *original* entry that counts and not the assembly of entries in the ledger, that it is now generally conceded that the loose-leaf ledger is just as

acceptable as evidence in a court as a bound ledger. In fact, with the precautions observed by the banks in their use of loose-leaf books, the evidence might be considered even more competent. The following rules are generally observed:

1. The keys of all loose-leaf ledgers and transfer binders are kept in the custody of the manager or of the accountant or other officer specially authorized, by whom blank sheets are inserted as required, and the used sheets removed and filed in the transfer binder.
2. After removing the sheets, the officer who has custody of the key must place a paper seal bearing his signature in the sealing device on the front of the ledger, and, when opening the book again, must satisfy himself that his last seal has not been tampered with.
3. A separate sheet must be used for each account, and each sheet must be signed in the upper right-hand corner by the manager or accountant when the first entry is made. The officer who signs the sheet must see that the account is properly indexed.
4. A few blank sheets may be locked in the current ledger for emergency use, but all others must be kept under lock in the custody of the officer who holds the key of the ledger.

Bound books have not prevented manipulation and fraud, and the above precautions combined with the comprehensive checking system of a bank should practically eliminate the danger of fraudulent substitution of pages. If a man is determined to be dishonest there are easier and less evident methods of defrauding than by switching ledger leaves.

4. *Cash book.*—This book contains a record of all the vouchers and entries representing the transactions of each day. Theoretically, the particulars of

every item in the cash book should be entered in detail, but owing to the wide extension of banking facilities and the constantly increasing volume of checks and other entries, it has been found necessary to use supplementary books for recording particulars of any class of items whose volume is sufficient to warrant a separate book—only the day's totals are carried into the general cash book. The majority of entries, especially in a large office, are therefore in the form of totals, and very few detailed entries have to be made; but all entries, when made, should be definite as to source and sufficiently self-explanatory to be understood by any one at any time—ten years after, if necessary.

In the larger offices, the officers in charge of the different departments after balancing their books hand to the cash-book clerk the totals in the form of a signed memorandum, and even in the smaller offices it is advisable to have the clerks entering up the various supplementary books, give a similar memorandum of their totals. This limits the responsibility and adds to the efficiency of the staff.

Debit and credit entries for cash book, other than the totals referred to above, are represented by vouchers giving the necessary particulars, signed by the manager, accountant or other authorized officer, and it should be an imperative rule that any slip, which does not contain sufficient particulars or which lacks the necessary signature, should be refused by the cash-book clerk and referred back to the teller for completion. In order to facilitate the sorting and checking of these vouchers, distinctive colored paper or printing should be used; for instance, yellow, debit slips and white, credit slips.

It should constantly be borne in mind that as the cash book and its supplementary books are recognized in a court of law as the books of original entry, faulty or meager particulars might cause serious trouble. Verbal explanation, even if available, would not be admitted. Examine a bank cash book of twenty or thirty years ago: there could be no better object lesson of what a cash book should be. Copper-plate writing and ample particulars are characteristic.

5. *Writing up the cash book.*—Many labor-saving and ingenious rulings are to be found among the books of banks, and improvements are constantly being devised and adopted. The most essential book however, the cash book, remains practically unchanged, and is simply an ordinary commercial cash book with two or three money columns, a space for date and particulars, and with no printed headings. The columnar cash book is not adapted to bank work and it has never found favor.

6. *Supplementary cash book.*—In this book are entered all the deposit slips, checks, and other vouchers pertaining to the ordinary deposit and savings bank ledgers. The ruling is simple, requiring no printed headings, and consists of columns for folio, names of customers and amount of vouchers—two sets of columns to a page. Two pages will easily contain

a day's entries for a small branch, the first or left-hand column being used for deposits and the remaining three for checks, the latter being much more numerous. The savings deposits and checks, being comparatively few in number, are entered at the end of the day under their own headings at the foot of the ordinary checks and deposits respectively, tho in some small branches they are entered in the general cash book.

In offices where it is found necessary to split up the deposit ledger into two or more alphabetical divisions, a special "supplementary" is devoted to each division including the savings bank ledger. It is not necessary to open up an account in the general ledger for each division of the deposit ledgers.

If the savings ledger contains a large number of accounts, it will be found of great advantage to split it up into several sections or blocks of accounts, as this greatly facilitates the location of errors when balancing. A special form of supplementary cash book should be used with a money column for each block of accounts.

In the case of a current account which has an unusual number of checks at a certain period of the month or year—for instance, payroll or dividend checks—it is permissible to detail a day's checks once, either in the supplementary cash book or ledger, and enter the total only with a reference in the other book.

In the larger offices of some of the banks, where the volume of checks is unusually heavy, a loose-leaf form of supplementary cash book is used in connection with the adding machine, the names being typewritten in afterward. Where this form is adopted, care should be taken to see that the sheets are consecutively numbered and filed, and that each sheet is signed by the two checking officers.

7. *Discount register.*—In this book, as its name implies, are entered all the notes and bills discounted by a branch. The book is ruled so as to provide space for a full description of every item, and the notes are entered and numbered consecutively. Two or more lines can be used where a note has numerous obligants, or when the description of the security is lengthy. A form in common use is shown in Figure 7. The headings are self-explanatory with the exception perhaps of the last two—loans and trade bills.

Loans comprise all the advances made to a borrower on his own name and consist principally of the following classes:

(a) Advances made on the name of the borrower alone;

(b) Advances secured by one or more indorsers;

(c) Advances secured by produce, stocks and bonds, notes and other collateral securities.

Trade bills represent settlements for actual goods sold, and are only offered by the party who has disposed of the goods. They may consist of either drafts or notes.

The last, or remark column, is used to denote the domicil of a trade bill when it is payable at an outside

SUPPLEMENTARY CASH BOOK

Figure 6

REGISTER OF LOANS AND TRADE BILLS

D Number	Maker	Endorser or Security	Term	Date of Note	Maturity	Rate per cent.	Discount and Interest	Exchange	Loans	Trade Bills	Remarks

Figure 7

point. It is also used for any special memorandum regarding renewals, and the like. Some banks have an additional column for proceeds in their discount register.

As already stated, all notes and bills are entered and numbered consecutively. The loans and local trade bills are then entered in the diary and taken over, checked and initialed by the manager daily, or at least twice a week. The other trade bills are entered in the trade-bills-remitted diary and initialed by the mailing officer.

8. *Discount blotter.*—This book is a valuable adjunct to the discount register and an excellent form is shown in Figure 8. In this book are entered the net total proceeds of the discounts to be credited to the various customers, also the amount of interest and exchange collected. If more than one deposit ledger is used, a column is provided for each ledger. These entries are made from the discount deposit slips or lists which are then passed on to the ledger-keeper who posts the net proceeds to the credit of the various customers in the ledger, marking the abbreviation "disct" opposite each entry.

In the case of casual or transient notes discounted for customers who have no deposit accounts, a special form of receipt is used which, when signed by the obligant, is cashed by the teller and charged to an account called "petty discounts" in the deposit ledger. The offsetting credits are entered in detail in the last column of the blotter, extended at the end of the day into the ledger column and posted in one amount to the account.

When the day's work is balanced, the interest, exchange, and ledger columns will agree with the total of the loans and trade bills in the discount register. The total for the deposit ledger is included in the total of the supplementary cash book for the day, and the balancing entries are passed thru the general cash book.

The entries in the blotter are called off with the deposit ledger daily.

9. *Discount diary.*—Figure 9 shows a useful form of diary for loans and local trade bills maturing, a page or part of a page being given to each day of the year. As each day's bills mature the notes are taken over and initialed by the teller, a line being drawn across the money columns, and the loans and trade bills for the day totaled. At the end of the day the unpaid items are extended into the past due column for debit to past due bills account, and the entries passed thru the teller's blotter, whose "Notes paid" column should balance with the total of the credits to loans and trade bills.

Any notes paid before maturity are marked off the diary on the day due, entered below the dividing line of the day's notes and added to the total. Similarly any past due bills should be marked off and entered in the column provided, all entries below the line in this column being considered credits.

The column for interest can be used for a record of

DISCOUNT BLOTTER

Account Credited	Discount and Interest	Exchange		Ledger A–K	Ledger L–Z	Casual Discounts

FIGURE 8

BILLS DISCOUNTED, MATURING.................. 191......

No.	Promissor	For Whom Discounted	Teller's Initials	Loans	Trade Bills	Date of Payment (If prepaid)	Charged Past Due Bills		
							Amount	When Paid	Interest

FIGURE 9. DISCOUNT DIARY

any interest collected which is not entered in the register, such as interest on past dues, demand notes, etc. The diary sheet of the day will afford, therefore, a complete record of all payments made to the discount department.

10. *Trade bills remitted diary.*—Only in the very large offices is it necessary to have a separate book for this diary. In the ordinary branch, the ruling given in Figure 10 appears at the foot of the discount diary. At the end of each day the total is credited to trade bills remitted and debited to cash items account, there to await the relative remittances, credits, etc., when the items are duly marked off as either paid or returned.

Considerable space is wasted in connection with this daily diary, and a weekly diary, as shown in Figure 11, has been used to advantage. Four sheets to the month are used, covering 1st to 8th, 9th to 15th, 16th to 23d, and 24th to the end of the month, and are filed in their chronological order in the discount diary, a different colored paper being used to distinguish them. The bills are entered in consecutive order according to maturity on these weekly sheets. On the second day of each week, say on August 2, for the week of August 1 to 8, the total for the week is credited to trade bills and debited to cash items account, and the sheet handed to the cashbook man to be marked off as the items are accounted for.

11. *Drafts register.*—The first form given in Figure 12 is for drafts drawn on foreign correspondents.

BILLS DISCOUNTED REMITTED, MATURING ________________ 191___

B.D.R.No.	Promissor or Acceptor	For Whom Discounted	Where Remitted			Initials	Amount	Remarks
			Bank	Place	Date			

Figure 10. Trade Bills Remitted Diary

TRADE BILLS REMITTED, MATURING WEEK AUGUST 1ST TO 8TH, 1913

No.	Payee	Discounted for	Due	Remitted to					Amount	Remarks
				Bank	Place	Date		Initials		
4641	Brown, J.	Smith, T.	4	B. of C.	Bankton	Mar.	4	R.	100	
4	Jones, S.	Roy, H.	7		Toronto		5	R.	200	

Figure 11. Trade Bills Remitted Diary

These generally have to be covered by remittances or credits to another branch or correspondent. Great care should be taken to see that the draft is properly made out, signed, advised and remitted for correctly.

Figure 13 is the register for drafts drawn on other branches. The total for the day is credited to an account in the general ledger called draft account. After payment the draft is returned by the drawee branch at debit, is marked off with the dating stamp, listed with other paid drafts in the right-hand column, and at the end of the day this total is debited to the draft account. The items unmarked at any time will be outstanding, and their total will balance with the draft account in the general ledger.

12. *Check lists.*—All debits between branches, including checks, drafts and money orders paid, and the like, are listed on a special form called a check list, and debited in one total to branch clearings account and the list forwarded direct. The receiving branch gives credit on the branch clearings statement immediately on receipt. Even if an item has to be returned or there is an error in the addition of a list, the amount as shown must be credited exactly, and the difference adjusted on "At Credit" advice or a return check list, as the case may be. Check lists are of different forms and sizes, but are invariably in duplicate, the carbon copy being retained as a record. In the larger branches the lists are on loose sheets of one, two or three lists each, for use with the type-

STERLING, FOREIGN AND SUNDRY DRAFTS, ETC., ISSUED

Date	No.	Drawn on		In Favor of	Purchaser	Selling Rate	Sterling or Foreign Currency	Cover Credited or Remitted				Credit Foreign Exchange	Initial
		Bank	Town					Foreign	Dollar	Corre-spondent	Rate		

Figure 12. Draft Register

BRANCH DRAFTS AND SETTLEMENT CHECKS ISSUED

Date	No.	Branch Drawn on	Favor of	Purchaser, etc.	Commis-sion	Drafts	Settle-ment Checks	Initials	Date Paid	Drafts Paid	
										No.	Amount

Figure 13. Draft Register (Drawn on Other Branches)

writer or adding machine, the carbon copies being filed in a binder for reference. Figure 14 is a common form.

In the smaller branches the lists are in bound form, generally two large and four small lists to a page, Figure 15. At the end of the day all lists for other branches are debited in the branch clearings statement, and only in case of loss or delay in transit will the copies be referred to.

Check lists sent to correspondents are entered and filed similarly, with the exception that they are debited to the head office in the branch clearings statement.

Originally, check lists were debited to cash items account until due advice of payment was received on "At credit" advice. The best practice now is to debit the lists direct to branch clearings account. No item is more promptly responded to than a check list, and much time and postage are saved by the elimination of the advice.

13. *Cash items.*—All debits originating at a branch against other branches, with the exception of check lists, are debited to an account in the general ledger called "cash items" account or "short date draft" account. These debits may consist of the following:

(a) Demand and sight drafts received from customers as cash, the currency of which is not likely to exceed one week;

(b) Coupons and other items requiring special advice or attention;

CREDIT Form 61 D

THE CANADIAN BANK OF COMMERCE

SHERBROOKE, QUE.

All items marked X and those under $10 no protest

Wire Non-Payment of items $500 or over unless otherwise stated.

Date____________________To ______________________________

Maker	Payer	Endorser	Amount

Figure 14. Check List

WHEN CREDITING THESE ITEMS GIVE DATE C.R.List

THE CANADIAN BANK OF COMMERCE

______________________________191

____

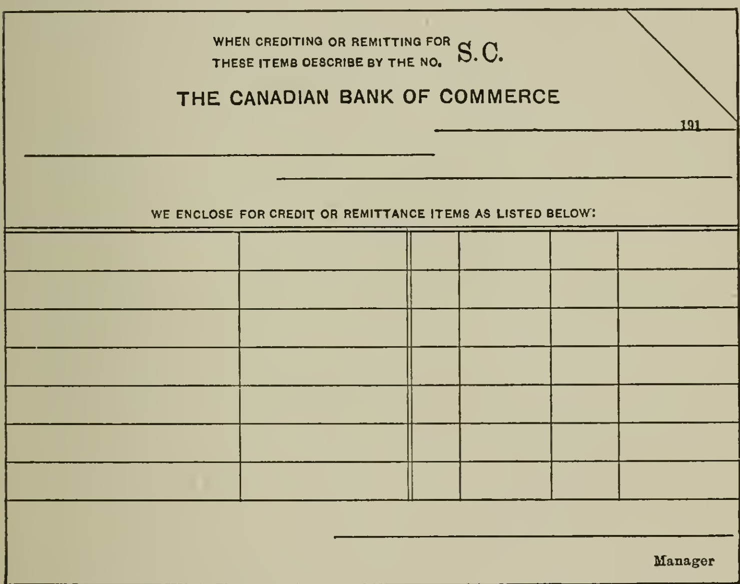
____

WE ENCLOSE FOR CREDIT OR REMITTANCE ITEMS AS LISTED BELOW

Figure 15. Check List

(c) Remitted discounts as debited each day from the diary. These include bills held by correspondents as well as by branches.

This account should be drawn off weekly and balanced with the general ledger. Any item outstanding an undue length of time should be promptly inquired about or "fated"—to use an office term.


WHEN CREDITING OR REMITTING FOR THESE ITEMS DESCRIBE BY THE NO. S.C.

THE CANADIAN BANK OF COMMERCE

191

WE ENCLOSE FOR CREDIT OR REMITTANCE ITEMS AS LISTED BELOW:

Manager

FIGURE 16. CASH OR SHORT DATE DRAFT ACCOUNT

Figure 16 is a common form, combining a record and a letter, bound six or eight to a page, a carbon copy being retained as the record.

14. *Remittance book.*—This book was originally used simply to record the remittances from other

Dr. REMITTANCE BOOK Cr.

Sundry	Branch Clearings	Ex-change	Remitted or Credited by	Place	Our No.	Ex-change	Cash Items	Branch Clearings		Particulars	Ledger Account

FIGURE 17

banks and the distribution of the proceeds; but it gradually developed into a general sorting-out book for the cash book, and is particularly useful in connection with the mail work. All credits for cash items account should be entered here and, if possible, all the entries for branch clearings account, in order to form a check on the completed statement. The ruling and headings vary in different banks, but a good form is shown in Figure 17.

The bulk of the entries for this book arrive in the morning mail.

Returned cash items are also entered in this book, being credited in the cash items column and debited in the sundry column to the indorsers, only the totals being handed to the teller.

This book is most useful in sorting out and blocking the work.

15. *Branch clearing statement.*—In a branch system there must, of necessity, arise each day numerous entries between the branches themselves, and between the branches and the head office. Direct accounts between branches are out of the question, and separate accounts with the head office are cumbersome, especially when the branches are at all numerous. The most satisfactory method in use is what is known as the branch clearing system. This is a simple and ingenious system which makes the head office the clearing house for all inter-branch transactions. The medium is a statement called the branch clearing statement which is sent to the head office daily by each branch, and on

Account
No. ________________ ________________191____

BRANCH CLEARINGS ACCOUNT

DR.			CR.		
Date of List	Branch	Amount	Date	Branch	Amount
	"At Credit" advices received			Check lists received	
	Check lists sent			"At Credit" advices sent	
	Head Office (debits to)			Head Office (credits to)	
	Total			Total	
	Balance			Balance	

I have compared the above entries with the relative At Credit slips, checked the summations, and have compared the balances shown with the figures of the General Ledger.

The balance to be carried forward from this account should be written on a LOWER line than that on which the balance from the previous day is given.

........................*Accountant*

Extreme care must be taken to avoid errors of any kind in this Return

FIGURE 18

which are entered all transactions with the other branches and with the head office. (See Figure 18.)

So far as possible, the entries passing thru branch clearings account consist of totals only. No particulars are necessary except the name or number of the branch credited or debited.

Check lists originate as debits and are responded to by credits. "At credit" advice slips originate as credits and are responded to by debits. Head office entries, both debit and credit, originate at the branches.

All entries for the statement should be systematically arranged both as to classification and the order of the branches. At the end of the day the branch clearings statement is added and the totals, debit and credit entered in the cash book. The statement is then balanced with the general ledger by the addition of the day's balance, carefully checked, and forwarded to the head office the following day. No change is permissible in the entries. They must be credited or debited to the statement exactly as received. Errors in check lists or advices must be corrected by the creation of separate entries.

16. *"At credit" advices.*—With the exception of check lists, no branch debits another branch in this statement without first receiving an advice on an "At credit" slip. (See Figure 19.)

All other items collected by one branch for another during a day are entered on an "At credit" slip, the total of which is credited on the branch clearings statement against the name of the branch interested,

"AT CREDIT" ADVICE

THE ____________ BANK, ____________ Transit No. ______

____________ 191___ At credit of ____________

Item	Name*	Amount[1] (D's [or D.R's.]) Cash Items, etc.		Amount[2] (Dep's, B.C's, S.B's, C.D's, Coll'ls, etc.)		For Whose Account
						Add column 1 and carry amount into column 2
		Total...				

* The name need not be given except in the case of items entered in the right-hand column.

1, 2.—Enter in the left-hand column all payments on account of D's made *at maturity;* in right-hand column payments on D's made *before* maturity. (Give due date of bills paid before maturity.)

No checking mark of any kind should be put on this slip by the sending Branch. ....

Particular Care should be taken to see that the *total* is written in plain round figures. Acc't.

Figure 19

and the advice is then mailed direct to the latter, a carbon copy being retained for record. Immediately on receipt of the advice the total amount is debited in branch clearings against the name of the advising branch, and the items credited to their several destinations. The credit entry is thus offset and ticked off in due course at the head office. Some offices will, of course, require the use of a much larger advice slip than the form shown.

Two columns will be noticed in the advice. The first column is used for debits already created at the credited branch, which await the relative credits in "Cash items account."

The second column is used to advise all other credits such as collections, deposits, collaterals, trade bills paid out of date, and other similar items.

Cash items consist principally of sight items and matured trade bills, and these, on the receipt of the advice, are marked off as paid, and the first column of the advice credited to the account as a total.

17. *Head office entries.*—Head office entries, both debit and credit, originate with the branches in every case. The entries can be made either in red ink at the foot of the branch clearings statement, or else entered on a special form in detail, and only the totals entered into the statement. Figure 20 is comprehensive and allows for an analysis of the contents of all money percels debited. All debits and credits on correspondents originating at the branches, are passed thru the head office account. Lists of dividend warrants, profit

Relative to Branch
Clearings Account No.__________ __________191____

Dr. **HEAD OFFICE ENTRIES** *Cr.*

MONEY PARCELS					Ck.	Amount	MONEY PARCELS		Ck.	Amount
Number	Branch	C.B. of C.	Other Banks	Dom. Notes or Specie*		Total	Number	Branch		
Date	Sundry Entries (Vouchers to accompany this return)						Sundry Entries			
	American Bank Entries						American Bank Entries			
	Total forward to Branch Clearings Statement				$		Total forward to Branch Clearings Statement		$	

* When parcels consist of specie, they should be so indicated opposite the amount.

................Manager

FIGURE 20

and loss entries, expense checks and other head office matters are all entered here.

18. *Business with other banks.*—Transactions between Canadian banks are generally effected thru the daily clearing, and very seldom thru the medium of an account. Foreign correspondents generally carry a deposit account at one of the large offices to which any collections made for them by any of the branches are credited or drafts drawn debited. Most accounts *with* correspondents, however, are more conveniently carried at the head office; all debits and credits originating with the branches being advised thru the branch clearings account. Daily statements from the correspondents give the responding entries, and the accounts are kept in constant adjustment. Not only does this concentration at the head office simplify the bookkeeping, but, as the balances with correspondents frequently form an important part of a bank's reserve, it enables the head office to control the balances accordingly.

19. *Teller's records.*—The teller's cash book or blotter consists of a skeleton ruling with no printed headings, these being written in daily by the teller according to his requirements. Were the headings printed it would require a specially printed book for each class of teller, and even then it might not be suitably spaced for local requirements.

A teller should arrange his entries, debit and credit to conform with the general system of the office. Checks should be sorted out and entered according to the divisions of the ledger, thus balancing with the various supplementaries. If the checks are very numerous, separate sheets, suitably ruled, can be used; these can be entered on an adding machine or by an assistant.

A teller's book is, in reality, a skeleton cash book, and the entries should be so arranged that the books of the various departments should balance with the combined entries of the tellers.

Figure 21 is used at the end of the day as a balance book and record of cash in hand; it is self-explanatory.

All parcels of money received are acknowledged, and entered in a special book. If the advice comes in first it should be at once entered in this book, and the parcel inquired for if necessary. Money parcels dispatched are also entered in a book. Great care is necessary in handling money parcels. Both sent and received parcels should be counted by two men in each other's presence and, in the case of the former, it is necessary to have the parcel in the uninterrupted custody of two men from the time it is counted and sealed until it is delivered to the express company or post office.

The relative advices and acknowledgments should be carefully watched and any delay immediately inquired into.

20. *General ledger.*—The general ledger, next to the cash book, is the most important book in a branch; in fact it is equally important, tho in a different sense. The cash book is the book of original entry, and con-

TELLER'S BALANCE BOOK AND RECORD OF CASH

	Totals		Particulars of Notes Held		Summary	
	Receipts	Payments				
Balance brought forward			Notes of the Bank x	5	Notes of the Bank	
				x 10		
Branch Clearings				x 20	Legal Tender Notes	
Current Accounts				x 50		
Savings Bank				x 100	Notes and Checks of Other Banks	
			Mutilated and unissuable Notes			
Loans						
Trade Bills			Other Bank Notes x	5		
				x 10		
				x 20		
Cash Items				x 50	American Currency	
				x 100		
Drafts			Legal Tender	x 1	Specie	
Money Orders				x 2		
				x 4	Amer. gold	
				x 5	Brit. gold	
Inland Exchange						
			Circulation-Notes on hand yesterday	$	Silver	
Foreign "			Received since	$	Copper	
Interest						
			Notes on hand to-day	$		
Total				$	Total Cash	
Balance on Hand			Cir. for the day bgt. for'd	$	Balance per Cash Book	
			Circulation for the month to date	$	Examined	Manager

FIGURE 21

tains a chronological record of all the transactions of a branch. The general ledger contains the summary or analysis of these transactions under the various headings, while its subsidiary books, the deposit and liability ledgers, summarize the amount due to or from individuals respectively. The general ledger is posted every day from the cash book, and contains all accounts necessary to show the position of a branch with regard to the business done under the various classifications called for by the government statement. As a matter of fact, however, the accounts kept in the average branch ledger are not very numerous and consist broadly of:

Assets—cash, loans;

Liabilities—liabilities to the public;

Office Accounts—profit and loss, branch clearings, etc.

The profit and loss and branch clearings accounts are internal accounts, and may be either debit or credit. The latter is the adjusting account of the branch with the bank as a whole, and varies approximately with the difference between its loans and deposits, as every branch either supplies funds to the head office or the reverse.

Loans are generally carried under two headings, loans and trade-bills, tho in a large city office they are frequently sub-divided into half a dozen accounts. This is merely a matter of convenience, however. In the same way the liabilities are divided into ordinary and interest-bearing deposits, etc. The form most generally used is similar in ruling to the current deposit ledger (Figure 22), with wider money columns and more space for particulars.

21. *Current deposit ledger.*—The ordinary or current deposit ledger is a very active and important book in a bank, and one which calls for both accuracy and dispatch on the part of the clerk in charge, as errors can easily be made, involving the bank in serious loss. The deposit ledger is always a loose-leaf book and ruled as shown in Figure 22. This form is invariably used by all the banks. The so-called Boston ledger has been tried several times, but was not found practicable in Canada, owing perhaps to the method of marking or accepting checks by a direct debit to the account. The accounts are arranged alphabetically, and are therefore self-indexing, but an index is usually kept on the tagged sheet dividing the alphabet.

In small offices there is usually only one current ledger used, A-Z. As work increases and becomes too much for one ledger-keeper, a second ledger can can be opened divided A-K and L-Z. For three ledgers the divisions generally run A-G, H-O, and P-Z, and for four the divisions are A-C, D-K, L-R and S-Z.

As the ledger is loose-leaf there is no accumulation of dead leaves, but the general regulations regarding loose-leaf ledgers given in Section 3 of this chapter should be observed closely.

The posting is invariably made direct from the

________________ BANK

Sheet No. ________________ Account No. ________
Name
Address

Date	Particulars	Debit	Credit	Dr. or Cr.	Balance	Date	Particulars	Debit	Credit	Dr. or Cr.	Balance

Figure 22. Current Deposit Ledger

Sheet No. ____________ Account No. ________
Name
Address Occupation
Signature Manager

Date	Particulars	Debit	Credit	Initials	Balance	Interest			
						Days	Debit	Credit	Balance

Figure 23. Savings Deposit Ledger

original deposit slips and vouchers, and called back or checked from the supplementary cash book. The balances should be kept constantly extended, and checked from time to time by the additions of the debit and credit columns.

22. *Savings bank ledger.*—This book is invariably in loose-leaf form, ruled as in Figure 23, in size generally about 8″ x 11″.

In a small branch one ledger suffices as a rule, but in the larger offices half a dozen or more are required to take care of the bank's deposits. The accounts, tho very numerous, are small in the number of transactions, and a leaf is used for each account. The signature of the depositor is generally taken on the ledger sheet for convenience of reference, as well as on a signature card.

The rules given in Section 3, Chapter IV, should be carefully followed. The manager must control the sheets and sign all that are inserted in the ledger. The bank pass-books, which are simply small copies of the ledger sheet, must also be kept in the custody of the manager, and given out in, say, dozen lots, to be accounted for as used. It is advisable that no name shall appear on the pass-book—just the account number.

The accounts are arranged sometimes alphabetically and sometimes numerically. Both methods have their adherents. In either case they are indexed on the tagged divisions or, in some cases, in a separate book. Where the accounts are very numerous the ledgers are balanced in blocks of one or two ledgers each, and in this way errors are easily located.

23. *Liability ledger.*—This book bears the same relation to a bank's advances as the deposit ledger does to the deposits. The latter shows how much the bank owes each customer, and the former how much each customer owes the bank. The liability ledger never shows an account in credit and the deposit ledger *should* never show an account at debit.

There are many different kinds of liability ledgers in use, some very elaborate. The simpler forms are the more practical, the main object being to see at a glance how much of each kind of paper a customer has under discount, the names of security against each note, and the total amount of advances.

A simple form is given in Figure 24. This provides progressive balances for loans and trade bills, and space for particulars of securities, other names, etc. The total of the loan and trade bills at any time shows the amount of the customer's total direct liability to the bank. Frequently, however, a customer is an obligant either as maker or indorser on a note discounted for another customer, and it is important for the bank to know how much of such indirect liability is outstanding. This class of paper can be indicated by an entry in red ink, but is omitted, of course, from the balance, as it has been posted once to the account of the customer discounting it. In this way a note with half a dozen indorsers can be re-

Name ______________________ Credit authorized Communication No. __________ Date ______
(Write surname first)
Business ______________________ Loans $ ______________________
Address ______________________ Trade bills $ ______________________

When Discounted 191	No.	Other Names, Residence, Etc.	Due			Loans			Trade Bills		
			Month	Day	Year	Dr.	Cr.	Balance	Dr.	Cr.	Balance

FIGURE 24. LIABILITY LEDGER

______________________ (Surname first)

Dun: ________ Bradstreet: ____________ ____________ P.O. ____

Date	No.	Due	Dr.	Cr.	Balance		If Dishonored	
					Date	Amount	Date Returned	Reasons Given

FIGURE 25. BLUE BOOK

corded against each account in red ink without affecting the ledger balance.

Where accounts involve the discounting of a large amount of trade paper, small loose-leaf books are used, known as "Blue Books" (see Figure 25), one for each account, and by this means track is kept of the total amount due from each borrower's customers. When a blue book is used, the totals only, debit or credit, are entered in the liability ledger, no details being required. The resulting balance in the account, however, should agree with the total of the balances in the blue book. The total amount of trade bills in an account is not of great importance, provided all the paper represents goods sold and delivered to responsible purchasers. The total amount on any one name, however, is vitally important, and should not be allowed without special consideration to exceed five per cent of the total amount of trade bills.

24. *Collection register.*—The form shown in Figure 26 is an economical ruling, as it only occupies one page and gives all required particulars. If necessary, two lines can be used for an item which requires a fuller description than ordinary. The entry of the name of the maker or drawee is unnecessary, for, in the case of a note or accepted draft, it is entered at once in the collection diary, where space is provided for the maker's name. If it is a draft for acceptance, the drawee's name is entered in the messenger's book, and in due course the draft is either returned refused to the correspondent or entered in the diary.

(Enter Month and Year

__________ BANK

BILLS RECEIVED FOR COLLECTION

__________ 19____

Their No.	In-struct-tion	Day of Month	Received from	Place	Maturity	Amount	B. C. No.	Date of Disposition	Remarks	Initials

FIGURE 26. COLLECTION REGISTER

Notes held as Collateral Security on Account of __________

When Received	C.R. No.	Promissors and Endorsers	Addresses	Due Date	Amount		Balance of Notes on Hand
					Dr.	Cr.	

FIGURE 27. COLLATERAL REGISTER

In the case of customers who have a large number of collections, separate forms are frequently provided, on which the customer lists the items himself in duplicate and the bank files the list in a binder as its register and diary, adopting the customer's number as its own. An initial letter or prefix number can be used to distinguish one account from another. (Figure 28.)

Collection diaries are very similar in form to those used for bills for discount, and need no special description.

25. *Collateral register.*—The collateral register is generally a loose-leaf book with an alphabetical index, ruled as in Figure 27. A page is given to each account, and the balance should always show the amount of notes held as collateral. The collection diary is used to diarize collateral notes, the entries being made in red ink to distinguish them from ordinary collections. Where a large number of collaterals are received from customers they can be listed on separate sheets and the totals only entered in the register (Figure 28).

26. *General statement books.*—In connection with the monthly return to the government each branch forwards to its head office a complete financial statement of its affairs at the close of business on the last day of the month. This is obtained from the general ledger, and a copy of the statement is made on a book called the general statement book. The general ledger is also balanced weekly, say, on the 8th, 15th and

To The

..........................BANK

Please receive herewith the following Bills for collection, and as collateral security for the payment of all present and future debts and liabilities of whatsoever nature to the Bank, I/We hereby waive demand notice and protest on the bills mentioned; should any of the same be refused acceptance on presentation, the claims upon the drawees are hereby transferred to the Bank as fully and effectually as if each of the said bills were accepted. Said Bank shall not be held responsible for the conduct, default or negligence of the party or parties to whom such notes or bills may be transferred for collection.

Yours truly,

No.	Payor	Address	Bank	Banking Town	Date of Remittance	Initials	Amount	Due Date	Remarks

Figure 28

23rd of each month, and a statement sent to the head office either in exact form or in even thousands, the latter method being sufficiently close for all general purposes.

27. *Balance book.*—The balance book is used to record the trial balances and adjustments of the different accounts in the office. The balances should be taken off on loose leaves and filed in a binder, either continuously in chronological order, or consecutively under tagged divisions, one for each class of balance. The divisions would be made for the various ledger balances, draft accounts, list of loan and trade bills, cash items account, etc.

28. *Overdraft register.*—It is very important that the manager should be fully informed of the amount and nature of the overdrawn accounts in his office. This register should be written up each morning and placed on the manager's desk so that he may have before him a daily indicator of the status of accounts to serve as a guide in extending further business.

29. *Discrepancies book.*—Canadian banks are very strict in their rules regarding the correction of errors in the books, any erasures being absolutely forbidden. Errors discovered immediately by a clerk should be neatly cancelled in ink and the correct figures entered above. All other corrections must be made by a reversing entry thru the cash book; full particulars must be entered in the discrepancy book and compared and initialed by the manager or accountant.

REVIEW

What is the principal book in bank accounting? Why? What books are added as the bank grows?

Make a list of the books used in a fairly large branch and indicate the importance of the record kept in each.

What is the legal value of accounts kept in loose leaf form?

How are remittances for collections made to other banks?

Why are all correspondents' accounts not kept at a branch?

CHAPTER V

DEPOSIT BUSINESS

1. *New accounts.*—As a rule, no new account is opened in a bank except under the authority of the manager or accountant, expressed by initials on the deposit slip. In other words, the privilege of a checking account should be extended only to persons who are known to be of good character and reputation, and therefore no account should be opened with a stranger until he has been satisfactorily identified. To do otherwise is to leave an opening for fraud. Ledger-keepers are usually held equally responsible with the tellers for any deviation from the regulations laid down in connection with the opening of new accounts, especially with strangers.

2. *Opening accounts.*—When an account is opened a specimen signature of the depositor duly witnessed should be obtained and placed on file—the card system is the best—for ready reference. In the case of a firm or company a specimen signature of each partner, or of the properly constituted signing officers, respectively, should be taken. If a power of attorney is filed, a specimen of the attorney's signature as such should be placed on file.

Every customer opening an account in the current account ledger should be provided with a pass-book and a book of checks. This does not apply, however, to out-of-town customers, copies of whose accounts are sent monthly usually.

Care should be taken in handing out check books and other supplies to customers. The nature and importance of an account should govern the size of the pass-book and the check book supplied.

3. *Particulars to be recorded in ledger.*—The full name, designation or occupation, and address of each customer is written at the head of every page of the account in the ledger. If the customer is a farmer, his lot, concession, and township as well as his post office address should be recorded. A concise description of the personal appearance or other mark of identification of all customers who cannot write their names should be noted in the ledger or on the signature card. Special care should be taken to record correctly the names of signing officers of benevolent and friendly societies, lodges and other bodies of this kind, their powers and other useful information.

In the case of a firm, the names of the partners and, where there is a special partnership, the date of its expiry should be recorded in the ledger; if a trust estate, the names of the trustees and in the case of corporations, etc., the names of the officials authorized to sign checks.

In the case of powers of attorney or of by-laws authorizing officers of incorporated companies to sign for such companies lodged with the bank, the record should state the date when the power is granted, the names of the persons authorized to sign, the extent of the power and the limitations placed upon its use, if any. Special sheets are usually supplied for recording such information in order to obviate the necessity of carrying forward the particulars from page to page; these are inserted at the front of the account.

4. *Partnership accounts.*—The law does not recognize co-partnerships of professional men, i.e., in contradistinction to traders; therefore, the individual signature of each member is requisite to paper of all kinds. Otherwise, if an account is opened in the name of a firm of solicitors, architects or other non-trading partnerships, a written agreement should be taken (Figure 29), signed by each of its members, whereby they undertake to be jointly and severally

NON-TRADING PARTNERSHIP
SIGNATURE BY ANY MEMBER TO BIND

....
........................191....

To the Manager
THE....................................BANK

....

We, the undersigned, composing the....................firm of .... do hereby acknowledge and agree that we are and will be jointly liable and responsible to the........................Bank for all transactions entered into, or to be entered into, with the said Bank in the name of our said firm by any individual member of the same, and that the signature of the name of our firm by any member of the same to any note, bill, draft, check, receipt or other document shall be as binding on us as if such signature had been affixed by each of us respectively under our own hands.

....
....
....
....

Figure 29

liable for every transaction, by check, note or draft, signed, made or indorsed, entered into with the bank by any individual member of the co-partnership in the firm name, or by any person they may designate to transact business with the bank on their behalf. In the latter case a differently worded form is used.

5. *Conversion of partnership into joint stock company.*—The conversion of a partnership into a joint stock company entails upon a manager the immediate necessity of obtaining from them and placing on file a copy of the company's by-laws, so that all transactions may be made to conform to legal requirements. Also, it should never be overlooked that a partnership differs from a corporation in that the latter is absolutely restricted by the terms of its charter, and its officers by the authority conferred upon them by the by-laws. The same reasoning necessarily applies to new customers who are already joint stock companies.

6. *Joint accounts.*—Where a deposit is made to the credit of two parties jointly, the form which should be used is as follows: "John Smith and Jane Smith, or either of them," and a declaration signed by both should be taken in every instance to the effect that the bank is authorized to pay checks on the account signed by either or both. (See Figure 30.)

7. *Accounts with married women.*—In the Province of Quebec, on account of the restrictions imposed by the law of that province on married women, it is essential that the fullest particulars should be obtained at the time the deposit is taken. When a mar-

..............................191....

TO THE MANAGER
THE....................................BANK
....

Dear Sir:
You have a deposit account standing in the name of "..........
....or either of them." We authorize you to pay and charge against said account all sums evidenced by checks on your branch or other vouchers signed by ......
....or either of them, and we confirm the verbal instructions to this effect already given to you, and all acts done by you in pursuance thereof.

Yours truly,

....

....

FIGURE 30
JOINT ACCOUNT

ried woman makes a deposit, the name of her husband, with the post office address of each (in the event of their not living together), should be given. Any other information necessary to identify or locate the depositor should be noted.

HUSBAND'S AUTHORIZATION
TO OPEN BANK ACCOUNT
For use in Quebec

TO THE MANAGER OF
THE....................................BANK
....

I hereby authorize my wife ....
to open an account in her own name with the ....
BANK; to deposit or indorse for deposit to the credit of such account, money, checks, drafts or other negotiable instruments; to receive deposit receipts and surrender the same; to draw checks upon the said account and to withdraw therefrom the whole or any part of any money standing to her credit in such account, all upon such terms and conditions as may be agreed upon between my said wife and the said Bank; and generally subject to terms of Art. 181, C. C., to perform all acts of administration with regard to said account. And I hereby agree to hold the said Bank harmless in respect of all transactions between my said wife and the said Bank done or entered into in pursuance of the foregoing authorization.

....

............................191....

FIGURE 31

When opening such an account it is advisable in every instance to obtain the husband's authorization to withdraw money (Figure 31), as without this she would be restricted to withdraw an amount not exceeding $500 in all. A separate authorization on each withdrawal would be satisfactory, but this is not always convenient.

In the Province of Quebec no married woman can enter into a contract, sign or indorse a note, or bind herself in any way for the benefit of her husband. Therefore notes signed or indorsed by married women should be refused.

The law in this respect, however, is not so strict in the other provinces, but recently, by a judgment of the Supreme Court, confirmed by the Privy Council, it was decided that a married woman's guarantee or indorsement for her husband is void unless she signs independently (Stuart versus Bank of Montreal).

Therefore in these latter provinces if it is found expedient or necessary to have a wife join in a guarantee or indorsement on her husband's behalf, care must be taken to see that she has had the advice of her friends, of whom her husband is not to be one, and of a lawyer other than her husband's legal adviser, with a declaration from the latter that she has been so advised.

8. *Waiver and authority to charge back.*—An authority (see Figure 32) to charge back returned bills, notes, etc., should be taken from every customer whose account is an active one. In every case of

The Manager

THE..........................BANK

....

Dear Sir:

In consideration of your lending money to the undersigned or discounting for or taking on deposit or for collection or otherwise from the undersigned bills of exchange, promissory notes, checks or other securities payable at points at which there is no branch of a chartered bank of Canada, you are hereby authorized to forward the same for collection to any National Bank, State Bank, private banker or private firm, and the undersigned hereby undertakes to keep you fully indemnified against any loss arising from the default or failure of any such bank, private banker or private firm to account to you for the said bills of exchange, promissory notes, checks or other securities so forwarded or for any sum or sums collected on account thereof.

The undersigned hereby waives every presentment, notice of dishonor and protest of all bills of exchange, promissory notes and checks now or hereafter drawn, made or indorsed by the undersigned, and now or hereafter deposited with or delivered to you for collection or discount or as security or otherwise. The undersigned, to avoid expense, requests you not to protest such bills of exchange, promissory notes and checks, and agrees not to hold you or your agents liable for not presenting or protesting or giving notice of dishonor of the same and to become and remain as fully liable to you upon and for said bills of exchange, promissory notes and checks as if its presentment, protest and notice hereby waived were duly made and given.

The undersigned hereby authorizes you to debit the account of the undersigned with you with the amount of any bill of exchange, promissory note or check payable at your office and which may be now or hereafter drawn, made or accepted by the undersigned, and with the amount of any bill of exchange, promissory note or check which having been previously credited to the said account is returned to the Bank unpaid, and with all such charges and expenses as the Bank shall have properly incurred in connection therewith, and the undersigned agrees to repay to the Bank the amount so debited to the account of the undersigned.

The above shall bind the successors and assigns of the undersigned.

Dated at....................the.......................day of ....19....

Figure 32. Waiver of Protest

charging a customer's account with a returned or dishonored bill, note or check, the ledger-keeper should immediately notify the customer by mail of the debit. A special form of advice is usually used for this purpose, which is written in duplicate, the original being mailed to the customer and a carbon copy used as a voucher to be charged to the account.

Dishonored bills, acceptances and the like charged to an account should not be given up until the customer's check has been received therefor or the account verified and the usual receipt for checks and vouchers received.

If there are not sufficient funds in an account to retire such items they should be held in the overdue file until provided for.

9. *The ledger.*—It is the rule in most banks that no entries shall be made in any ledger by any officer other than the accredited ledger-keeper. All entries are made from:

(a) Checks, acceptances, drafts, notes, etc., of customers.

(b) Deposit slips initialed by the teller.

(c) Debit slips for items charged up, etc., initialed by the manager or accountant.

The rules regarding loose-leaf ledgers should be carefully followed both as regards the current account ledgers and savings bank ledgers.[1] The ledger-keeper should watch out carefully for customers having the same or similar names, as there is always the danger of a mistake occurring between the two accounts. In such case it is advisable to put a warning notation on the account, as well as in the index, so as to attract the attention of any one looking up the account. All indexing should be carefully checked.

[1] See Section 3, Chapter IV.

10. *Deposit slips.*—The usual form of deposit slip is shown in Figures 33 and 34. The deposit slip after being checked, stamped and initialed by the teller should be handed by him direct to the ledger-keeper. The latter should see that each slip has been initialed and stamped by the teller; he should then post the credit in the ledger and enter the amount in the customer's pass-book, initialing the entry. At the same time he should enter in the pass-book all checks which have been charged to the account since the book was last presented and insert the correct balance according to the ledger. No blank lines should be left be-

THE CANADIAN BANK
OF COMMERCE

CREDIT

DEPOSITED BY

OF 191

X 1 =		
X 2 =		
X 4 =		
X 5 =		
X 10 =		
X 20 =		
X 50 =		
X 100 =		
$		
$		

FIGURE 33

THE CANADIAN BANK
OF COMMERCE

SAVINGS BANK DEPARTMENT

Account No.
For Credit of

Occupation
Address

191

X 1 =		
X 2 =		
X 4 =		
X 5 =		
X 10 =		
X 20 =		
X 50 =		
X 100 =		
Silver		
Checks		
$		

FIGURE 34

tween the entries, or between the entries and additions of the debit and credit columns.

The teller should not, when he has received a deposit, return the deposit slip to the customer, that he may hand it to the ledger-keeper for entry or for any other reason. To do so would, obviously, be dangerous.

11. *Money received after hours.*—Frequently money is received by the teller too late in the afternoon to be entered on the books on that day. In that case it is the usual rule to require the teller to enter it in his blotter for the following day and hand the deposit slip, after initialing, to the accountant, who will have it, if a customer's deposit, entered in the ledger at once. This practice is followed in order that no deposit may remain overnight unrecorded and entirely in the hands of one officer.

12. *Customers' pass-books.*—The teller should not make any entry in the pass-books of customers, or in any of the books of the bank other than his blotter and balance book.

Pass-books are collected from customers at the end of each month in order to be written up and balanced on the last day of the month. The work is usually done on the evening of the last day of the month, when the entire staff, with the exception of the teller, assists with the work in order that the pass-books may be ready for the customers the following morning. Altho the teller takes no part in writing up and balancing customers' pass-books, he may assist in comparing the checks with the entries in the books after they are balanced. The manager or accountant, provided the latter does not also act as teller or ledger-keeper, afterward compares the balances in the pass-books with the corresponding balances in the ledger, attesting the comparison by placing his initials opposite the balance in the ledger, and against the balance carried forward in the pass-book.

13. *Customers' certification of accounts.*—Each balanced pass-book when delivered to a customer should be accompanied by a certificate (Figure 35), stating the amount of the balance and the number of checks returned. The checks may be returned at the same time if the customer or his attorney is prepared to compare these with the pass-book and sign the certificate at the bank counter; otherwise the certificate should be signed and returned to the bank before the checks are surrendered.

THE.................................. BANK

..........................191....

The undersigned hereby agrees with the.........................
Bank that at the close of business on the.....................day
of.......................the balance of the accounts and dealings
between the undersigned and the Bank is the sum of...............
..............................Dollars in favor of the $\frac{\text{Bank.}}{\text{undersigned.}}$
100

And in consideration of the account of the undersigned as a customer of the Bank being not now closed, and subject to the correction of clerical errors (if any), the Bank is hereby released from all claims by the undersigned in connection with the charges or credits in said accounts and dealings up to said day.

The undersigned hereby acknowledges receipt of the checks charged in said accounts.

....

N.B.—This receipt must be signed by the Customer or his Attorney.

Figure 35
Pass Book Certificate

In the case of out-of-town customers, receipts (Figure 36) should be obtained before the checks are surrendered. It may be necessary to make exceptions in special cases, when vouchers should be carefullly

......................191....

RECEIVED from THE.......................BANK pass-book and..............................checks and vouchers for amounts charged to my/our account in the books of the said Bank during the month of ....last.

Insert the number of checks in words — not figures.

....

FIGURE 36

compared with the pass-book or copy of the customer's account by a second officer before being mailed, so that in event of a loss in transit or of a dispute with a customer, the bank may be able to prove that the vouchers were dispatched. In every case in which checks are sent out before the receipt is obtained they should be sent by registered mail. After being signed the certificates should be checked with the ledger by the manager or accountant, who should place his initials and the number of the vouchers opposite each balance in the ledger.

As this certificate is equivalent to an adjustment of the account between the bank and its customer, it is very important that as few balances as possible remain uncertified.

14. *Guarding against fraud.*—Fraud has been perpetrated upon employers by confidential clerks making false entries in a bank pass-book, or by keeping a spurious pass-book for the eye of their employers. It is fully within the range of an observant officer's

power for the safeguarding of the bank and the protection of its clients to detect embezzlement attempted by such methods. If an account, operated under a power of attorney, or by one particular employee, is frequently overdrawn, or if anything of a questionable nature occurs in the working of the account, the circumstances should be discreetly brought to the notice of the principal by the manager.

As the teller comes more into contact with the public than any other officer he has exceptional opportunities for observing things which may be of great use to the manager. He should train himself to observe every circumstance connected with each transaction, and especially with any unusual occurrence. Any attempt at "kiting" by means of checks should be reported at once to the manager, who will deal with it as he may consider advisable. This applies also to accommodation checks, indeed, to anything unusual or irregular.

15. *Certification of checks.*—Checks are accepted by the ledger-keeper only after they have been charged to the account on which they are drawn. Checks should not be marked "good" by the manager or any other officer unless previously debited to the proper account, or be crossed "Negotiable at par" thru another branch until accepted.

No check should be charged to an account unless there are funds at credit to meet it, without the authorization of the manager signified by his initials on the check. A check which has been altered or erased in any vital part should be refused. Any blank space in the amount should be distinctly filled in or the customer's attention called to it. In accepting a check which has been carelessly filled in the ledger-keeper should write across the face of the check the amount for which he has accepted it, so that it cannot be "raised" or changed to a larger amount.

In the case of a check for which there are funds being returned for some informality in the indorsement, it should be "accepted" before being sent back for correction.

No overdraft should be allowed without the permission of the manager expressed in writing at the head of the account or by his initials on the checks.

16. *Cashing checks.*—Tellers are generally forbidden to cash or receive on deposit unaccepted checks on any bank, or any drafts or other items unless they have been initialed by the manager. In special cases, where the manager deems it necessary, he may give the tellers written authorization to accept from certain customers checks, drafts and items to a specified limit. This is only done, however, when the undoubted responsibility of the customers justifies this action.

The possibility of being victimized by confidential clerks or other employes of the bank's customers by means of forged or raised checks should always be borne in mind. A check for an appreciably larger sum than is customary, for which cash is demanded in payment, is in itself significant and should excite suspicion. A check drawn payable to the customer of another bank should, in the ordinary course of business, be presented thru the other bank, and such a check, even if payable to bearer, presented over the counter for cash should carry suspicion on its face and suggest inquiry.

It should always be borne in mind by the teller that accepted checks, bank drafts, express orders and circular letters of credit are also all liable to forgery and alteration; payments made on the latter, especially to strangers, should be limited to a reasonable amount for traveling requirements. If they call for a large amount great care should be exercised.

Checks payable to corporations or wholesale firms should not be paid over the counter of the bank to an employe without express authority of the company or firm.

Checks should not be cashed for strangers until they have been satisfactorily identified; even then, there is not, as a rule, much profit to a bank in the transaction.

No identification is safe or satisfactory excepting the attendance at the bank of a well-known and responsible person, who indorses the check or other instrument in the presence of an officer of the bank. Any other ostensible identification or indorsement may be fraudulent. A person who forges the signature to a check, or raises the amount of a draft, or steals any negotiable instrument, might be presumed also to forge a letter of identification or an indorsement, to serve the purpose of identification. The safest course is always to give the bank the benefit of the doubt.

A written identification which purports to be that of a hotel-keeper or hotel clerk is especially open to suspicion.

Every check for a large sum should be particularly scrutinized, and the attention of the manager called to it.

Customers or others who are unable to write and who sign by mark on checks or other documents, should be identified to the satisfaction of the teller, but in no case should the teller witness the mark, which should be attested by an independent witness, not an officer of the bank.

17. *Savings bank department.*—The rules to be observed with respect to the current account ledger are applicable to the savings bank ledger, with the following exceptions:

The manager should take charge of and keep under lock and key all blank savings bank pass-books, and issue them to the ledger-keeper in unnumbered lots of one or two dozen, as he may think best, keeping a record thereof and verifying them according to the new numbers when checking the ledger entries with the supplementary cash book. Should it be necessary to issue a new book in continuation of an old account the ledger-keeper should then and there draw the manager's or accountant's attention thereto. By this method it is intended that the manager should personally know that no deposit is received for a new account without a corresponding credit to the ledger.

The savings bank pass-book should be presented when withdrawals are desired so that the entry can be made in the book itself. Whenever it is necessary to make an exception to this rule there should be no question as to the depositor's identity, and the manager should initial the check, making note of any particulars, especially the name and address of any outside party called in for identification.

When a savings bank account is closed the pass-book should be returned and written up in full with a heavy line ruled across the page under the last entry, and filed away by the ledger-keeper in a box provided for the purpose.

18. *Duplicate pass-books.*—Where the identification of the depositor is without question, and the manager is fully satisfied that the pass-book has been lost, the balance of the account should be withdrawn by check and a new account opened with a book under a new number. A memorandum, giving the circumstances of the case, should be made on the old account in the ledger.

19. *Machine statements.*—Nearly all the large city branches of Canadian banks have adopted the practice of rendering machine statements of the customers' accounts in preference to using pass-books for the purpose. The statement system eliminates the dreaded "pass-book night" at the end of the month, relieves the congestion at the ledger wicket, enables

the accountant or statement clerk to maintain a constant check on the accuracy of the ledger balances and, above all, lessens the chance of fraud and error by insuring the receipt by each customer of a statement of his account at regular intervals, monthly or weekly as desired. With the pass-book system a mistake might run for several weeks or months thru the failure of the depositor to bring in his pass-book to be balanced. Where a regular statement is sent an error is sure to be detected on receipt.

The adoption of the statement system involves no extra expense in the long run, as the improved service to the customers soon justifies the initial expense of the statement machine and the salary of a statement clerk.

The machine usually used is the Burroughs Adding Subtracting Statement machine and the method of operation is very simple. After the cheques and deposits are posted in the Current ledger they are immediately handed over to the statement clerk who enters them on the various statements. The latter first records on the machine the last balance shown on the statement and after making the day's entries extends the new balance. In this way the balances shown on the statement and in the ledger at the end of each day should agree and as the work on each has been performed independently, a comparison of the balances furnishes a check upon the work and eliminates the laborious duty of checking each deposit and cheque from the cash book to the ledger. In fact the supplementary cash book is reduced to an adding machine list of cheques and deposits which is used principally for balancing with the tellers. These lists are filed in the binder for future reference. As it is

PLEASE EXAMINE AT ONCE AND REPORT ANY DIFFERENCE IN THE STATEMENT DIRECT TO THE ACCOUNTANT

________________ IN ACCOUNT WITH

THE CANADIAN BANK OF COMMERCE __________

________________ MONTH OF __________

KINDLY NOTIFY THE BANK OF ANY CHANGE OF ADDRESS MONTH OF ____

No. of Items Paid	CHECKS	CHECKS	CHECKS	CHECKS	DATE	DEPOSITS	BALANCE
1				BALANCE BROUGHT FORWARD			
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26					Balance		
27					Credit		

INDEX TO ABBREVIATIONS:

D Discounts Credited L List of Checks Debited
C Collections Credited I Interest
R Returned Items

________________ VOUCHERS RETURNED

Figure 37

necessary to have slips for each entry the ledger-keeper furnishes the statement clerk with a memorandum for each accepted check outstanding, which is replaced by the check itself as soon as it comes in. The statements are filed in ingenious trays so divided that the balance slips of the day's operative accounts project from the general file of statements. Thus the active and inactive accounts for the day are separated without disturbing the alphabetical or numerical arrangement. It is therefore a simple matter to make a comparison of the statement files with the relative ledger balance if desired. Where the employment of a special statement clerk is not warranted, statements can be made up at regular intervals instead of daily, but the work should be so arranged that the entries for only one day should be necessary at the end of the month. Where the volume of the ledger work is found to be sufficiently large to warrant the expense, ledger posting machines are usually installed. These machines are very similar in their operation to the statement machines and as in the case of the hand ledgers each is operated concurrently and independently.

The pass-book is still used in connection with statement accounts, but simply as a receipt for deposits to the customer. A special form is generally used with provision for deposit entries only.

Pass-books will, of course, continue to be used for certain accounts, but the envelope system can be used to advantage for small accounts. An envelope specially ruled with a progressive balance is kept entered up from the ledger or vouchers, the checks being enclosed as entered. With the exception of perhaps a few entries, the statement is always ready to be handed to the customer as opportunity offers. This method, combined with the statement system, is of great assistance in relieving the vaults of an accumulation of checks and vouchers.

REVIEW

What precautions are taken upon opening an account? Who approves the opening of a new account?

What provisions are made in the case of professional partnerships? Of joint stock companies?

To what extent can the bank guard against fraud?

How is interest on savings accounts computed?

What is the value of the monthly statement system?

CHAPTER VI

LENDING A BANK'S MONEY

1. *Experience the only teacher.*—David Harum's definition of banking, "Loaning your money and gettin' it back" presents the gist of this chapter in a few words.

A bank must naturally expect to make some losses in its business but discrimination in making loans will reduce these losses to a minimum. The avoidance of losses is seldom a matter of good fortune, but rather of good judgment, and the time to avoid a bad debt is when the paper is offered for discount.

The ability to recognize the difference between a good loan and a poor one cannot be acquired from books or even from personal teaching; it can only be gained from experience supplemented by other necessary qualifications. True, there are certain fundamental principles to observe in analyzing any account, but, outside of these, no two accounts can be judged exactly alike; conditions are too varied.

Certain qualifications are essential to a manager in lending money. He must be a man of pleasing address, able to meet with and draw out from men the information he desires, and above all must be able to say no without giving undue offense. He should have a fair knowledge of accounting, so as to be able to read between the lines of a statement, or detect a discrepancy. He should have a good memory, supplemented by a record of all essential information obtained verbally from a customer. As a rule, it is bad policy to take notes during a conversation, as it is likely to restrain a customer from giving information freely.

Credit has been defined as "A question of ability to pay coupled with an intention to pay." Both ability and intention must be assured in order that the loan may be considered a safe proposition; the latter of these requisites is one that must be settled on the basis of past experience, habits of life, character and the like. If a man has always paid his debts and is not living beyond his means his intention to pay would be practically assured. The ability to pay, however, is another matter and much more difficult to determine.

There are, therefore, certain facts that a manager must know in order to determine whether or not the bank will be willing to extend credit to a borrower:

(1) Antecedents and character of a borrower
(2) Nature of the business
(3) Organization
(4) Competition
(5) Business methods
(6) Outside opinion
(7) Net worth.

In addition to this general information the manager should know what kind of transaction every piece of paper discounted by him represents, and should make a practice of putting the following questions to himself:

1. For what purpose is the bank's money to be used?
2. Is the loan safe: would I lend my own money on the security offered?
3. Is it a transaction that the bank should undertake to, or which can legally or morally become a party?
4. Will the money be used for the purpose for which it is borrowed?
5. Will the paper be met at maturity, and from what source?
6. Would the indorser be able to pay the amount, if called upon to do so, without seriously impairing his means?

To sum up, is the transaction a good banking proposition? If all these questions can be answered satisfactorily, and are corroborated by an analysis of the borrower's statement, the manager is in a position to discount the paper if within his discretionary limits, or otherwise to recommend the loan to the head office for authorization.

A simple rule is never to give out the bank's money without having rational or common sense reasons for knowing that it can be repaid within a reasonable time. It is the first principle of banking science that money must not be locked up in land, buildings, mines or similar non-banking ventures, or so lent that it can only be paid out of future profits by being transferred to another bank.

2. *Causes of failure in business.*—A study of the

principal causes of business failures may be useful in demonstrating the relative importance of the various factors of weakness. The accumulated experience of many years has been shown by Bradstreet's to prove that a large number of failures occur because of deficiencies in the traders themselves, rather than because of happenings beyond their immediate control. In *Bradstreet's Journal* for January 25, 1912, eight leading causes were grouped under the first heading, while only three were given as existing apart from the individuals themselves. These causes are as follows in the order of their importance:

A.—*Due to faults of those failing:*

1. Lack of capital
2. Incompetence (irrespective of other causes)
4. Fraudulent disposition of property;
5. Inexperience (without other incompetence)
6. Neglect of business (due to doubtful habits)
7. Unwise granting of credits
10. Personal extravagance
11. Speculation (outside of regular business)

B.—*Not due to faults of those failing:*

3. Specific conditions (disaster, prolonged sickness, etc.)
8. Competition
9. Failure of others (of apparently solvent debtors).

In 1912, 30.3 per cent of the number of failures and 80 per cent of the liabilities were due to the shortcomings of those who failed. Bradstreet's gives the following interesting table:

PERCENTAGES OF NUMBER OF FAILURES AND LIABILITIES IN THE UNITED STAES AND CANADA IN 1911 AND 1912

CLASSIFIED AS TO CAUSES

Failures Due to	United States, Per Cent				Canada, Per Cent			
	Number		Liabilities		Number		Liabilities	
	1912	1911	1912	1911	1912	1911	1912	1911
Lack of capital	29.7	31.4	33.5	28.3	50.3	49.3	45.8	47.8
Incompetence	30.2	27.0	26.8	23.5	16.3	16.1	22.8	18.9
Specific conditions	16.5	16.9	13.8	20.7	12.8	14.6	8.8	10.1
Fraud	10.3	10.6	8.8	8.9	6.7	8.1	10.3	9.9
Inexperience	4.6	4.1	3.0	2.2	5.1	2.9	3.5	1.5
Neglect	2.0	2.2	1.0	1.3	4.3	4.1	3.1	2.5
Unwise credits	2.0	2.0	2.6	2.2	1.3	.9	1.7	1.0
Competition	1.9	2.9	1.3	4.8	1.0	1.1	.6	.6
Failures of others	1.3	1.3	4.9	4.2	.9	1.1	2.5	1.4
Extravagance	.7	.9	.9	1.2	.8	.9	.5	3.2
Speculation	.8	.7	3.4	2.7	.5	.9	.4	3.1

These percentages afford much interesting and instructive information and point definitely to the more serious ills of commercial life.

It is at once apparent that the most dangerous factor in Canadian business life is the lack of capital, which is responsible for over 50 per cent of the business failures. The lack of liquid capital is one of the most serious difficulties a bank manager has to contend with, and he must ever be on the alert for its appearance. It is a condition which may arise at any time. For instance, a loan made to a customer ostensibly for the creation of liquid assets may be improperly diverted into building, real estate or other fixed assets. Lack of capital, altho the apparent cause of these failures, is not necessarily the primary condition, but may arise or be aggravated by any of the other causes; injudicious buying, for instance, extravagance in living or speculation, may all result in this condition, without showing as an apparent factor in the failure.

Incompetence shows the next largest percentage in Canada and, combined with inexperience, gives a total of 21.4 per cent in number and 26.3 per cent in liabilities. These particular causes assert themselves in various ways: injudicious buying, lack of organization and various unwise business transactions. It must be borne in mind that a man may be most successful in operating a small business, but may prove quite unfit to handle a larger one, on account of lack of business education.

The other causes are self-evident reasons for non-success in business and call for no particular comment. It is not only necessary to keep these causes of failures constantly in mind, but it is advisable also to watch carefully that the presence of these causes in an account of the least important does not assume larger proportions or induce even more serious conditions.

3. *Statement of affairs.*—Reference has already been made to the necessity for obtaining a knowledge of a borrower's net worth. This information is arrived at by an analysis of the business statement which is required from all customers seeking credit from a bank.

Altho the practice of requiring statements from borrowing customers is by no means an innovation on the part of banks, it is only of late years that it has been found advisable to make the rendering of a statement an invariable condition of lending a bank's money. This necessity is due to several causes; one is the rapid expansion of the country and the opening up of branches in new territories; another is the gradual elimination of the personal element in modern business life, due to the incorporation of old-established firms into joint stock companies, a shareholder in which has only the amount of his investment in the company at stake, and not his whole fortune and the honor of the family name. The principal reason, however, is no doubt a response to the constant demand for efficiency and thoroness in all branches of business life. The granting of commercial credits, as the keystone of the whole structure, has been raised almost to the dignity of a profession. The excellent work accomplished by the various credit men's associations in the United States [1] has naturally extended its influence to Canada, and practically every business house of any importance has its own credit department doing invaluable work.[2]

[1] Much credit is due to the late Mr. James G. Cannon, President of the Fourth National Bank of New York, to whose unremitting efforts in arousing public interest in this question may be ascribed the present high standard of credit requirements in the commercial world. Mr. Cannon is the author of many interesting and exhaustive articles and addresses on the subject of commercial credit, and he was instrumental in having the banks and credit associations thruout the United States adopt a uniform statement blank.

[2] The Canadian Credit Men's Association, altho only started in

In analyzing a statement it is well to bear in mind the old saying that "A man tells his hopes to his banker and his fears to his lawyer," and further, that a statement of affairs is often an expression of opinion rather than a statement of facts.

In the course of one of his addresses on "Bank Credits," Mr. Cannon, in an interesting and instructive way, remarked on the necessity of an analyzed statement in lending money:

The cornerstone of credit may be said to be the requiring from borrowers of statements of the condition of their affairs. This has now become an accepted custom in the relation between banks and borrowers on commercial paper. It has come to be recognized that the practice is of value to both the bank and the borrower, and this may be considered the reason for its success. Furthermore, the making of statements oftentimes renders concerns themselves aware of their weaknesses in their methods of operation, financial practices and results of business. The banker, having a substantial interest in the success of the customer, may frequently give wholesome advice or timely warning from his wide experience in commercial affairs and his foresight in monetary matters.

A statement, however, which is not submitted to analysis is a menace. Because, first, if errors have been made, if lack of judgment on the part of the management of the concern has been shown which is not brought to the attention of the borrower, if reckless methods have been indulged in or any dishonesty has been practised, the very fact that a statement has been received and accepted by a banker either lulls into a sense of security the careless or heedless borrower, confirms the reckless financial habit or establishes the dishonesty, if such exists. Frank and open statements,

Winnipeg in 1910, has extended its organization thruout Canada and has already accomplished much excellent work.

bearing upon their face the evidence of a true condition of affairs, are the greatest factors in establishing credit. Nothing will more firmly cement the union between borrower and banker than such a statement, and nothing will be of more value to a banker and of less harm to an honest, enterprising borrower. Hidden facts are revealed by analysis, and skill in reading between the lines is an important part of a manager's training. By this means, weaknesses may frequently be discovered and proper steps taken to avert trouble before acute difficulty arises.

A large number of statements will show on their face such evidence of weakness as to require no further investigation. This information, of course, is valuable to bankers, and they will at once decline to extend these applicants any accommodation; whereas, if, on the other hand they were only in possession of indefinite data, they might be disposed to extend a line of credit.

Many old firms, because they have been in the habit of conducting their business without revealing their financial affairs to any one, feel a natural reluctance to making a statement of their condition; but we should bear in mind the fact that great and deplorable mistakes have been made by banks in granting large lines of credit to old houses simply because they had an unblemished record and were supposed to be entitled to liberal consideration.

Notes, bills, drafts, checks, book credits, or any form of obligation resulting from a credit transaction, come into existence, not antecedent to, but as a consequence of, a transfer of goods involving futurity. Paper is purely fictitious and illegitimate which is not the outcome of an operation in goods; and we are enabled to test whether loans are legitimate or not according as we know whether the discounts are granted or not for actual transfers of salable goods. This test gives us the means of drawing the line between sound and unsound banking.

The manager as a rule trusts too much to his customer—if the latter wants money, presumably he is an ordinarily prudent man, and knows what to do with it; he must know his own business better than his banker, and it would be presumptuous in the latter to undertake to guide him. While this may be true of the well-trained and experienced merchant, it is very wide of the truth with hundreds of traders and small manufacturers all over the country. There are really very few men anywhere who can be trusted to handle prudently and safely unstinted loans of money. The proverb "Give him rope enough and he will hang himself" fitly illustrates the tendency of the average trader to get into difficulty when he is too freely provided with money.

With careful and prudent banking, however, much of the mischief would be prevented. Inflation is seldom developed to a very great extent without accommodation loans, and these would be very sparingly indulged in if not altogether avoided.

Credits would be carefully scanned and risks divided; and so the skilful banker, by simply following safe rules in his own business—rejecting here and encouraging there—cannot help saving his customers as well as himself from much trouble and loss. But in order to do this well he must be a man who thoroly knows his business; of strong self-reliance, a man who arrives at his opinions and judgments from observed facts, not from hearsay, and who is not to be frightened into altering his course to suit importunate and perhaps influential borrowers.

4. *Science of credit.*—The following analysis of the principles and rules which govern a credit man in his work were suggested by Mr. Cannon:

PRINCIPLES:

1. To reduce losses
2. To eliminate disproportionate risks
3. To conserve worthy interests
4. To war on dishonesty and incompetence.

MECHANISM:

1. The statement of condition, including:
   Assets and liabilities

Annual business or turnover
Net result of business
Bad debts
Commercial expenses
Character and antecedents
Special trade conditions.

2. The analysis and study of the above.

GUIDING RULES:

1. Quick assets only are a basis for loans

2. Fixed assets only considered as giving an unknown support to the quick assets

3. The debt limit of the borrower has been exceeded when his liabilities exceed 50 per cent of his quick assets (the so-called 50 per cent credit rule)

4. It should always be borne in mind that there is a cardinal difference between banking credit and other kinds of commercial credit; you can afford to run much less risk in banking than in commerce and therefore you must take much greater precautions.

5. *Form of statement.*—Altho for many reasons it is preferable to have a statement rendered on one of the standard forms supplied by a bank, the main object is to obtain information, and frequently a statement made up by a customer along his own lines may disclose weakness which a more formal statement might not reveal. Figure 38 is a comprehensive form combining both a statement and an application, and is adapted to the statements of private individuals, firms and corporations. It will be noted that each partner of a firm is required to sign the statement and application.

The statement generally submitted to a bank is the annual statement of the customer's affairs. This should be made at the end of his fiscal year, when his merchandise and raw material accounts are at their lowest, and his bank loans cleaned up.

In any business there should be at least one period in the year when the direct indebtedness to the bank is fully paid up. This is of vital importance both to the bank and the customer. Under normal conditions inability to clean up bank loans annually points to a lack of working capital, which may be due either to the gradual change of quick assets into fixed assets, or to injudicious buying or selling. To allow this condition to become chronic is fatal; it should be remembered that 50 per cent of the failures in Canada are due to lack of capital.

A brief comment on the information called for by the statement shown in Figure 38 will be instructive. It must first be noted that what are called "quick assets" consist of cash, receivables and merchandise, while "current liabilities" include practically all indebtedness except mortgages. The ratio of liabilities to quick assets is usually the first test of the statement. The two totals are therefore in line with each other for purposes of quick comparison. Except in certain businesses such as lumber, grain or other staples, the liabilities should not exceed 50 per cent of the quick assets, and as a rule the former should not exceed the cash and receivables, thus leaving the amount of merchandise on hand to represent working capital.

6. *Cash.*—The cash on hand should always be a

To the Manager

......................................BANK. 19

As a basis for credit with the above bank I/we hereunder submit for your information the following Statement which, without any reservation whatever, shows clearly and fully my/our financial position, made on a fair and conservative valuation from an actual inventory taken on ....191.... and includes all my/our direct and indirect liabilities.

DIRECT LIABILITIES			ASSETS		
Due to______________Bank Bills Payable for merchandise Accts. " All other Direct Liabilities (exclusive of Mortgages)			Cash on hand $__________In Bank $______ Stock on hand, at cost or under(Insurance $______) Bills Receivable for Goods Sold Accts. " " " " Other Bills & Accts. Receivable Other Reliable Quick Assets		
Current Liabilities Mortgages on Real Estate, particulars of which see below Surplus forward $ Gain for year $			Total Quick Assets Real Estate, particulars of which see below, actual value		

Figure 38. (Front—Upper Half)

PARTICULARS OF REAL ESTATE

Description	Insured for	Assessed Value	Actual Value	Mortgage or other Liability	Equity in

INDIRECT LIABILITIES

Customers' paper discounted ....$..........
On other paper indorsed or guaranteed.....$..........
Other liabilities ....$————

MERCHANDISE

Finished ....$..........
Unfinished ....$..........
Raw ....$————
Valued at cost or market? ....
Annual amount of sales or turnover........$..........
Regular time of taking inventory and balancing books? ....
Inventory taken by whom? ....

ACCOUNTS AND BILLS RECEIVABLE

Are all due from customers? ....
Are any due from members of firm, relatives or employees? ......
Are there any which you will probably not be able to collect? ....

ACCOUNTS AND BILLS PAYABLE

Are all due for goods purchased? ....
Are any due to members of firm, relatives, employees, or any other than trade creditors?
....

Usual Terms of Purchase ....

BUILDING, MACHINERY AND FIXTURES

Are buildings well-appointed and maintained? ....
Is machinery equipment modern? ....
Is anything without value, or not now in use included in this item?
....

Provision for depreciation, $...........................

LIFE INSURANCE　　　　IN WHOSE FAVOR

$................　　　　.........................

$................　　　　.........................

$................　　　　.........................

Amount of marriage contract, if any.　　　　In favor of

$................　　　　.........................

Your obedient servant,

....

....

....

N.B.—If a Firm, each partner to sign under the firm signature.

FIGURE 38. (FRONT—LOWER HALF)

PROFIT AND LOSS For Year Ending

Expenses, including interest, taxes, insurance, repairs, maintenance, etc. Written off for depreciation " " a/c bad debts Withdrawals by self or partners $ " for salaries $ " for other purposes $ Net Profit			Gross Profit on sales for last fiscal year Gross Profit from other sources Net Loss		
$			$		

IF A PARTNERSHIP: FIRM NAME

GENERAL PARTNERS			SPECIAL PARTNERS		
Name	Amount Contributed	Outside Net Worth	Name	Amount Contributed	Until

IS PARTNERSHIP REGISTERED?

IF A LIMITED COMPANY: CORPORATE NAME

Date ______ By ______ (State Officer's Title)

Office Address ______ Nature of Business ______

Location of Plants and Branch Offices ______

FIGURE 38. (BACK—UPPER HALF)

OFFICERS: DIRECTORS:

________________ President ________________

________________ Vice-President ________________

________________ Treasurer ________________

________________ Secretary ________________

APPLICATION

To the Board of Directors of

THE ____________ BANK

____________ hereby beg to apply for a line of credit from the ________ Bank, during the pleasure of the Bank, of ____________ for the purpose of ________________________________

____________ to be drawn during ________________________

As security ____________ offer

H. Approved Customers' Notes to be discounted from time to time, not exceeding $

D. Direct Loan secured by ________________ $

E. " " " Endorsements of ________________ $

F. " " " ________________ $

Standing of proposed endorsers or full description of security offered

Name	Occupation	Estimated Worth

Your obedient servant

____

____

____

N.B.—If a Firm, each partner to sign under the firm signature

Figure 38. (Back—Lower Half)

comparatively small amount. If large, the reason should be inquired into, as this means either carelessness in financing or that some worthless note or *bon* is carried as cash. Practically all the cash on hand should be carried in the bank, and the balance maintained should be commensurate with the amount of work which the account involves to the bank.

Comparison should be made with the bank ledger on the same date, and if outstanding checks have been allowed for by an entry on the liability side of the statement, the amount should agree, otherwise the deposit ledger balance will be the larger; if the reverse, the reason should be inquired into.

7. *Merchandise.*—Stock on hand or merchandise calls for most careful consideration and analysis. Old and unsalable stock accumulates rapidly, especially under poor management, and even if the stock is reasonably new, its amount, if out of proportion to the total sales, may be a burden to the business and prove a source of weakness. It is important to know if the figures are the result of actual inventory at cost price, and also on what basis old or unsalable goods have been included. In revaluing the merchandise for credit purposes due consideration must be given to the nature of the business. A deduction of 10 per cent is generally sufficient for staples such as groceries, provisions, iron and leather, while on goods partaking of the nature of luxuries, or depending for their sale on changing fashions or seasons, there should be a much heavier discount. It is always

advisable to look over the stock as occasion offers. Another good plan is to keep a record of the result of local liquidation sales of goods and receivables; no better object lesson can be found as to the realizable values of different kinds of merchandise.

In a manufacturing business it is necessary to know the several values of raw materials, finished goods and goods in process of manufacture. Raw material if not too much broken in bulk is worth within 10 or 15 per cent of the cost. Finished goods, if ready for shipment, should be worth actual manufacturing cost, but unfinished goods should only be considered to the extent of the goods actually in process of manufacture, as established by the ratio between the daily and total annual output. Any balance over this amount should be inquired into, as under this heading are often inventoried parts of articles whose manufacture has been discontinued.

The amount of merchandise in a business should form a reasonable proportion of the annual turnover. Conditions vary in different trades and localities, and it is impossible to establish any standard. Roughly speaking, however, the turnover of a business should be two and one-half to three times the working capital.

Ample insurance is necessary in any business. Whether a bank is interested or not, every customer should be advised of the wisdom of keeping fully insured. If the insurance is assigned to the bank the schedule should be compared with the annual statement, and all the conditions of the policy carefully examined.

8. *Bills and accounts receivable.*—Bills receivable in the statement of a Canadian merchant are generally few in number, as practically all his trade paper is discounted, or else left with the bank for collection. With the facilities offered by the banks there is scarcely any object in holding paper in the office. Under these circumstances a large amount of bills receivable, in excess of collection held by the bank, should be looked into, as it probably means an accumulation of past due or worthless paper or else some special transactions which should be disclosed.

Accounts receivable should be inquired into, especially as to the method of allowing for bad and doubtful debts. A distinction is made in the statement between receivables for goods sold and receivables from other sources. Loans to officers, relatives and friends, and other irregular transactions are frequently found in the latter.

Receivables should bear a reasonable ratio to the turnover and goods on hand. This ratio, of course, would vary in different trades according to the terms of sale. A business selling on ninety days' time would naturally show a higher proportion of receivables than a business selling at thirty days.

9. *Machinery and fixtures.*—Real estate, machinery and fixtures are known as fixed assets and should only be considered as offering an unknown support to quick assets. In fact, real estate should be practi-

cally ignored unless a direct and steady revenue is derived therefrom. In other words, real estate should be looked upon only as something to fall back upon in case of need and never considered as a basis for a bank loan.

In a manufacturing business both buildings and machinery are constantly being converted into goods, and proper allowance for depreciation should be made each year out of profits.

If the premises are rented they should be suitably located for the business, and the rent paid should be in proportion to the business done. Much depends, however, on the nature of the business itself. A drug or tobacco business could afford to pay a large rental for a corner store because of the quick turnover for cash. The same rent, however, might ruin a more profitable business with a slower turnover.

Where the premises are owned outright the rental test should be applied on a basis of interest and taxes. If the valuation of the owner is higher than the business can stand on a reasonable rental basis, the valuation is either excessive, or the business should be moved elsewhere and the property sold. The owner must acknowledge either overvaluation or poor business judgment, if he continues to do business at a more expensive stand than his business warrants.

The value of the real estate as security is the price for which it can be sold at a forced sale. If the holder of a mortgage has to foreclose, the property, altho seemingly desirable and well situated, depreciates enormously, a result which is intensified if the mortgage is to a bank. Experience shows that a large sum is consumed for overdue interest, legal expenses, commissions and the like; this should be taken into account in estimating the real value of such an asset as a means of paying off indebtedness.

10. *Current liabilities.*—Current liabilities generally consist of amounts due the bank and the wholesale trade for goods purchased. If due to any other creditors the circumstances should be explained. As already stated, amounts due to the bank should be cleaned up at least once each year either by cash or trade paper discounted.

The observance of a borrower's daily transactions and a critical scrutiny of his liability account from time to time, and one year with another, should reveal whether he is progressing or otherwise.

A comparison of the indirect and other liability of the customer on the books of the bank with the amounts shown in his statement will sometimes disclose an omission in the latter. In one instance, a branch held for collection from other banks more than double the amount of the bills given in a statement. Needless to say the account was not entertained.

Where amounts are due to other than trade creditors, such as members of the firm, relatives and employes, it is a disturbing feature, as such loans are liable to be given first consideration in case of trouble.

Should the account be at all weak in other respects, postponements of claim to the bank should be obtained from such creditors.

11. *Mortgages and other factors.*—Mortgages should invariably be shown as a liability, and the relative real estate as an asset. The equity alone should never be considered. The position of a mortgage in regard to taxes, interest and insurance will frequently warrant examination.

It is very important that all contingent liabilities should be given, such as trade paper discounted and paper indorsed or guaranteed. Such obligations, if not disclosed and allowed for, will always be a source of menace.

It is useful to know the amount and disposition of life insurance in force and, in the province of Quebec, the amount of the marriage contract is material information, as the latter ranks prior to an unsecured liability.

The information called for by the reverse side of the statement figure No. 38 (pages 245, 246) is self-explanatory, and is pertinent to the consideration of an application.

Every borrowing customer should provide, in his will, power to his executors to continue his business after his death until it can be profitably liquidated. If a firm, the partnership agreement should contain a similar provision; otherwise the business must be liquidated without the expenditure of further moneys. In many cases this would entail heavy loss and, if the bank were interested, the safety of its loans would be endangered.

Where a firm or corporation operates branch offices great care should be taken to see that no cross drawing or sales are allowed to swell the assets. Many losses have been made thru the careless scrutiny of branch operations, especially where a branch carries a deposit account at a local bank. Check kiting is one of the first symptoms of the disease; others quickly follow.

12. *Sundry information.*—No statement can be analyzed by rule of thumb. The points brought out in this chapter are by way of suggestion only. To many accounts, of course, they would not all be applicable. No unfavorable fact, however, is too unimportant to be overlooked and a competent manager is constantly adding to his knowledge and developing his power of drawing inferences and making deductions. At the risk of repetition the following questions are given and may be found helpful in realizing the varieties of causes which contribute to the formation of a borrower's credit standing.

Are the borrower's antecedents and character good?
Are his personal drawings from the business large?
Has he ever failed or had a suspicious fire?
Is he well liked and respected in the community?
Does he kite notes or checks?
Is he in good health? His age?
Is he what is known as a "rebater," a man who makes unfair claims for goods in the hope of getting rebates or other concessions?

Can reliance be placed on his statements?

What are his personal habits?

How does he spend his evenings?

Has he technical ability in his business?

Are his books properly kept?

Does he extend credit too freely or without discrimination?

Does he cut prices?

Is he careful and discriminating in the purchase of his stock or does he carry an unnecessarily heavy stock?

Is he inclined to dabble in outside ventures such as real estate or stocks?

Does the business depend on conditions that may not be permanent?

Does he allow his machinery to become out of date and inefficient?

Does he study the particular wants of his trade with a view to meeting public demands?

Are his accounts receivable and bills receivable all genuine collectible accounts or are they padded with slow or worthless paper?

Does he take advantage of all trade discounts?

Are his sales out of proportion to his capital?

Is his position improving year by year?

Has he any large contingent liability?

Are all his liabilities given in the statement?

Are his profit and expense accounts in proportion to his sales?

Does he buy his raw material before he is reasonably sure of the amount of his sales?

Is he over-ambitious and anxious to extend his plant out of all proportion to his working capital?

Does he turn his capital quickly, or as many times as his competitors in the same line of business?

Does he always plan ahead in regard to his financial engagements, and know where the money is to come from?

Has he made provision for continuing his business in case of death?

Does he advertise wisely?

Is the line of goods he manufactures or sells one which is easily affected by changing fashions or seasons?

How do his annual sales compare with his stock on hand and bills payable and receivable accounts?

On what basis is the inventory taken and by whom?

Are his books audited by a chartered accountant?

13. *Preparing the application.*—The consideration of a customer's statement along the lines suggested in the previous sections should assist a manager in promptly deciding whether he will grant a loan or not. A prompt "no" is often preferable to a belated "yes." The latter implies indecision. The least indication of weakness in the statement should not be overlooked. The margin of profit in banking is too small to allow unnecessary risk to be taken, and the bank should always be given the benefit of the doubt.

A reference book or card index should be kept on the manager's desk, and any credit information about customers and others, whether borrowers or not, should be systematically jotted down.

In the case of larger firms submitting regular statements, it is necessary to keep a careful record year by year of the changes in the statements and course of the account. It is advisable, whether the account falls within the manager's discretionary limits or not, to do this.

When a loan is outside the manager's discretionary limits it must be submitted to the head office accompanied by a definite recommendation. The latter is essential. Therefore, as soon as the manager decides that a loan of this nature is desirable, he prepares the statements required by the head office and forwards them with his letter. Figure 39 gives an exact copy of a customer's statement with space at the foot for a revaluation of the assets by the manager. Figure 40 provides for a detailed analysis and comparison of the last two statements on file, and also gives a comparison of the statements for the past five or six years. The course of the liability account is given for the past year with sundry other information. The course of the deposit account should also be referred to.

14. *The application.*—The most severe test of a manager's ability and soundness of judgment is found in the writing of a letter of application. The reasons for recommending the loan should be concisely stated and no pertinent fact omitted. In other words, the head office should never have occasion to write back for further information or missing particulars.

A separate letter should, of course, be written for each account, and the condition of the liability and security at the moment of writing should be set forth at the head. The letter should further give a concise statement of:

(a) The amount of credit applied for;

(b) The purpose for which the advances are to be used;

(c) When the advance will be required;

(d) When and from what source payment is expected.

Give full Name or Names of Partners, Age, Business, and Residence. ______________________ Branch

STATEMENT OF THE AFFAIRS OF

______________________ as at ______________________ 19___

Item No.	Assets	Per cent deducted in Mgr's valuations			Liabilities		
					Sales for past year ________ $____ Losses " ________ $____ Insurance on Liquid Assets $____ " on Fixed Assets $____		
					Real Estate Searched ____________		

MANAGER'S ABSTRACT OF ABOVE, WITH HIS VALUATION OF ASSETS

	Liquid Assets: Cash, Bills Receivable and Accounts ________ Merchandise held for Sale ________				Floating Liabilities: To Bank Accounts Payable ____ Bills Payable ________ To Sundry Parties ________		
	Miscellaneous movable property ________ Fixed Assets:				Mortgage Debts: Surplus ________ Liability as Indorser or Guarantor not included above, namely on:— Trade Paper in Customer's Account ________ $____ On other Accounts at Branch ________ $____ On other Accounts elsewhere ________ $____		

FIGURE 39

Name of customer________________

COMPARISON BETWEEN ACCOMPANYING STATEMENT AND LAST PREVIOUS STATEMENT

	As per Last previous Statement Dated ___19___		As per Present Statement Dated ___19___		Increase		Decrease	
Liquid Assets:								
Cash, Bills Receivable and Acconnts______								
Merchandise held for Sale______								
					Net		Net	
Total Liquid Assets______								
Fixed Assets:								
Mortgages and other Investments______								
Chattels and other Dormant Assets______								
Premises and Stationary Plant______								
Other Real Estate, unencumbered______								
Other Real Estate, encumbered______								
					Net		Net	
Total Fixed Assets______								
Total Assets______								
					Decr	ease	Incr	ease
Floating Liabilities:								
To Bank Accounts Payable______								
Bills Payable______								
To Sundry Parties______								
					Net		Net	
Total Floating Liabilities______								
Mortgage Debts:______								
					Net		Net	
Total Mortgage Debts______								
Total Liabilities______								
Surplus:								

Increase—Decrease in Liquid Assets______ $
Increase—Decrease in Floating Liabilities______
Increase—Decrease in Liquid Surplus______ $
Increase—Decrease in Fixed Assets______ $
Increase—Decrease in Mortgage Debts______
Increase—Decrease in Total Surplus______ $

	___19___		___19___		___19___		___19___		___19___		___19___	
Liquid Assets______												
Floating Liabilities______												
Liquid Surplus______												
Fixed Assets______												
Mortgage Debts______												
Fixed Surplus______												
Total Surplus______												

FIGURE 40

Sometimes preliminary letters may have been written giving information on some of these points, but the final letter should nevertheless contain full particulars, and reference to previous letters or statements should not be made merely to save the trouble of repeating information, except in special and involved cases. It is much more economical in time and labor for a branch manager to set forth the case fully, rather than to put the head office to the trouble and delay of looking up references.

The reasons leading to the recommendation and any criticism of the account should be carefully and systematically assembled and the information set out in due order and sequence, each subject being discussed in a separate clause, and all to be said on a particular subject brought together in one place as far as possible. This can only be accomplished, as a rule, by the letter being first drafted and carefully corrected before it is written. If the application is from a new customer the cause of the change in his bank account should be reported, and if the application is for a line of trade paper a list of the trade bills under discount with his previous bank should accompany the letter.

If these simple requirements are carefully complied with, the head office will be in a position to accord a prompt authorization or otherwise of the application.

15. *Guarantees.*—Guarantee bonds are a dangerous form of security, liable to be voided by what may

appear to be a most trivial incident not affecting in any way the equities of the situation.

A special form used by banks is given in Figure 41. In cases where a guarantor is also a creditor of the borrower it is generally the custom to obtain a postponement of the former's claim in favor of the bank.

It must be borne in mind that a bond of guarantee would become ineffective if the business of a firm or individual were converted into a stock company, or if the ownership of a business changed, altho the same business style should be continued.

16. *Customers' wills.*—Under ordinary circumstances and speaking generally, the business in which a man is engaged at the time of his death must be liquidated by his executors, or, if he is a member of a firm, by the surviving partners, without the expenditure of further moneys. In many cases, this would entail heavy loss.

For this reason, it is very desirable that every borrowing customer should be influenced to provide in his will that his executors be empowered to continue his business after his death until it can be profitably liquidated. Deeds of partnership should also make similar provisions.

The borrowing powers of executors, if they have any, are determined by the will of the testator. Upon the decease of a borrower the conditions of the will should be ascertained, and unless authority is specially

To the Manager

.....................BANK

In Consideration of The Canadian Bank of Commerce agreeing to deal with ....herein referred to as "the customer," in the way of its business as a Bank, the undersigned hereby jointly and severally guarantee payment to the Bank of the liabilities which the customer has incurred or is under or may occur or be under to the Bank, whether arising from dealings between the Bank and the customer, or from other dealings by which the Bank may become in any manner whatever a creditor of the customer; (the liability of the undersigned hereunder being limited to the sum of......................dollars with interest from the date of demand for payment of the same).

And the undersigned agrees that the Bank may grant extensions, take and give up securities, accept compositions, grant releases and discharges, and otherwise deal with the customer and with other parties and securities as the Bank may see fit, and may apply all moneys received from the customer or others, or from securities, upon such part of the customer's indebtedness as it may think best, without prejudice to or in any way limiting or lessening the liability of the undersigned under this guarantee.

And this guarantee shall apply to and secure any ultimate balance due to the Bank, but the Bank shall not be bound to exhaust its recourse against the customer or other parties or the securities it may hold before being entitled to payment from the undersigned of the amount hereby guaranteed.

And that this shall be a continuing guarantee, and shall cover all the liabilities which the customer may incur or come under until the undersigned, or the executors and administrators of the undersigned, shall have given the Bank notice in writing to make no further advances on the security of this guarantee.

And it is Agreed that this guarantee shall be good notwithstanding any change or changes in the name of the customer, or any change or changes in the membership of the customer's firm by death or by retirement of one or more of the partners, or by the introduction of one or more other partners.

Any debts or claims against the customer now held, or which may, during the continuance of this guarantee, be held by the undersigned or any of them are for the further security of the Bank, and as between the undersigned and the Bank are hereby postponed to the debts and claims against the customer now held or which during such continuance may be held by the Bank, and until the Bank has received payment in full of its said debts and claims any such debts and claims of the undersigned or any of them shall be collected, enforced or proved subject to and for the purpose of this agreement, and any moneys received by the undersigned or any of them in respect thereof shall be received as trustee for the Bank and shall be paid over to the Bank on account of its said debts and claims.

The Guarantee and Agreement on the part of the undersigned herein contained shall extend to and enure to the benefit of the assigns of the Bank.

Given Under Seal at.................this................day of ....A. D. 191....

Witness:

Figure 41

given thereunder the executors cannot legally borrow or renew any note which may be running.

17. *Power of attorney.*—The original of any power of attorney should be permanently lodged with the bank, unless it has been filed in a city or county registry office, in which case a certified copy under the hand and official seal of the registrar may be accepted. A notarial copy of a power of attorney which remains in the hands of an attorney cannot be acted upon. As a rule, however, the powers of attorney are executed on forms provided by the bank (Figures 42 and 43). A power of attorney must not be witnessed by the party in whose favor it is drawn and, as a general rule, should be delivered to the bank by the grantor and not by the attorney.

Where an instrument is executed before a notary public in the province of Quebec and the original left on record in his office, a copy certified by the same notary may be accepted. A notary in the province of Quebec is a public officer and authorized to act as a depositary for such documents.

Bear in mind always that the authority conferred by a power of attorney is closely circumscribed to the acts which it specifies by the most strict reading. Unless specially authorized an attorney for a customer cannot hypothecate collateral to the bank.

An overdraft created by check signed by an attorney is not binding upon the principal unless the power of attorney granted by him expressly specifies that

LIMITED FORM

WITH POWER TO OVERDRAW

Know all Men by these Presents that

Fill in here the name, business and address of the Attorney.

....

of...

....

has been made, constituted and appointed, and is by these presents made, constituted and appointed the true and lawful Attorney of the undersigned........

Fill in here the name, business and address of the Customer.

....

....

of...

....

for and in the name of the undersigned to indorse all or any Bills of Exchange, Orders, Drafts and Checks for deposit with the .... Bank, to draw and sign all Checks, Orders and Drafts for payment of money on the said Bank, *and to overdraw the account of the undersigned with the same if he shall think fit;* to arrange, settle and balance all books and accounts, and to sign the Bank's form of settlement of balances and release; and generally for and in the name of the undersigned, to transact with the said Bank any business that may be necessary in the premises; and all that the said Attorney shall do by virtue hereof is hereby ratified and confirmed.

The words in italics may be ruled out if the Attorney is not to have power to overdraw.

The said Bank may continue to deal with the said Attorney under this power until notice of the revocation hereof has been given in writing to the Manager or Acting Manager of the Branch of the said Bank at which the account of the undersigned is kept, and until such notice in writing has been given, the acts of the said Attorney hereunder with the said Bank shall be binding on the undersigned.

In witness whereof these presents have been executed by the undersigned at..........the.......... day of............One Thousand Nine Hundred and ....

Witness

Figure 42

FULL FORM

KNOW ALL MEN BY THESE PRESENTS that

Fill in here the name, business and address of the Attorney.	.... of... .... has been made, constituted and appointed, and is by these presents made, constituted and appointed the true and lawful Attorney of the undersigned
Fill in here the name, business and address of the Customer.	.... of... ....

for and in the name of the undersigned to *draw, accept, sign, make, indorse, negotiate and dispose of* all or any Bills of Exchange, Promissory Notes, Checks, and Orders for the payment of money; to pay and receive all moneys and to give acquittances for the same; to discount or deposit with or transfer to the................BANK any negotiable paper, Stocks, Bonds and other securities; to draw and sign all Checks, Orders and Drafts for payment of money on the said Bank, and to *overdraw* the account of the undersigned with the same if he shall think fit; to arrange, settle and balance all books and accounts, and to sign the Bank's form of settlement of balances and release; and generally for and in the name of the undersigned to transact with the said Bank any business he may think fit; and all that the said Attorney shall do by virtue hereof is hereby ratified and confirmed.

The said Bank may continue to deal with the said Attorney under this power until notice of the revocation hereof has been given in writing to the Manager or Acting Manager of the Branch of the said Bank at which the account of the undersigned is kept, and until such notice in writing has been given, the acts of the said Attorney hereunder with the said Bank shall be binding on the undersigned.

IN WITNESS WHEREOF these presents have been executed by the undersigned at ....
.................the.............day of..........
One Thousand Nine Hundred and.............

WITNESS

FIGURE 43

it confers power to overdraw, for which the principal undertakes to be responsible.

When a power of attorney is revoked the revocation may be acknowledged, but under no circumstances should a power of attorney once lodged with a bank be surrendered.

A power of attorney is terminable by the following causes:

(a) Revocation by the principal

(b) Renunciation by the attorney

(c) Dissolution of a partnership

(d) Loss of civil rights or civil capacity (as interdiction)

(e) Death of the principal

(f) Bankruptcy of the principal.

Care should be taken to procure properly certified copies of the by-laws or resolutions authorizing officials to sign for incorporated companies, municipalities and other similar bodies. These should be entered in the register in the same manner as the powers of attorney.

The properly authorized signing officers of a municipal corporation whose checks are a correct charge against a credit balance may not create a debt, which an overdraft would be, unless authorized by by-law to do so. However temporary an advance to a corporation may be, a by-law or resolution authorizing it must be passed and a certified copy of it should invariably be lodged with the bank. Such resolution should state the source from which payment is to be made, such as taxes, for example, and should also provide for renewals, if necessary.

REVIEW

What should be the basis of credit extension by a bank?

Why is a statement of affairs of the borrowing concern necessary in extending credit?

What principles and rules should govern the credit man?

What are quick assets? Fixed assets? Current liabilities? To what extent may current liabilities indicate a man's worth as a credit risk?

What is the value of a guarantee bond?

Why should a bank retain the original of any power of attorney?

CHAPTER VII

CLASSIFICATION OF LOANS

1. *Call loans.*—The subject of call loans in Canada, or elsewhere, as an asset of the bank has already been dealt with in Chapter VI, Part I, and it is only necessary to describe briefly the methods of making such advances in Canada. These loans are generally made to brokers on satisfactory stocks and bonds listed in the local market, and with a margin of about 20 per cent and 10 per cent, respectively.

Two margin tests should be applied: first, a 20 per cent margin of security above the amount of the loan; second, ten points per share less than the market value of the stock. The first test insures an ample margin on high-priced stock, and the second discriminates against low non-dividend paying stock. For instance, 20 per cent on stock selling at $30 per share would mean a margin of $6 per share as against $10, or 33⅓ per cent, called for by the second rule.

Figure 44 is the form in general use, and combines in one the hypothecation and the agreement of sale in case of default in keeping up the necessary margin. The discount clerk should see that every certificate of stock pledged is good delivery; that is, the certificate must be in the name of a responsible broker or the

....................................191....

The undersigned hereby acknowledge to have received from THE ....BANK...............
..................Dollars, as an advance, which sum will bear interest from this date......................at the rate of..........per cent per annum, as well after as before maturity, and is repayable..............................

And the undersigned having cause to be transferred to the Bank, or to one or more of the officers thereof in trust, the following security, namely: ....
....
....

..........Shares.......... @ .... = $..........
.... " .... @ .... = $..........
.... " .... @ .... = $..........
.... " .... @ .... = $..........

to be held as collateral security for the payment of the said advance and interest, the Bank is hereby authorized to sell and convey the said security, or part thereof from time to time, whenever the Bank shall think proper, upon default in the payment of the said advance, and to apply the proceeds thereof towards its reimbursement, without prejudice to its claims upon the undersigned for any deficiency.

Should the said security depreciate in value before the maturity of said advance, the Bank is hereby authorized to sell and convey the same, or part therof, from time to time, without waiting the day of payment.

It is also hereby agreed that should the Bank at any time determine upon a sale and conveyance of the said security, or part thereof, from time to time, for either of the reasons above stated, such sale and conveyance may be made without notice to the undersigned, all and every formality prescribed by law or otherwise in relation to such sale and conveyance being hereby waived.

And it is further agreed that should the Bank allow the undersigned to substitute for the above other collateral security such substituted security shall be held by the Bank, subject to the same terms and conditions, and with power and authority to dispose of and apply the same in the same manner as the Bank could have done with the original security.

And it is understood and agreed that the Bank is at liberty to retain and use the above mentioned security (or substituted security) as collateral for any other indebtedness or liability, present or future, of the undersigned to the Bank.

In case any security or substituted security transferred to, or lodged with, the Bank is in the form of a certificate for shares of stock, with a blank transfer and power of attorney in blank to transfer the shares of stock on the books of the Company endorsed thereon or attached thereto, the Bank is hereby authorized, through any of its officers or employees, to fill in all blanks in such transfers and powers of attorney with such names and in such manner as may be thought best by the Bank, and to seal and deliver the same after such blanks have been filled in.

Witness the hand and seal of the undersigned.

....

Figure 44. Form for Hypothecating Collateral

indorsement guaranteed by a broker whose signature the bank knows, and should be assigned in blank and witnessed. These requirements not only insure the genuineness of the stock, but also that claims for dividends are made on responsible brokers by the holders of the stock. To make a transfer every time a certificate changes hands would, of course, be impossible. Bonds should be scrutinized to see that they are payable to bearer, and all bonds, debentures, certificates of stock and similar certificates pledged as collateral for advances, or lodged for safe keeping, should be kept in the treasury under the joint custody of the manager and accountant. All securities, as soon as received, should be recorded in the securities register by the number of the certificate or bond, the name of the company, the number of shares, the par value of the shares and the name of the broker to whom the certificate is assigned. It should be the invariable practice of every bank to record the above particulars of any stock passing thru its hands, whether received as security or simply passing thru the bank's books attached to a draft. In case of the loss of the script such information has often proved invaluable.

2. *Loans to joint stock companies.*—A joint stock company has been defined as an association of individuals possessing corporate powers, enabling them to transact business as a single individual. Such companies may obtain incorporation in Canada in several ways:

1. By special act of either the Parliament of Canada or the provincial legislatures;

2. By letters patent issued under the General Companies Acts of the Dominion of Canada or of the provinces of New Brunswick, Prince Edward Island, Quebec, Ontario or Manitoba;

3. By memorandum of association in the provinces of Nova Scotia, Saskatchewan, Alberta and British Columbia.

As the powers conferred on companies under these several methods of incorporation vary, banks, as a rule, issue instructions to their branches in the different provinces regarding loans to joint stock companies; special forms for by-laws, etc., are also supplied.

When considering loans to companies incorporated by special acts, it is, of course, necessary to refer to the companies' charters in each instance.

In opening an account with a joint stock company, it is, therefore, necessary to ascertain the following:

1. Has the company power to borrow?

2. Have the directors authority to exercise that power without a by-law of the shareholders?

3. Is there a specified limit to the amount which can be borrowed, and has that limit been reached?

4. Have the directors power to secure the payment of moneys borrowed by giving security under Sections 86-90 of the Bank Act or by mortgage or other charge on all or any part of the assets of the company?

This information can be obtained from the charter and records of the company and from the statute under which the company is incorporated. These

RESOLUTION *passed by the Board of Directors of the..at a meeting duly called, held at the office of the Company in..........................on the...................day of............................, 191....*

On motion it was resolved that..............................be and ....hereby is authorized on behalf of the Company to draw, accept, sign, make and agree to pay all or any Bills of Exchange, Promissory Notes, Checks and Orders for the payment of money; also to authorize any Manager or other officer of THE.........................BANK to accept all or any Drafts or Bills of Exchange on behalf of the Company; also to sign checks upon and to borrow money from THE........................BANK on behalf of the Company, either by overdrawing the account of the Company with the said Bank or otherwise.

Also that......................................be and........... hereby is authorized on behalf of the Company to assign and transfer to the Bank all or any Stocks, Bonds, Warehouse Receipts, Bills of Lading, and other securities, and to give the Bank security under Section 88 of the Bank Act, and to sign a written promise or promises binding the Company to give any such securities as aforesaid.

Also that...or any one of them, be and..........hereby is, authorized on behalf of the Company to negotiate with, deposit with, or transfer to the said Bank (but for credit of the Company's account only) all or any Bills of Exchange, Promissory Notes, Checks or Orders for the payment of money and other negotiable paper, and for the said purpose to indorse the same or any of them on behalf of the Company; also to arrange, settle, balance and certify all books and accounts between the Company and the Bank, and to receive all paid checks and vouchers, and to sign the Bank's form of settlement of balances and release.

CERTIFIED a true copy of the Resolution passed as above set forth and recorded in the Minute Book of the proceedings of the Board of Directors of said Company.

Dated the...................day of......................, 191....

L. S.

....
PRESIDENT

....
SECRETARY

The President and Secretary will sign as above; the other officers as follows:

....*Vice-President*

....

XVI—C19

FIGURE 45

questions being satisfactorily answered, it is customary for the directors of the company to pass a resolution outlining the powers of the signing officers, and specifying who they are to be. A certified copy of this is generally supplied to the bank on a form similar to that in Figure 45.

Where a by-law of the shareholders is necessary to confer borrowing powers on the directors, a certified copy of the by-law is supplied to the bank on a form similar to that in Figure 46, supplemented by the directors' resolution above referred to.

It may be seen from the above that care should be exercised by a bank, not only in opening an account with a company, but also in any subsequent transactions. It is well to remember that a corporation has no personal liability, that no director or officer of a company is identified with the business of the company as closely as he would be if it were his own undertaking, and that failure of a company can affect a director or shareholder only to the extent of the amount of his shares. In view of this limited liability it is customary among banks, when a company is a frequent applicant for loans, to require the personal guarantee of the directors. The logic of this is sound, and the refusal on the part of the directors to comply with this condition should be considered with extreme caution. If the men who are managing the company have not sufficient confidence in their own management to guarantee the loan, why should the bank take the risk?

BY-LAW of the..
....

BE IT ENACTED as a By-law of the Company as follows:

The Directors may borrow money on the credit of the Company from time to time and in such amounts as they may think proper, and may hypothecate, mortgage or pledge the personal property of the Company to secure any sum or sums borrowed for the purposes thereof.

The borrowings of money from time to time heretofore under the authority of the Directors from THE..........................BANK and the giving of securities therefor under Section 88 of the Bank Act or otherwise are hereby ratified and confirmed.

IN WITNESS WHEREOF the corporate seal of the Company has been hereto affixed, and this By-law duly countersigned the ....day of..................191....

L. S.

....
PRESIDENT

At a general meeting of the shareholders of the above-named Company duly called for considering the foregoing By-law, which was passed by the Directors on the.............day of.................. 191...., and held on the.............day of.................191...., the same was duly sanctioned and confirmed by a vote of not less than two-thirds in value of the

(1) subscribed stock represented

....at such meeting.

(2) shareholders present in person or by proxy

....
CHAIRMAN OF THE MEETING

....
SECRETARY

FIGURE 46

3. *Loans to municipalities.*—The conditions governing loans to municipalities, school districts and other public bodies differ in the various provinces and also in the case of cities incorporated under special charter. As the laws are frequently changing no general procedure can be formulated. The head office of each bank generally issues specific instruc-

tions and forms regarding these loans to their branches in the several provinces.

Generally speaking, municipalities, on resolution of their councillors, are authorized to anticipate taxes by borrowing up to a certain percentage of their annual assessment. These borrowings must usually be retired by the taxes as they are paid in. The loans are, and should be, short in term. When, however, one year's borrowings overlap another the advances should be kept distinct. Such loans, when supported by authentic copies of the resolution of the council, may be considered legitimate banking undertakings.

Frequently a municipality is authorized by a by-law, voted on by its ratepayers, to borrow money for some specific purpose, such as water works, drains and the like. It is advances of this description which form one of the objectionable features of municipal accounts. As a rule, municipalities postpone any definite arrangement as to the disposition of the bonds until the construction, for which the issue is authorized, has been completed. In the meantime, they look to their banks for advances from time to time until the work is fully accomplished. This feature in itself is not objectionable if the municipality takes immediate steps to dispose of its bonds on the completion of the work. Unfortunately, this is seldom the case. Financial committees sometimes number among their members one or more amateur financiers, who not only have exalted ideas of the market value of the bonds in question, but also overestimate their own ability in judging market conditions. The result is that the time in their opinion is rarely opportune for making a sale of the bonds, and the bank is confronted with the necessity of continuing to carry an unsatisfactory loan or enforcing a sale of the bonds, both undesirable alternatives. The proper method to follow in making such advances is to see that, at the inception of the loan, a definite arrangement is made as to the disposition of the bonds, irrespective of market or other conditions.

4. *Loans to professional men.*—Loans to professional or salaried men cannot be considered desirable from a banking point of view, or from any point of view for that matter. Even where the applicant is possessed of private means, a loan of this nature is more or less objectionable according to its object and the understanding as to final payment. The money may be locked up in some undesirable venture, and tho sure of ultimate payment the bank is confronted with the alternative of carrying a dead loan or, by enforcing payment, making an enemy of a desirable citizen.

Loans to men who depend entirely on their salaries and professional earnings should not be considered except in very exceptional cases. If a man cannot live on his salary he cannot hope to pay off an indebtedness in addition. The loan is either intended to discharge another indebtedness or to purchase something which cannot be paid for out of future salary. Credit is a good servant and a bad master, and many men in these days of competition, both social and otherwise, are induced to "keep up" with their neighbors, to purchase automobiles, and generally to live in a style beyond their means.

Retail merchants frequently offer this class of paper for discount, and the objection to this is even more pronounced. If a man cannot pay for the necessities of life for his family there is not much likelihood of his being able to pay off a debt.

These remarks are not intended to apply to worthy people who have suffered misfortune, and to whom every consideration should be shown, but it does refer to people entirely dependent upon moderate salaries, received with a regularity which renders credit unnecessary.

5. *Loans to farmers.*—Under certain conditions of farming, more especially in the West, credit for a farmer is more or less a necessity, and loans to responsible farmers is a desirable and legitimate business for a bank. In the East, where mixed farming prevails, the farmer is not only in easy circumstances, with perhaps a savings bank account or money loaned out on mortgage, but he has a more or less certain income thruout the year from the sale of farm produce to the neighboring towns. Loans when made to him are generally for some specific purpose—such as the purchase of cattle for fattening—in other words for the creation of an immediately liquid asset.

In the West, however, where only grain-growing prevails, a farmer has practically only one crop a year, and it is necessary for him to have credit while he is preparing for the crop, as he has to wait until the fall before receiving any return for his year's work. Seed must be bought, labor paid for and, while the crop is growing, the farmer must live. Few farmers can cultivate their farms without some credit either from a bank or store, and if no credit were extended they could neither purchase nor produce anything.

Credit to a farmer, no matter what his moral or financial standing, is relative and should not exceed a year's supplies at any time. The loan should be cleaned up regularly after harvest, unless arrangements were made by way of advances under Section 88 of the Bank Act. The size of the farm and the amount of land under crop should also be carefully considered, for some farmers are too ambitious and try to farm too much land. The tenure of the land, the amount of mortgage, and other indebtedness, especially for machinery, are all important features in considering advances to this class. As a rule, the farmer should not need to borrow from the bank until seed-time to pay for seed, labor and the like. If his crop is successful, he should be clear of his indebtedness before the end of the year, and have a good surplus to pay on his mortgage or to place in the bank.

A clause in Section 88 of the Bank Act of 1913 permits a bank to lend money to a farmer "on the security of his threshed grain grown upon the farm." The addition of this clause was due to the fact that the grain grown by a farmer in the West was expected to clean up his indebtedness at harvest time or shortly afterward. This condition worked a hardship on the farmer, who sometimes had to throw his crop on the market regardless of prices, instead of having an opportunity to await normal conditions. The volume of sales, moreover, at this time depresses prices and adds to the confusion and congestion on the railways. The farmer is now in a position to offer the security of a staple article, and can borrow enough on his crop to pay off his indebtedness. It is still early to give any opinion on the result of the new law but, speaking generally, it possibly will not make very much difference to the responsible farmer, as he was able to borrow money on his own note in any case. As to the farmer of less favorable standing, it is questionable whether a security entirely under his control will improve his chance of credit.

6. *Loans to retail merchants.*—As a general rule, retail merchants are not entitled to unsecured advances on their own name. A storekeeper who takes considerable credit from the wholesale trade should be able to obtain all his credit from that source. If his position is not such as to enable him to do this, a bank should not intervene unless he is able to put up good trade bills or other security. A bank has only the bare interest in the loan, while the wholesale merchant has a margin of 20 or 30 per cent profit to fall back on in case of loss. If the loan is sought for the purpose of paying cash for goods purchased,

it should be borne in mind that the usual discount granted by the seller for cash is 12 per cent per annum or more, that being, in effect, his estimate of the degree of risk, while for precisely the same risk the bank is asked to be satisfied with seven per cent or even less. The mere transfer of an obligation from the mercantile creditor to a bank does not diminish by one-half the monetary risk of the accommodation; it is illogical and irrational to assume such risks for an ordinary banking rate of discount.

Loans to retailers are dangerous both to the bank and to the borrower; to the bank on account of the risk, and to the borrower because it frequently leads to lax methods of collecting.

7. *Loans to manufacturers and merchants*—Naturally the bulk of the loans of a commercial bank consists of advances to manufacturers and wholesale merchants. Both classes are considered highly desirable customers. They are at times heavy borrowers from banks, and a consideration of their relative merits in that connection is of interest. Mr. George Hague, in his "Banking and Commerce," has expressed himself so clearly on the subject that he is well worth quoting:

> There is this fundamental difference between the wholesale merchant and the manufacturer; the merchant, if his credit is good enough, can put the whole of his stock upon his shelves without the expenditure of a single dollar except for freight and duties. Good credit will enable him to obtain all he wants from manufacturers on this side of the Atlantic, or from wholesale houses in England. But a

manufacturer can do nothing of the kind. From the time that he begins operations he has to provide for a cash expenditure which never ceases until goods are ready for sale. In nearly every branch of manufacture he must pay cash for his raw material and his fuel. And the moment he begins the manufacturing process, his pay-roll of wages confronts him week by week, and must be met. There can be no possibility of asking credit here; not for a single week could wages be left unpaid. In the case of special lines of manufacture where wages are a most important item of cost, the necessity of meeting the large sums required is the most harassing of all financial pressures. It presses, indeed, more heavily than the necessity of meeting acceptances and promissory notes, for the payees of these can be approached for renewal, at a pinch, while a request to a body of workmen to defer payment of wages is utterly impossible. And as payment is imperative, the manufacturer will naturally, in such circumstances, have recourse to his banker.

Hence, it is more difficult to finance for a manufacturing establishment than for the business of a wholesale merchant. The latter, having the power to buy goods at all times on credit, has no reasonable ground for asking regular advances from his banker. His dealings should be confined, as a rule, to the discount of bills given by his customers.

The only payments a wholesale merchant has to make, which are absolutely imperative, are the customs duties and freight on imported goods. It is just as impossible to ask credit here as it would be for the payment of wages. But no wholesale merchant could reasonably think of commencing business without capital, and the very lowest minimum necessary would be an amount sufficient to pay the duties on the stock requisite to commence business, and thereafter on his average stock.

Once he has his goods in warehouse, he can begin to sell, and with such facilities as bankers are now ready to offer for the cashing of customers' bills, a merchant may, from a financial point of view, be said to be able to sell for cash.

Thus, by the time the payments for his stock become due, the proceeds of his sales ought to be sufficient to meet them.

From all which the rule may be deduced that loans to a wholesale merchant (as distinguished from the discount of trade bills) should be considered as irregular in the nature of things, and only to be granted in exceptional circumstances.

But the whole system of loans to wholesale merchants is exceptional, and requires exceptional treatment at the hands of a banker.

The character of that treatment may be indicated as follows:

First, no regular line of credit should be arranged for in respect of loans; that is, no amount which a customer can always have at his command. Second, advances should be temporary, each being applied for on its own merits, with the explanation of circumstances. Third, they should only be allowed at certain seasons, and never last more than two or three months at the most. Fourth, renewals should not be granted. Indications of continuance should be carefully watched and promptly dealt with. If advances become chronic, security should be insisted upon. Fifth, it is always desirable, too, that when such advances are granted to a firm, the indorsement or guaranty of each individual in it should be obtained; for individual partners may have separate estates which the indorsement would bind. If the business is carried on by a joint-stock company, the guaranty of some of the principal stockholders would be desirable.

8. *Collateral notes.*—There are several reasons why it is preferable sometimes to make advances against notes as collateral instead of discounting them. The borrower may need, perhaps, only part of the face value of the notes, and that only for a short time. The quality of the paper may not warrant an advance

of more than a certain percentage, or the notes may be of a longer currency than three or four months, beyond which time a bank is loath to make an advance. Its assets must be kept liquid and not locked up in long time loans.

The merits of a note tendered as collateral should be gauged with no less care than if offered for discount; a large nominal margin may be delusive and by no means an adequate security. Such notes should be scrutinized as critically as discounted bills, and rejected if defective in any vital part. If notes offered by agricultural implement dealers and others are encumbered with conditions which render them non-transferable, they should be refused. Lien notes, or notes secured by lien on implements, machinery and other movable equipment, sold, should only be taken for collection, as it must be borne in mind that the maker has the right of set-off for any legitimate claim against the vendor, and third parties must always be prepared for something of this kind.

The bank in making advances of any nature has the right to expect the note taken to be free from any irregularity, and in accord with the requirements of the Bills of Exchange Act. It is not sufficient that a bank could probably overcome any irregularity by proving its case; even successful litigation is objectionable, and invariably means considerable worry and some loss in costs and time.

All notes taken as collateral security should be hypothecated to the bank on a form duly signed by the borrower (Figure 47 or 28). The form Figure 47 can also be used to pledge stocks and other securities, permissible under the Bank Act. The attorney for a customer cannot hypothecate collateral notes unless specially empowered to do so. All collateral hypothecations should be consecutively numbered as received from the customers, and filed in proper order in the vault.

The full margin of good collateral stipulated as the basis for any credit must always be maintained. A liberal margin will generally be found to be insufficient in case of trouble. The margin agreed upon in all cases should be calculated on the amount of collateral offered, and not based on the amount of the advance. For instance, on a margin of 25 per cent, advance $75 on each $100 worth of collateral deposited. Do not base the margin on 25 per cent of the advance, which in the above would only give $93.75 collateral for every $75 advanced.

Overdue paper should not be accepted as collateral. √

In the case of wholesale accounts obtaining advances against trade paper deposited as collateral, it will be necessary to follow the account as closely as if the paper were discounted. For this purpose the blue book used in the discount department should be used (see Figure 25), and an account opened up for each obligant.

In all cases of advances against this class of security it is necessary to see that drafts and notes which are returned unaccepted or unpaid are settled for, eventu-

HYPOTHECATION OF BILLS AND SECURITIES

_______________ 191____

_______________ *Bills, Notes and/or other Securities in connection with the account of* __________, *customer of* The __________________ Bank

If security is a bill or note enter its date in this column	No.	Enter in this column: Name of principal obligant, if the security is a bill. Description, if any other form of security.	Amount.

The above mentioned securities and any renewals thereof and substitutions therefor and proceeds thereof are to be held by THE....................BANK as a general and continuing collateral security for payment of the present and future indebtedness and liability of the above-named customer, and any ultimate unpaid balance thereof, and the same may be realized by the Bank in such manner as may seem to it advisable, and without notice to the undersigned, in the event of any default in such payment. The said proceeds may be held in lieu of what is realized, and may as and when the Bank sees fit, be appropriated on account of such parts of said indebtedness and liability as to the Bank seems best. The undersigned agree that the Bank may grant extensions, take and give up securities, accept compositions, grant releases and discharges, and otherwise deal with the customer and with other parties and securities as the Bank may see fit, without prejudice to the liability of the undersigned. The claims of the undersigned against any party on whom any of the foregoing unaccepted bills are drawn are hereby assigned to the Bank in the event of non-acceptance.

N.B.—If any bill or note lodged has been given for the accommodation of the customer, the accommodation maker or indorser must sign this document, and if any bill or note payable on demand is included, on which there is an indorser other than the customer, such indorser must sign also.

If the securities lodged are owned by some one other than the customer, this document is to be signed by such owner as well as by the customer.

FIGURE 47

ally, by the maker or drawee. The wholesale surrendering of these returned items to the pledger in exchange for fresh collateral drafts should not be permitted. Under no circumstances should unaccepted drafts which are lodged as collateral be held without presentation at the request of the pledger, or for any other reason.

9. *Accommodation paper.*—Accommodation paper is most dangerous when, as is generally the case, it is carefully concealed. A proof of a banker's sagacity will be best seen in his detection of the accommodation taint wherever it may exist, however dexterously covered up, and in keeping clear of it and of the other dangerous complications and contingencies inseparable from it.

Accommodation paper disguised as trade bills should be looked for and regarded with the same discrimination applied in separating spurious coin from genuine. Such paper should be detected if a manager is observant of the working of his accounts.

The most ordinary kinds of accommodation paper, according to an old rule book, are the following:

(a) Paper floated by the borrower with the names of his friends for the general purposes of his business, say, a drygoods, grocery or hardware business, or a manufacturing business of any kind.

(b) Paper floated by the parties to it for the purpose of going into some speculation outside of their legitimate business. They are induced to buy or build a ship, a saw mill or factory of some kind, a farm, a mine, timber lands, or a score of other enterprises.

These two classes of accommodation must be avoided at all hazards.

(c) Renewals of notes that were legitimate enough in the first instance. If the goods they originally represented are still unsold by the promissor, the paper may still, in a sense, be held to be legitimate, altho, even in that case, the renewal is a most unhealthy sign, being proof of over-production and over-trading. But in the case of most renewals they have lost all connection with the goods they originally represented, the proceeds of which should have gone to wipe the notes out of existence at maturity. The proceeds of goods have been used for something else, and the notes remain, representing nothing. This is accommodation of the worst kind.

There is no more significant indication to a banker who has eyes open than renewed paper. In the most favorable light you can take it shows miscalculation. But in most cases it means something much worse—the beginning of the end.

If accommodation paper is taken at all you should be absolutely certain of the genuineness of the signatures. The danger from forgery is not the least of the dangers attending the handling of this objectionable kind of paper. The way is left open for that kind of fraud when indorsed notes are discounted for the promissors, but this is prohibited in most banks.

Never overlook the consideration that if you take an accommodation endorsement you see perhaps less than one-half of the paper afloat bearing the same names. The obligant calls for a *quid pro quo,* the accommodation becomes reciprocal and, likely enough, develops into a network of cross indorsements.

10. *Overdrafts.*—The strong objection which all banks have to making advances by way of overdrafts is based on sound principles, which are not generally understood fully or appreciated. The principal reasons why this form of advance is not desirable are as follows:

(a) That it does not fix the customer's liability as indisputably as a note does;

(b) That it leaves the date of repayment uncertain and thereby tends to encourage laxity on the part of the borrower;

(c) That the maintenance of an active account in the current account ledger involves an actual out-of-pocket cost in the matter of stationery and clerical work, and it is important that the average free balance in such accounts should be sufficient to afford the bank a proper remuneration. Accounts in which the balance is frequently reduced to zero or converted into an overdraft are not of any direct value to a bank. It is further to be borne in mind that accounts which from time to time are overdrawn are a further expense, thru the waste of the time of the managers and ledger-keepers, whenever proper authorization has to be obtained for payment of a check creating or increasing an overdraft, as all such checks have to be referred to the manager.

(d) No customer has the right to issue an order upon a bank to pay money which he has not at his credit. The least he can say is that he wishes to borrow so much, for such a time, so that the manager may decide whether the money will be lent or not; otherwise an attempt is made to borrow the bank's money without its consent.

The practice of issuing a check without having any account is a criminal offense, and many business men are in favor of placing a check for which there are not sufficient funds in the same category. In some towns the banks make a practice of adding 10 or 15 cents to each check returned dishonored from the clearing house before charging it to the indorser's account. This charge has been found to have a deterrent effect on the practice, and has therefore met with the approval of the merchants.

An overdraft in a savings account is, of course, absurd and under no circumstances should be allowed.

REVIEW

What margin tests should be applied to the security for call loans?

Why is it sometimes preferable to make advances against notes as collateral rather than to discount them?

What is the maximum term of credit to a farmer? Why?

What are the ordinary kinds of accommodation paper?

Why is an advance in the form of an overdraft undesirable?

CHAPTER VIII

ADVANCES ON WAREHOUSE RECEIPTS AND ASSIGNMENTS

1. *Merchandise as security.*—Before studying the special conditions governing advances on the security of merchandise, etc., it is necessary to grasp thoroly the difference between security afforded by warehouse receipts under Section 86 and the security on a loan given under Section 88 of the Bank Act. The main difference is one of the possession of the goods, namely, constructive and actual possession of the security, respectively.

Advances on a warehouse receipt or bill of lading can be made to *any* person, and the continued existence of the security depends upon the reliability of an independent party, the warehouseman or carrier, production and surrender of the warehouse receipt being necessary to obtain the goods. Loans of this kind are reasonably safe, and the conditions governing them are very simple.

In the case of advances made under Section 88, however, the conditions are much more complicated, as advances under this section can only be made to manufacturers and wholesalers dealing in certain classes of goods, the continued existence of the security depending entirely upon the probity and the ability of the pledger, who retains possession and control of the goods himself. Consequently, a bank never lends money under Section 88 unless it is absolutely certain of the honesty and experience of the customer. Even then, loans of this class are not very desirable, owing to the technical detail and work involved in their operation. There is always a latent risk. Men who have had no previous experience in this kind of business, no matter how competent in other lines, are not good credit risks for this kind of loan. They should furnish good indorsements or other security in addition, until they have shown by actual experience that their operations are successful.

Sections 86–90, which give the bank special privileges to take such security, are based on the principle that the security must be taken and bear the same date as the advances, for which it is taken, thus insuring that the assets of the borrower will be increased concurrently, and therefore the act will not in any way operate to the injustice of any creditor. Consequently, if there is any discrepancy between the date of the advances and the date of the taking of the security, the legality of the latter is voided unless, prior to the advance, the bank holds a written promise that the security would be given.

It must always be borne in mind that banks alone are permitted to take this kind of security. For that reason, it is necessary when making advances to follow strictly the letter as well as the spirit of the law.

Otherwise the courts, if called upon to adjudicate, would no doubt render judgment against a bank. The whole of this system is more or less a novelty in business practice, and in some respects may act contrary to established business customs. The fact, however, that there have been so few lawsuits arising out of such transactions goes to show that the system works well in practice, and that no interests have suffered, notwithstanding the enormous volume of business transacted. The conditions governing the classes of loans under Section 88 are varied and more or less technical, and the following brief description is intended only as a general, rather than a specific, explanation of some of the more important features.

2. *Section 88.*—Under this section banks are permitted to make advances:

To any *wholesale purchaser* or *shipper* of or *dealer* in products of agriculture, the forest, quarry and mine, or the sea, lakes and rivers, or to any wholesale purchaser or shipper of or dealer in live stock or dead stock or the products thereof upon the security of the same.

To a farmer upon the security of his threshed grain grown upon the farm.

To any *wholesale manufacturer* of goods upon the security of the goods actually manufactured by him or procured for such manufacture (a bank may not, however, lend to a manufacturer upon the security of any goods procured by him to be sold in substantially the same condition in which they were received). No definition of the term "wholesale" manufacturer, purchaser, shipper or dealer is given in the Act—in fact, it would not be possible to define the term—but no difficulty, probably, will arise in the majority of cases, as the dividing line is generally well defined.

A correct appreciation of the intention and legal effect of the forms used in this connection will be helpful. Only one form, the assignment or pledge (Schedule C), is given in the Bank Act. All forms, however, are based on a correct interpretation of the act, and vary but slightly in the different banks. Among the more important forms may be mentioned:

1. The *pledge* or assignment of goods (Figure 48)
2. The *promise* to give security (Figure 49)
3. The *contract* with the customer respecting sales, insurance of goods, etc. (Figure 50)
4. The *declaration* by the customer as to the quality and value of the produce assigned and also a statement as to wages and other privileged claims (Figure 51)
5. The *note* (Figures 52 and 53). To be used with all advances made under Sections 86–90.

3. *Promise.*—When advances are made to facilitate operations extending over a season or for a certain period of time, as, for instance, in a lumber or grain business, it is obvious that the bulk of the security will be brought into existence in great part by the use of the bank's money. A general written promise to give security (Figure 49) must, therefore, be obtained before any advance is made, and pledges or assignments of goods should be obtained as often as any property constituting the security can be described or located. In addition to "the promise" a bank generally obtains an undertaking from the customer (Figure 50) regarding the insurance of the

goods in question, and an agreement as to the sale of the goods in case of default in payment, etc. Furthermore, each note form refers to the general promise and supplements it (Figure 52). Casual loans are made on another form of note (Figure 53), the promise being original and therefore calling for particulars of goods and location.

It must always be borne in mind that the "promise" is not in itself security; it is simply a contract to give security, and can only be enforced as a contract: in other words, it is an equitable assignment, in contradistinction to the pledge which is a legal assignment or transfer of property actually existing. The "promise" confers upon the bank no legal title to the property mentioned in it, and until a legal transfer in form of a pledge is made, the borrower, if dishonest, may sell, mortgage or otherwise deal with the goods intended to be the bank's security. The penal provisions of the Bank Act are not applicable to equitable assignments. It is important, therefore, to obtain a legal assignment as soon and as often as there are goods capable of being transferred. Under a "promise" the bank is not entitled to priority over unpaid vendors, unsecured creditors, or, in fact, to any greater rights than the customer himself.

It is important to remember that when a promise to give security does not exist, a bank cannot, except under the substitution clause of Section 88, claim any right to, or security upon, any other goods than those pledged at the time of the advance, and even these must be specially described so as to be distinguished from others.

Care should be taken to have the written promise include each class of product on which it is at all likely that the bank may be asked to lend during the season, and all places where the customer is likely to store or warehouse goods.

If a customer desires to obtain advances upon goods of a different nature from those covered by the original promise, or if the goods, whether of the same nature or not, are stored in places not mentioned in the original promise, then a fresh promise should be taken for the amount of advances required under the new conditions, and a separate account should be opened, thru which must pass the proceeds of all advances made in accordance with the terms of the second promise. Under such circumstances, the proceeds of the advances made under one promise must on no consideration be used to repay advances made under the other.

4. *Assignment.*—The assignment or pledge is in the exact form prescribed by the Bank Act or of like effect (Figure 48), and is a legal transfer to the bank of the title of the customer to the goods described in it. A legal acquisition of valid pledges, warehouse receipts or bills of lading confers on the bank priority of claim over an unpaid vendor. To obtain title it is necessary that the pledge should be contemporaneous with the advance, or pursuant to a written promise to give security made either prior to

SECURITY UNDER SEC. 88 FOR ONE OR MORE PROMSSSORY NOTES

In consideration of advances of....................................
.......................dollars made by The Canadian Bank of Commerce to the undersigned, for which the said Bank holds the following bills or notes made by the undersigned:

Notes dated..............191....., due.............191....., $........

Here describe fully the bills or notes so taken.

....

....

Rule out the classes of products, etc., not covered by this assignment.

the products of agriculture, the forest, quarry and mine
the products of the sea, lakes and rivers
the live stock or dead stock, or the products thereof
the goods, wares and merchandise
the grain

mentioned below are/is hereby assigned to the said Bank as security for the payment of the said bills or notes, or renewals thereof or substitutions therefor and interest thereon.

The security is given under the provisions of Section 88 of the Bank Act, and is subject to the provisions of the said Act.

The said

Rule out the classes of products, etc., not covered by this assignment.

products of agriculture, the forest, quarry and mine
products of the sea, lakes and rivers
live stock or dead stock, or the products thereof
goods, wares and merchandise
grain

are/is now owned by the undersigned and are/is now in the possession of......

....

and are/is free from any mortgage, lien, or charge thereon (except previous assignments to the Bank) and are in...............................

Describe fully the place or places where the goods are.

....

situated ....

....

and are the following..

Insert as full description as possible of goods assigned, e.g., logs, lumber, wheat, etc., and specify the products on hand.

....

....

....

....

Dated at..............the............day of.............191....

....

N.B.—If necessary, for want of space, the bills or notes or the description of the goods may be set out in schelule to be annexed, in which case insert in the appropriate spaces the words "those mentioned in the schedule hereto."

FIGURE 48. ASSIGNMENT

or at the time the advance is made. When assignments are given in connection with a general or continuous promise to give security, it is advisable to include all goods covered by previous assignments given under that promise, by describing all the property then in existence and in the customer's possession.

In filling out an assignment all the notes representing the total advances to date should be clearly detailed in the blank provided, and the goods and the places where stored should be described as definitely as possible.

The advance from the bank should be described as it actually is and not in general terms such as "all advances" used in the written promise. Assignments must be given as security for a specific loan in money, or for a specified promissory note or notes.

The best description is one which takes in all goods in a particular place, such as the following: "all the logs, lumber, lath and shingles which are now in the following place(s), namely. . . ." This description, if the place or places are properly described, would leave no doubt as to what goods are assigned. It would transfer the goods to the bank subject to whatever claim it might already have under previous assignments and, in addition, all goods covered by the description that had been added since the date of the last previous assignment. The words "except previous assignments to the bank" should always be left in the form when there are previous assignments.

Failing this general description, the security, to be good, must contain such a definite description by marks, location or otherwise as will enable the bank to identify the goods without question, even if there are other goods of the same kind in the same place not assigned to the bank.

A clear and definite description of the place or places where the property is stored is as necessary as a description of the goods themselves, and indeed, is an essential part thereof. The ponds, yards, etc., where logs and lumber are stored, the warehouses about a mill containing flour or grain and, in fact, all the places in which the goods to be assigned are situated, must be described in such a way that there can be no doubt which particular places are meant, and so that if there are other places of a similar kind belonging to the customer they can be clearly distinguished. Such a description as "my mill" or "my elevator" if the customer owned two mills or two elevators would not be good. If the customer is likely to use any other than the usual storage places the phrase in the written promise and assignment should be made broad enough to include these also.

It is to be noted that the act authorizes a bank to take assignments of goods whether in the possession of the owner or not. The pledge (Figure 48) has been framed to meet customary cases, but it may be altered to suit the circumstances when goods are in possession of another person, as, for instance, at a railway station where the agent cannot grant a warehouse receipt.

PROMISE TO GIVE WAREHOUSE RECEIPTS OR SECURITY UNDER SECTION 88

..................................191....

TO THE MANAGER

THE.....................BANK

....

DEAR SIR:

The bank is hereby requested by the undersigned to grant and continue during the current season a revolving line of credit for my/our..business of $............., and to make advances to the undersigned thereunder either by way of overdraft or in the form of discounting bills and/or notes of or for the undersigned on the security of all the

....

....

....

(hereinafter referred to as "goods") which are now owned or which may be owned by the undersigned from time to time while any advances made under this credit remain unpaid, and which are now or may hereafter be in...

....

....

situated ....

....

....

And the undersigned promise and agree to give the said Bank from time to time security for the said advances by way of assignments under Section 88 of the Bank Act, covering all the said goods or part thereof, and/or bills of lading and/or warehouse receipts for goods of the above kinds or some of them; and you or the Acting Manager for the time being are hereby appointed the Attorney of the undersigned, to give from time to time to the Bank the security above mentioned and to sign the same on behalf of the undersigned.

The Bank may from time to time take from the undersigned bills and/or notes representing the advances in whole or part. Such bills and/or notes shall not extinguish or pay the indebtedness created by such advances but shall represent the same only.

This undertaking is to apply to all advances made to the undersigned under the said line of credit, the intention being that all said goods which the undersigned may from time to time have in said place(s) shall from time to time be assigned to the Bank under Section 88, as security for all advances, and that all bills of lading or warehouse receipts covering goods of the above kinds which the undersigned may receive from time to time shall be given to the Bank as such security.

Yours truly,

FIGURE 49

The goods and their location must, of course, be similarly described in both the written promise and the assignment.

CONTRACT WITH CUSTOMERS RESPECTING WAREHOUSE RECEIPTS, ETC.

IN CONSIDERATION of the advances being made to the undersigned upon the security of warehouse receipts or bills of lading, or upon security under Section 88 of the Bank Act, the undersigned consent and agree with the Bank as follows:

1. To keep the property covered by the warehouse receipts, bills of lading, or security given from time to time, insured against fire to the extent of the advances made thereon, or to the full insurable value thereof in case such advances exceed the insurable value, and to assign the policies to the Bank (or have the loss, if any, made payable to it). Should the undersigned neglect to keep up such insurance, the Bank may insure and hold the property as security for the premiums paid and interest thereon, which premiums and interest the undersigned will pay on demand.

2. Any sale of the property covered by any such warehouse receipt, bill of lading, or security under such Section 88, given or which may be given to the Bank by the undersigned, may be by private sale, if the Bank thinks fit,—no advertisement or public notice of sale or intention to sell need be given,—and if three days' notice of general intention to sell be given by registered letter mailed in the Post Office and addressed to the undersigned at the address last known to the Bank, such notice shall be sufficient, and the property may be sold *en bloc* or in smaller quantities either by public auction or private sale or partly by each mode, at any time after the expiration of such period without further notice.

This is to be a continuing consent and agreement, and is to apply to all warehouse receipts, bills of lading and securities (and the property covered thereby) given, and which may be given, to the Bank by the undersigned.

Dated at..................the........day of..........., 191....

FIGURE 50

An assignment of goods is continuous and follows the relative goods thru all processes of manufacture until the bank's security is converted into the finished article.

5. *Declaration.*—Every borrower under this section should be required to furnish a statement at

least monthly, even if estimated, showing what stock he is holding at that date under assignment to the bank. This declaration (Figure 51) is of importance, because if a manufacturer, the pledger may have changed the status of the goods from raw material to manufactured articles; or, if a dealer, he may have substituted other goods in the place of those originally pledged. The intention of the declaration is to show, periodically, just what the bank's security is at stated intervals. It also keeps in the borrower's mind his responsibility to a bank, and would show conclusively to a court that a bank was following these goods, according to the spirit of the act. The form also contains a statement as to the amount of wages or other privileged liens on the goods.

Particular attention is directed to the prior rights of wage-earners under an amendment incidental to the 1913 revision of the act. Even if the customer is not in a position to give periodically the information regarding quantities and values of the products, etc., assigned, the statement should nevertheless be taken with respect to wages, salaries and the like. When an exact inventory is taken, or a sufficiently detailed declaration made, it would be advisable, in most cases to utilize it as a basis of an assignment.

It is customary to make an examination of the security pledged at irregular intervals, and a manager should, at all times, keep himself informed as to the fact that the security is fully sufficient to protect the advances. At the same time, even with the best surveillance, so much depends on the integrity of the pledger that a bank should not consider making advances in this form unless the applicant is a person of unquestioned integrity, with a previous record which leaves no doubt on the subject.

..................................191....

TO THE MANAGER

THE......................BANK

....

The undersigned submits the following true statement of products, stock, merchandise, grain, etc., and values thereof as at............ ...., assigned to The..................Bank under Section 88 of the Bank Act by the undersigned as security for advances made by the said Bank to the undersigned. The said products, stock, merchandise, grain, etc., are free from any mortgage, lien or charge thereon, except previous assignments to the Bank. The wages, salaries or other remuneration owing by the undersigned to persons employed do not now exceed $............, of which not exceeding $............are in arrears. The undersigned hereby agrees with The..................Bank that should this statement be found incorrect, then you or the Acting Manager for the time being may declare to be due and payable all moneys owing by the undersigned to the Bank and all bills and notes held by the Bank in respect thereof, and on such declaration being made, the said moneys and bills and notes shall thereupon become and be due and payable.

....

(Statement follows showing quantities, values, insurance, etc.)

FIGURE 51
DECLARATION

In making advances under promise to give security it is a general principle that the money the bank advances should go directly into the creation of the goods intended to be pledged. No portion should be diverted to any other purpose. This is an important matter and should be checked constantly, even if it is necessary to make a special visit in the early stages of the operations. The time to do it is at the beginning of operations before the money can be diverted into fixed assets or plant.

In the case of a large company the fact that the funds have been placed in actual production is often an intricate question to decide, being shown by the concurrence of several lines of evidence, the scale, inventory sheets, state of the books, etc. It is therefore advisable that there should be an understanding that these are open to the bank if it sees fit to send an auditor at any time.

Care should be taken to see that all workmen and artisans are paid within a reasonable time and that no privileged liens for wages are demandable, in fact, that no preferential claim exists on the stock. Full insurance in a bank's favor in satisfactory companies should always be held upon goods and the policies retained in the bank's possession.

Insurance held upon goods under assignment must not be regarded as effective security should fire occur, for if the goods were not there to be destroyed, the insurance company would not pay. The loss has to be proved. It must not be assumed that the existence of a policy of insurance is any evidence of the existence of the merchandise which it is supposed to cover.

6. *The note.*—Altho an ordinary promissory note form can be used in conjunction with either the promise or the assignment, it has been found more convenient in practice to adopt a special form of note

PROMISSORY NOTE TO BE GIVEN FOR ADVANCES MADE UNDER AN AGREEMENT ON FIGURE 49.

Due......................

$...............   ....191......

....months after date..........promise to pay to

THE.....................BANK at its office in..

the sum of .... Dollars,

for value received.

....

This Note is given to The Canadian Bank of Commerce for an advance made to the undersigned under the terms of the application of the undersigned to the Bank, dated the.............day of ....191...., and the undersigned hereby promise to give the said Bank security for this Note, under Section 88 of the Bank Act, upon the "goods" mentioned in the said application, or by way of Warehouse Receipts or Bills of Lading for the same or part thereof, and the Manager of the said Bank, or the acting Manager for the time being, is hereby appointed the Attorney of the under signed to give from time to time to the Bank the security above mentioned and so sign the same on behalf of the undersigned.

The borrower to sign here also } ....

FIGURE 52

Promissory Note and Promise for Casual Advances Under Section 88

Due.................................

$.....................   ....191......

....*after date*............*promise to pay to*

THE........................*BANK at its office in*..*the*

sum of.. *Dollars,*

for value received.

....

The undersigned promise and agree to give the above-named Bank security for the above note and any renewal thereof under Section 88 of the Bank Act covering all the.......................................

....

....

which are now or may be from time to time owned by the undersigned, and which are now or may be in.....

....

situated ....*or*

by way of Warehouse Receipts or Bill of Lading for the same part thereof; and the Manager of the said Bank or the Acting Manager for the time being is hereby appointed the attorney of the undersigned, to give from time to time to the Bank the security above mentioned and to sign the same on behalf of the undersigned.

The borrower to sign here also ....

Figure 53

(Figure 52 or 53), with a promise to give security appended thereto. Both the note and the promise require to be signed. This form should be used in connection with all advances under Sections 86-88-90. The note should preferably be drawn on demand, as then the original note will remain current in the possession of the bank until the loan is retired. When taken on demand, the note is made to read with interterest, which is collected monthly. If advances are made on time notes, they will have to be renewed, and the old notes and all other documents retained, to show the continuity of the transaction. The file will show, therefore, the current note and, attached thereto, any renewed notes, the promise (if any), the pledge and the insurance policies. Where an account is operated under a general promise it is not necessary to repeat the descriptions, and a note, similar to Figure 52, is used.

7. *Making advances.*—Before making advances the manager should be able to answer the following questions:

1. Is the customer a wholesale dealer, manufacturer or farmer within the meaning of the act?
2. Are the goods of such a character that they can be held as security under the act?
3. Does the character and standing of the applicant for the loan, entitle him to consideration?
4. Has he had sufficient experience to insure a successful outcome of the transaction?

5. If there is an advance on the warehouse receipt, is the warehouseman unquestionably reliable?

6. Has the borrower sufficient means to supplement the margin on the goods in case of depreciation?

7. Are there any unpaid vendors or has the borrower large outside liabilities which might lead to trouble or litigation?

8. Will the insurance requirements of the bank be complied with?

9. If a farmer, is there a definite understanding as to the eventual sale of the grain?

10. Is the procedure under which the account is to be conducted perfectly clear to the customer and the bank staff?

If these questions can be satisfactorily answered the manager is in a position to recommend the credit.

Whenever possible the property upon which advances are to be made should be examined by the manager with a view to ascertaining where and what it is, and he should, subsequently, be able to identify it if necessary. The goods must be particularly described both in the promise and the assignment, and there must be no mistake as to where they are stored.

As already noted, if the advances are to be continued during a season's operations, the general promise and other forms should be taken in addition to the note. If the advance is of a casual nature, it will be necessary to take only the note, the assignment and the contract in regard to insurance.

A reasonable margin should be maintained at all times, depending upon the class of security. If the margin will permit and further advances are subsequently necessary, for instance, in order to saw logs, for the purchase of which the original advance was made, or for additional expenditure in manufacturing, it is permissible to make additional advances and take additional assignments. These should, of course, recapitulate all the security in the original assignment, including additional goods, if any. But under no circumstances must the original pledge be renewed, the goods being carried out to their final realization on each pledge given.

All that is here said as to taking assignments applies equally to warehouse receipts, provided these cover property which is clearly a portion of that described in the promise. There could be no doubt on that point if the promise is to give security by assignment of all the grain, etc., now held or hereafter held by the customer, or by warehouse receipts covering the same or any part thereof, as the printed form provides. It may be well to mention that the taking of the subsequent warehouse receipts or assignments referred to above *is not a substitution*. The customer has promised that he will from time to time give security on all his goods for all his advances. The subsequent assignments, therefore, are not substituted for previous security, but are given in addition and in fulfilment of his promise to give security on the particular goods covered thereby.

It should be distinctly understood that the proceeds of all loans under Sections 86-90 must be used by the borrower for current expenditure in connection with his business, and no portion of them must be applied, either directly or indirectly, in settlement of any provious existing loan to the bank.

Altho not essential, it is found more convenient in most cases to have two accounts; first, the customer's current account, from which his regular disbursements can be made and to which proceeds of the advances under this section would be credited; second, a collateral account, into which all the proceeds derived from the goods pledged should be credited and from thence applied on the loan. By this method of carrying collaterals the same rate of interest may be credited as is charged on the loan on which it is finally applied. It should be noted that an overdraft should not be permitted in the current account of a customer borrowing under Section 88.

8. *Warehouse receipts.*—The bank may acquire and hold warehouse receipts and bills of lading as collateral security for the payment of any debt incurred in its favor, but it is necessary that the warehouse receipt be acquired at the time the advance is made or pursuant to a written promise to give security made prior to the time the advance is made. Loans may be made by the bank to *any* person upon *any* goods, wares or merchandise covered by warehouse receipts or bills of lading. In lending on the security of warehouse receipts or bills of lading, it is not necessary that

WAREHOUSE RECEIPT

The undersigned acknowledges to have received *from* ....

....

and to have stored in ....

....

....

....

....

to be delivered pursuant to the order of the said..

....

to be indorsed hereon, and to be kept in store till delivered pursuant to such order.

This is intended as a Warehouse Receipt within the meaning of the Statute of Canada entitled "An Act respecting Banks and Banking," and any amendments thereto, and within the meaning of all other Acts and laws under which a bank in Canada may acuire a Warehouse Receipt as security.

Dated at ....

the ....*day of* ....191...

Figure 54

a customer should be a manufacturer or wholesale shipper or dealer, as in the case of advances made under Section 88.

A definition of a warehouse receipt is given in Section 2 of the Bank Act. In making advances on warehouse receipts an ordinary note form or, preferably, the special form (Figure 53) can be used. Altho the delivery of a warehouse receipt constitutes a legal transfer, it is generally considered advisable to take an ordinary pledge or to use a special form (Figure 55). Immediately an advance is made on a warehouse receipt, the warehouseman should be notified and his acknowledgment received.

9. *Substitution.*—Section 88 of the Bank Act authorizes a bank to allow pledged goods taken from a wholesaler, purchaser or shipper to be removed and other goods substituted therefor. The permission to substitute is accompanied by so many restrictions that its use should be avoided whenever possible, and never allowed until the individual conditions have been looked into and the proper procedure decided on.

It is important to note that the provision for substitution is, in the first instance, expressed as conditional upon the consent of the bank, and tho failure to obtain such consent does not affect the validity of the security, there should always be an understanding with the customer that the goods are not to be removed without the bank's previous consent. As a rule, in an active account, it is not feasible to require a customer to obtain the bank's consent to

WAREHOUSE RECEIPTS and/or BILLS OF LADING ACQUIRED BY THE ....BANK as Collateral Security

No.	W/R or B/L	Issued,	Description of Goods

The above-mentioned Warehouse Receipts and/or Bills of Lading are to be held by the Bank as security for the payment of the indebtedness of the undersigned, as follows:

Note dated..............191...., due................191...., $......

....

....

or renewal(s) thereof or substitution(s) therefor, and interest thereon.

The goods covered by the above-mentioned securities may be realized by the Bank in such manner as may seem to it advisable, and without notice to the undersigned, in the event of any default in payment of the said indebtedness. The proceeds may be held in lieu of what is realized, and may as and when the Bank thinks fit, be appropriated on account of such parts of said indebtedness as to the Bank seems best.

....

Figure 55

remove the goods for each day's shipment, and the only practicable plan appears to be to have a general understanding with the customer (Figure 56) that he may remove goods from time to time and substitute others of the same character and equal value; that is, of course, to such an extent as the proceeds of the goods removed are not applied directly to reduce the advances.

Under the system of taking a general promise (as well as a promise with each note discounted) to give security on all the goods which the customer may have from time to time in certain named places, and taking assignments at frequent intervals, the value of the clause respecting substitutions is, in many instances, not important. It would be of benefit, however, under certain circumstances, for instance, where goods have been removed and others taken into stock subsequent to the date of the last assignment and the borrower failed or was seized up. In such a case, if the goods were of substantially the same character as those which they replaced, the bank would have a right to hold them under the last assignment.

Speaking generally, it may be said that the benefit of this clause will be most felt when security has been taken upon any stock of grain, minerals, logs, live stock, etc., at a time when the quantity of stock is at the highest point. The removal, with the bank's consent, of a portion of the goods, and the substitution of other goods of the same character, would leave the assignments applicable to all the remaining stock.

. . . . .191. .

THE . . . . BANK pursuant to Section 88 of the Bank Act hereby, until this provision is withdrawn, allows . . . .

. . . .

to remove from time to time in the ordinary course of business, for the purpose of delivering the same to purchasers thereof, the products, goods, wares and merchandise, live stock or dead stock or the products thereof, or any portion or portions thereof, on the security of which the Bank has lent or may lend him/them money under the provisions of said Section, and to substitute respectively therefor other products, goods, wares and merchandise, live stock or dead stock or the products thereof, respectively of substantially the same character.

For The. . . . . .Bank

. . . .

MANAGER

The undersigned, in consideration of the foregoing permission, hereby agree .. with The. . . . . .Bank not to remove any of the said products, goods, wares and merchandise, live stock or dead stock or the products thereof, in respect of which the said permission is given otherwise than in accordance therewith, and within a reasonable time from any such removal (what shall be a reasonable time in each and any case to be determined by the Manager for the time being of The. . . . . .Bank at ——————————, whose decision shall be final) to substitute respectively for the products, goods, wares and merchandise, live stock or dead stock or the products thereof so removed other goods, wares and merchandise, live stock or dead stock or the products thereof respectively of substantially the same character as and of not less value than those so removed, and in case of breach of this agreement the undersigned agree .. that the said Manager may during the continuance of such breach declare to be due and payable all moneys owing by the undersigned to the Bank and all bills and notes held by the Bank in respect thereof, and on such declaration being made the said moneys and bills and notes shall thereupon become and be due and payable.

Figure 56

Substitution Agreement

It will be observed that under this clause the right to substituted goods will not depend on an assignment being taken after the substituted goods are required, but on having an assignment covering the original goods for which the new goods have been substituted. This is an added reason for keeping all the assignments until all the advances to a customer are cleaned up for the season.

10. *"Current season."*—There is no special limit to the time during which the bank can hold security on goods properly assigned to it. For example, an assignment from a grain customer, dated August, would be effective in the following year provided the actual grain was still on hand in the following August.

The question of season is one which involves some difficulty in the case of accounts of tanners and other manufacturers, whose business goes on unbroken from year to year, so that it is hard to say where their season begins or ends. But there can be no risk in making the promise apply to the recognized term for bank credits—that is, one year following the date of the promise only.

In the case of advances which are not retired in full within the year, it is advisable to act on the theory that a general promise would not be applicable to advances made after the expiration of the particular season of the customer's business to which it refers. The general promise, however, undertakes to give security by way of assignment from time to time "while any advances made under this credit remain unpaid," and under this clause a bank would be entitled to continue taking assignments for loans carried over the end of the season until such time as they are entirely cleaned up. Renewals of notes representing advances carried over the end of the season should not be merged with notes representing new advances, and the former should be liquidated first. It is not necessary, however, to take separate assignments for the renewals, if any, of advances carried over.

While assignments of new goods may be taken for advances carried over the end of the season, and while the same form of assignment may be used for new and old advances, the proceeds of advances on a new season's account should not be used to liquidate any portion of the advances carried over from the previous season. This requirement can best be observed by opening new accounts in both the liability and deposit ledgers for the new season's business, and keeping the old season's business entirely separate.

When the old liability account is fully liquidated the old deposit account may, of course, be closed.

It should be borne in mind that the object aimed at in conducting separate accounts is to make sure that not a single dollar of indebtedness which existed before the new promise was taken is paid out of the proceeds of the advances charged to the new liability account.

11. *Default.*—Provision is made in the Bank Act (sub-section 3 of Section 88) for the sale of goods, in case the bank finds it necessary to realize on its secur-

ity, owing to the non-payment of the debt. A distinction is made between products of the forest and other goods. For the former the law requires that thirty days' notice should be given the pledger; if it concerns other goods, only ten days' notice of the time and place of sale is required. In both cases, however, the sale must be by public auction and after due advertising in at least two local papers. In the Province of Quebec one of the papers must be in French. If, however, the consent in writing of the pledger had been obtained the above procedure is unnecessary, and the sale can be proceeded with at convenience. (Figure 50.)

There are four penalties in the Bank Act which refer particularly to Sections 86-90. These are set forth in Sections 141-2-3-4. A bank is subject to a fine if it takes security for a pre-existing debt, or fails to comply with the requirements of the act in connection with the sale of goods in case of the default of the borrower. It is an indictable offense for any person to make a false statement in any warehouse receipt or pledge, or alienate any part of the bank's security under such pledge. The two latter clauses should be printed on the warehouse receipt or otherwise brought to the attention of those interested.

12. *General remarks.*—The whole question of making advances under Sections 86-90 demands careful study of the Act, as well as of the definite instructions issued by every head office on the subject. Losses are generally made by banks in connection with loans un-

der this section, due to carelessness in the details of taking the security. In some cases banks have lost their rights to the security. Security taken under this section gives a bank preference over other creditors because the bank created its own security by advancing the money, and in the event of the failure of a customer this preference may be attacked. If any flaws exist in the security a bank has practically no defense. Where this class of security is taken, therefore, it is essential that the procedure be strictly in accordance with the legal requirements, if the security is to be at all relied on.

The most important thing to remember is that the security under this section cannot be taken to secure any pre-existing debt, and to obtain title it is necessary that the pledge should be contemporaneous with the advance, or pursuant to a written promise to give security either prior to or at the time the advance is made.

When a manager has had little or no experience in this class of loan, it is advisable that in making application for the credit he should outline the necessary procedure as he understands it, referring to the forms he intends to use in this connection. Head office, in reply, will correct or confirm his conclusions. Assurance is thus made doubly sure.

As already mentioned, the above brief explanation of this important class of loan is not intended for direct application, but rather as a general commentary on the specific instructions, which are included in the rule book of every bank. It is hoped, however, that this chapter will prove helpful to any who have not had sufficient opportunity to grasp the spirit which actuates the law.

REVIEW

Under what circumstances does the Bank Act permit banks to make advances to wholesale purchasers of goods? To wholesale manufacturers?

What is an assignment?

Why is a declaration important?

What information must the manager have before making advances?

What conditions govern loans on warehouse receipts?

CHAPTER IX

INTERNAL INSPECTION

1. *Branch inspection.*—At irregular intervals and at least once a year every branch is visited by an inspector and his assistant from the head office, and a thoro audit of the books and assets of the office is made.

An inspection consists of two kinds of examinations, namely, verification and valuation. The first is called the audit or routine inspection, and consists of an audit of all the books, and a verification of the physical existence of the assets of the branch, as well as the correctness of the liabilities. All routine matters are carefully checked to see if the head office instructions are being conformed with.

The first part of the inspection is made by a routine inspector, or, as he is sometimes called, audit officer, who either accompanies or precedes the senior inspector, with one or more assistants, according to the size of the branch.

The second phase or inspection proper is made by a senior inspector, and consists of a thoro analysis and valuation of the loans and other assets of the branch. The senior inspector's particular duty is to discuss with the manager the inspection liability return with a view to obtaining a valuation, as correct as possible, of the loans and securities held by the branch.

To be a good inspector requires special training and qualifications. In the first place, a thoro knowledge of all conditions of branch work is essential, and this training can be acquired only thru actual experience in branch positions, from that of manager downward.

The inspector follows the audit officer as soon as the inspection report on liabilities is completed, tho in the case of small branches, which have but few large loans, the liabilities can be discussed by the routine inspector or by correspondence, and a visit from an inspector is therefore not necessary.

2. *The audit.*—Altho the work involved by an audit is too specific to be dealt with fully in this chapter, a brief consideration of its methods and requirements will be of value in emphasizing some of the essential features of Canadian practice. Practically all banks are similar in their method of auditing, tho with some the examination may be more exhaustive and searching. The following procedure may be considered as fulfilling the requirements of an average audit:

The audit officer and his staff of assistants time their arrival in a town so as to reach the office at the close of the day's business, and thus interfere as little as possible with the service to the public. Their arrival is, of course, unheralded. Immediately on entering the office, control of the safe is obtained and the following taken into custody:

Treasury and teller's cash, etc.

Bill cases containing discounts, collateral notes, collections, etc.

Cash books, vouchers for the day, including letters received.

Current account, general and saving ledgers.

Collection register.

3. *Cash and securities.*—The auditor then proceeds to:

Count in detail the teller's cash and the treasury cash.

Take charge of deposits made for the clearing house and see that they are credited by other banks the following day without deductions, or if deductions are made, ascertain their nature.

Obtain verifications of balances due to or by other banks.

Ascertain from the teller's cash statement book whether or not the cash has been examined in detail at irregular intervals at least twice a month.

See that a satisfactory explanation is entered in the teller's cash statement book opposite each important cash over and cash short item.

Check list of collateral securities with the securities themselves and with the register.

Examine all life and fire insurance policies and see that they are properly assigned to the bank and otherwise in form.

See that all securities are properly hypothecated and otherwise in order.

Check list of securities held for safe-keeping with the documents or packages themselves.

Send lists of all negotiable securities held as collateral or for safe-keeping for verification by owners.

Verify existence of loans, trade bills, and past due bills, initialing for each item in the diary or past due bills register.

Make a summation of the totals in the bill diary and compare with balances in the general ledger. The bill diary should be kept in the custody of the inspecting officers from the time they begin to check the bills until the totals have been verified.

Examine bills. Take a memorandum of all items not correctly drawn in every respect, and hand them to the manager or accountant to be put in order as soon as possible.

Verify the existence of local collections and collateral bills held, checking off each item with its relative entry in the collection diary.

See that all collections outstanding in the collection register are properly accounted for.

Examine collections and collateral bills, ascertaining regularity of acceptance and correctness of due dates.

Mail to branches and correspondents for verification, lists of trade bills remitted, collateral bills remitted and items outstanding in cash item account.

4. *The ledgers,* etc.—

Call off the day's checks and deposits and other vouchers with cash book, and compare cash book entries with current account and savings ledgers.

Take a rough list of current account balances and outstanding checks, and afterward instruct ledger-keeper to balance ledger in the usual way in his balance book.

Take off balance from savings ledgers, listing balances on inspection return.

When the current account ledger has been balanced, call off balances, initialing the balances in the ledger and comparing them with list previously prepared.

Check general ledger balance sheet, initialing balances in the general ledger.

Examine each ledger heading in the current account and savings ledgers and see if all particulars required have been entered, also if rules regarding loose-leaf sheets have been observed.

Check all entries for authorities, powers of attorney, etc., with list of authorities held.

See that proper entries have been made in deposit receipt account in the general ledger for all receipts issued and paid since last inspection.

Examine indorsements on receipts paid since last inspection, and see that they are tied up and sealed with the inspector's private seal.

Examine powers of attorney, resolutions and documents respecting signing officers.

Check date of last certification of each ledger balance.

See that certificates are properly filled in and signed.

5. *Sundries.*—

Compare inspection liability sheets prepared by the staff with liability ledger.

Examine entries in cash item register since date of last inspection, noting any items outstanding an undue length of time.

Ascertain if any items have been put thru as cash items which should have been shown on discount return as trade bills remitted.

See that the following books and records, etc., are properly kept:

Manager's diary
Discrepancy book
Record of lost drafts, stopped checks, etc.
Overdrafts register
Circular book
Overdue debt register
Postage account
Record of examination of bank premises
Character card file
Receipt for duplicate keys, etc.
Rates book
Record of mercantile agency reports received.

The following lists and statements are prepared by the staff and handed to the manager or accountant, and when checked and completed by them given to the inspector:

Adjustments
Assignments of goods
Balance sheet, general ledger
Bank premises, safes and vaults
By-laws, minutes, etc., list of
Comparative statement of condition of branch
Current account balances
Deposit receipts outstanding
Drafts issued accounts
Insurance policies held—fire
Insurance policies held—life
Letters of credit outstanding
Letters of guarantee
Liabilities of customers
Partnership agreement
Past due bills, list of
Powers of attorney, list of
Reports on officers
Securities, collateral
Securities, safe-keeping
Sterling exchange purchased and current
Trade bills remitted, summary of
Verifications, current accounts
Verifications, letters of credit
Verifications, trade and collateral bills remitted
Warehouse receipts, loans on
Waivers

6. *Inspection liability return.*—This return shows every liability in detail whether overdue or not. The names of all obligants should be in strict alphabetical order, and the totals of the loans and trade bills in each account should be shown in the proper column opposite the names of the customers. All securities

should be shown in detail with the manager's estimate of values. The following information should appear in the report on each important account:

Names and ages of individuals or partners

Head office authorization and expiry date of credit

Total fire insurance carried both on liquid and fixed assets, and the amount, if any, assigned to the bank

Discussion of customers' position and balance sheet giving copy of the latest statement of affairs and notes as to the changes of importance therein, indicating progress or the reverse

Remarks regarding customers' wills or deeds of partnership, having reference to the way in which the bank would be affected by the death of the customer

In reporting on farmers' and other casual loans, the original date of the transaction must be given, if any portion of the advance has been running for more than twelve months. The object of the loan, time of repayment and source from which the money is to come, should also be stated

The purpose for which a loan has been granted and the source of repayment should be stated—also the probable course of the advance, unless payment is assured at maturity.

In connection with all important accounts the following points should be fully discussed with the manager by the inspector, and the significant features made the subject of correspondence:

Personal:

Moral character, habits, and business ability

Past record

State of health

Life insurance carried

General:

Is financial progress satisfactory?

Fluctuations in liability and reason for any substantial increase—highest and lowest points of advance monthly for past year

Promptness in meeting obligations

Obligations in connection with interests outside the business, if any

Titles to, and liens or mortgages on property, information, researches, etc.

Value of collateral held

Value of the account or the connection

Any special features or influences which are likely to benefit or be detrimental to the customer or the business.

If a wholesale house:

Distribution and classification of risks in credits to customers, also any recent or anticipated losses

Financial responsibility of largest customers

Percentage of bills returned unaccepted or unpaid.

Having fully discussed all the outstanding features in the different accounts with the manager, the inspector is in a position to offer a reasonably close valuation of all the accounts, which he does according to the following ratings:

First-class business

Accounts regarded as desirable, but which do not liquidate satisfactorily

Business desirable because of the connection or local conditions, but not on its merits otherwise

Undesirable but probably collectible

Locked up but eventually collectible

Marginal loss probable

Bad

A. Secured by mortgage, etc.
B. Interest being set aside as a contingent fund
C. Not producing interest.

On his return to the head office, the inspector takes up with the branch and records by correspondence any objectionable features in the accounts, which he thinks require adjustment or comment.

REVIEW

Of what does a bank inspection consist?
How are the securities and cash checked? The ledgers?
According to what ratings does the inspector value all the accounts?

CHAPTER X

BANK COST ACCOUNTING

1. *Need of a cost system.*—Practically every bank of any importance in the United States has installed a system of cost accounting and made a careful study of the principles involved. In Canada, however, very little attention has been given the subject by the banks, altho in almost every other line of commercial industry cost accounting is accorded thoro consideration, and in fact has become an absolute necessity under modern business conditions.

The necessity of a cost system to a bank is really greater than in any other business, owing to the narrow margin of profits on the *gross amount handled* in banking, and the number and variety of services rendered by the banks to their customers and the public without remuneration.

In the stress of competition most banks overlook the fact that every transaction made for a customer, no matter how simple, bears a basic cost to the bank. They have allowed the public to encroach gradually on their legitimate exchange and other profits. Banks are not only rendering a great many services for nothing, but frequently at a loss to themselves. The public has been quick to grasp this weakness of the banks, and has naturally pressed its advantage to the utmost.

Until the beginning of the present century the profits obtained from the banking business were large enough so that the loss from a few unprofitable accounts had no appreciable effect on a bank's net earnings. Competition, however, has brought conditions to a state such as has existed for some time in other lines of business, so that it has become more and more necessary that all the business handled by a bank should show a certain amount of profit or, at all events, not be transacted at a loss.

The development of a new class of business—that of small and unremunerative checking accounts—the vast increase in the volume of checks, the tendency to carry active checking accounts in the savings bank department and the constantly increasing cost of operating, have made the analysis of the profit or loss on individual accounts an absolute necessity. The only remedy for excessive or unintelligent competition among Canadian banks lies in an accurate knowledge of costs. No ordinary argument will appeal to a branch manager sufficiently to restrain him from offering extra inducements to customers, as long as he honestly believes that he is securing such business at a *profit*. But few managers would persist in offering the goods or the services of the bank for less than cost if they knew the actual facts.

With expenses constantly on the increase, and with returns for banking services steadily diminishing, the banks have been forced to study seriously the reduction of expenses, both by the introduction of improved labor-saving methods in the work, and by systematic study of costs, with a view to adjustment or elimination of any accounts or transactions which have hitherto been handled at a loss.

2. *Principles of cost accounting.*—There are a great many factors entering into what constitutes a profitable account to a bank. The amount of credit balance maintained is not the principal factor to be considered, but the per item cost of the entries. In other words, an account with a balance of only $200, with a few entries, can easily be more profitable to a bank than one with a balance of $1,000 or more, but with a large number of checks, deposits and outstanding items.

In analyzing accounts the following questions should be considered:

(a) Is the account producing a profit?

(b) Is the account handled at a loss?

(c) If the latter, exactly what increase of balance or other change of conditions governing the account will change the loss to a profit? Tho an account may be operated at an apparent loss it frequently happens that there are collateral advantages which warrant a continuation of the arrangement.

(d) If the account is profitable, is the bank justly entitled to a larger profit than now obtained?

(e) Is the depositor entitled to any additional concessions?

In considering these points the following are axiomatic:

(a) In order for a *deposit* account to be profitable the balance must be a *credit* balance.

(b) Any account is profitable if the income from it exceeds the expense of keeping it.

(c) In determining whether or not an account is profitable the amount of credit balance maintained is not necessarily the principal factor to be considered. In the valuation of an account the amount of the balance is of secondary consideration as compared with the per item cost.

(d) In reviewing an account, the minimum weekly credit balance is the one that determines the lending value of the balance. Care should be taken to discriminate between the value of an average balance and a steady balance; the former, if a violently fluctuating account, is valueless.

(e) Discount on loans and trade bills, as well as interest on debit balances, should not be taken into consideration in this connection. The net discount or interest earned is regarded as a part of the profit accruing from the general loanable funds of the bank and therefore cannot be regarded as a benefit derived from an individual account, which receives due credit for the amount of balance maintained on deposit.

(f) In considering unprofitable accounts, one point should always be looked into, especially in the case of accounts in newly established branches. This consideration is whether or not the *actual loss* to the bank in carrying the account is *less* than the amount of fixed charges which such an account is carrying.

(g) General conditions of policy must govern a bank in the consideration of cost figures, and the introduction of a cost system does not imply the elimination of this element. It does mean, however, that in deciding upon a concession in any individual case, the bank will have an exact knowledge of the costs and earnings of the account and will know exactly what it is granting and the actual cost thereof.

(h) It is important to bear in mind that an apparently large balance is not necessarily remunerative. It may be partly, wholly, or more than offset by items in transit or process of clearing, so that without an accurate analysis, a customer's balance as it appears on the ledger may be a very deceptive measure of the value of the account.

3. *Small checking accounts.*—The steady increase in the number of small current accounts is becoming a serious problem in banking, owing to the difficulty and expense of operating them. There are several classes of small accounts, some of them desirable, others neutral, and many undesirable. A consideration of the origin and intention of these small accounts is of interest. Roughly speaking, they may be divided into eight classes: the last class, No. 8, however, is the one to which particular reference is made, owing to the per item cost with no compensating balance to support fixed charges.

1. A balance created by the payment of notes or other items collected by the bank for a customer. These accounts are generally closed by one withdrawal.

2. Proceeds of discounts credited. These accounts are generally inactive and the balance left comparatively small, a few dollars as a rule.

3. Money left for safe-keeping and generally withdrawn in one amount.

4. Funds deposited from time to time to meet certain payments; inactive and generally withdrawn in one amount.

5. Balances of subsidiary business accounts of large customers, such as coupon and dividend accounts, pay check accounts, etc., the checks for which would otherwise go thru the general account; therefore a matter of bookkeeping convenience to the customer, and as a rule a convenience to the bank. Include in analysis of general account.

6. Private checking accounts of partners, managers and other officers of a company, and occasionally their wives. These accounts are generally carried willingly by the banks as a matter of courtesy. Such accounts frequently have good balances in the savings department.

7. Seasonal accounts. The balances of these accounts during the greater part of the year are generally small, with practically no entries, and represent the balance left over after a season's operation in a certain class of business, such as agriculture or lumbering. These classes of business as a rule maintain satisfactory balances during the height of their activity and are carried as a courtesy during their period of comparative inaction.

8. Small checking accounts with a maximum of entries and minimum of balance.

The bank, for this last class of accounts, practically acts as bookkeeper and saves the depositor in some instances $5 or more per month in that connection. Experience has shown that these accounts are more fruitful of trouble and risk to the bank than any other accounts, and once a mistake is made the loss is seldom recovered. Forgeries, raised checks, and other forms of criminal financing are frequent. "Eternal vigilance is the price of safety." Beyond the personal equation of the customer and his good opinion, whatever that is worth, there is little or no value in these accounts. The balances are small and of such a fluctuating nature that practically 100 per cent cash reserve has to be carried to meet their requirements. Furthermore, as the deposits would probably show that about 90 per cent of the amounts consist of checks and bills redeemable at other banks in the city, there is in many cases a real overdraft in the account, pending the clearing of these items.

The entries on these accounts, credit and debit, cost at least three cents each. Accounts of this character take up a great deal more of the time of the manager and staff than practically any of the desirable accounts. As a rule checks are issued before the deposit is brought in, and frequently it is necessary to call up the customer by telephone in order to protect his checks from protest.

It must be remembered, however, that in many small branches a number of these unprofitable accounts can be carried under certain conditions without any actual money loss to a bank. The reason for this is obvious. A small branch, especially if newly established, has certain fixed charges to maintain irrespective of the business done. For several years after opening, it has men and machinery to spare to handle this class of account without any additional expense. It is only when the business has increased and more men and office accommodations are required that these accounts become burdensome. This explains why some banks advertise for and encourage small accounts. They enable the manager to become acquainted with his neighbors, and frequently a small account may later turn out desirable or bring desirable connections.

The same arguments do not, however, apply to a small savings bank account. Such an account is not intended to be checked against. It should have practically no expense except the cost of opening, calculating the interest and holding the reserve.

The tendency to check against savings bank accounts is to be deplored for many reasons. The banks have no machinery for handling these checks. The cost amounts to over six cents per entry, as practically every signature has to be looked up with each presentation, the pass-book called for, etc. Moreover, this abuse of the savings bank account is an open door for forgeries and other frauds.

The increasing activity in the savings bank business is constantly adding to the expenses of that department, owing to the number of checks that are now being issued on the various accounts and the practical elimination of any notice, or deduction of interest in lieu thereof. No bank can afford to pay a higher rate than three per cent under present conditions. In fact, a study of the statements of the various banks in Canada graphically demonstrates this fact. (See Section 21 of Chapter VI, Part 1.)

4. *Branch expenses.*—A service which the Canadian banks render the country, and which is usually but poorly appreciated, is the branch service. It speaks well for their progressiveness in this connection when the number of branches is compared with those of Great Britain or elsewhere. According to the *Bankers' Magazine,* during a recent five-year period, Canadian branches were increased fifty per cent, while in Great Britain the increase was only fifteen per cent. These statistics show also that while Great Britain had one bank for every 4,801 inhabitants, Canada had one for every 2,847 people. Thus, according to population, the bank offices in Canada are nearly double those of Great Britain. It must be remembered that the Canadian banks open branches under a great deal heavier expense and more inconvenience than their English confrères, and a branch is more likely to remain an expensive burden in Canada for a longer period than a similar branch in the old country. There are few villages in England which cannot show a fair proportion of affluent residents either living in the village or occupying the neighboring country houses, whereas in Canada a new branch generally means more loans than deposits with which to start. Were it not for the circulation privileges the expense would be a serious deterrent to the practice of opening up branches, especially in newly settled localities.

It has been argued that there is a great economy in the branch system thru the fact that there is only one executive for a large number of branches as compared with the individual executives required for the American national banks. This economy, great tho it is, is partly offset by the increased cost of operating branches, owing more particularly to the non-concentration of the clerical work. In other words, a teller or ledger-keeper, for instance, in a big office can easily put thru four or five times more work than he would be called upon to do in a smaller office. This statement is substantiated by figures the writer obtained from one of the leading American banks where for the past ten years the average number of men per million dollars deposited has held steadily at about four and six-tenths, whereas Canadian banks average twelve or thirteen men per million dollars of deposit.

Very interesting statistics concerning the business of a branch can be derived from the books. A progressive record of all useful data should be made and compared either annually or semi-annually, such as total turnover, number of items passing thru the different departments, number and aggregate salary of men employed, amount of stationery used, average amount of deposits, loans for the year and other information of similar nature. These figures are generally called for by the head office, but in any case their comparison with previous years is invaluable to a branch manager who aims to keep expenses within a proper ratio to the business transacted.

As the main work in an office consists in handling the loans and deposits, a simple but valuable test of this ratio is to find the percentages which salaries and expenses bear to the combined total of the average loans and deposits. It is interesting to note how sensitive these percentages are. It is possible to account for any change over the previous year or half-year. An increase, for instance, in the expense percentage over the previous year would probably be due to some extraordinary expenses for repairs or the like. An increase in the salary percentage might show that the staff employed was getting more expensive than the business warranted, and steps should be taken to exchange for lower salaried men where possible.

The normal tendency of both percentages is constantly downward. Every upward movement should be inquired into closely.

5. *Inland exchange.*—The transfer of funds between banks, or from one branch to another, is a serious source of expense, a fact which is frequently overlooked by the banks in attempting to meet competition and the demand of the public for "par facilities."

Generally speaking, out of every $100 deposited, over $90 consists of checks; the balance consists of bank bills and legal tenders, the species is negligible, except in special cases. All the cost of the special machinery required for the handling of this vast volume of checks and drafts, for their transfer from bank to bank in the same city or in outside cities, is borne by the banks. Local transfers are handled without any remuneration and, in the case of outside transactions, at a charge frequently insufficient to cover the actual expense involved. True, this one feature may be considered but a small part of a bank's business. It is usually looked upon as one not worth considering. Yet, in acting as a clearing house in this connection, the banks of Canada render an inestimable service to the country, at a cost of millions of dollars annually.

The average amount of outstanding items held over night for the daily local clearings of the Canadian banks is over $110,000,000. This offsets nearly two-thirds of the average circulation of the banks. At six per cent interest it represents over $6,000,000 annually. In addition to local clearings there is a much larger number of items in transit between branches and correspondents, some of which business is transacted at a loss.

A customer of a Toronto bank, for instance, meets a note by depositing a check on another bank in Toronto; interest stops when the note is charged up to his account. But his bank does not receive returns for the check thru the clearing until the following day, a loss of one day's interest. If the check had been drawn on a bank in Montreal it would be two, or in some cases three days (where Sunday intervenes) before the branch at Montreal would receive clearing returns for the item. Even if the check were only for $100 the loss at six per cent would amount to over 3¼ cents. Broadly speaking, a day's interest at six per cent is equivalent to a little over one sixty-fourth of one per cent. It is important to bear in mind that a check or sight draft outstanding seven days has exhausted the equivalent of one-eighth of one per cent in interest alone.

In making an exchange charge to a customer there are three elements of expense to be considered and adjusted to meet the special conditions of the customer's business, namely:

1. Postage and the actual cost of stationery, clerical work and the like
2. Interest for the time outstanding [1]
3. (a) If a branch: the cost of the ultimate transfer of funds between branches
   (b) If a correspondent: the actual commission charge
4. Profit to bank.

The first three clauses—expenses—are incurred in connection with every transaction, whether with a branch or correspondent or whether put thru at par or not. It is advisable for every branch to test out its exchange charges on the above basis and see if the bank is being fully remunerated for its services. As an example, we shall work out the details of handling a check between two such important centers as Montreal and Toronto.

[1] The time element in clause 2 is frequently overlooked, with the consequent absorption of the profit into expense.

Take a check for $100 in Toronto:

Office and postage charges	3 cents
Interest for time outstanding (2 days) at 6%	3.288 cents
Total cost	6.288 cents

In other words, a check for $100 between the two branches costs approximately $6\frac{1}{4}$ cents.

It may, of course, be advanced that a bank is not out any interest when the check is between two customers of the bank at different branches. This is true when the account of the drawer is in funds at the time the check is cashed. But, theoretically, the transaction must be dealt with as it concerns each customer and each branch.

No merchant would sell an article at a loss to one customer simply because he expected to make a sale to another customer at a profit.

There is a tendency on the part of some customers to expect, almost as a right, all sorts of par privileges and concessions from their banks, presuming on the fact that the bank would be sorry to lose a good account. This is a peculiar trait in men who are otherwise honorable and free from petty motives. If a bank manager, in buying goods from one of these same customers, tried regularly to beat down the price or expected to get all small wares for nothing because they did not cost much, what would the merchant say?

With the change in the time only, the foregoing figures would apply to a check remitted thru any other branch. Should the item be sight instead of a check the interest period would be increased to seven days, or 7-64 per cent; approximately 11 cents.

A collection sent to a correspondent, however, has to stand a double charge in the interest. Take a check for, say $100 sent from Toronto to Carleton Place, the cost would be as follows:

Office and postage charges................	3	cents
Interest for time outstanding, Carleton Place and return, 2 days at 6%..... Remittance sent to Montreal, 2 days......	6.575	cents
Exchange charged on check by correspondent at Carleton Place..............	10	cents
Total cost........................	19.575	cents

If 25 cents was collected on this item, the bank would have earned a profit of five cents; which is little enough. Had this been a sight item, the bank would have lost three cents or more. Of course, amounts below the hundred on which a minimum is charged help to improve the average profit.

A small table (Figure 57) showing the approximate time and interest cost to various parts of the country, to and from a branch, will greatly assist in these calculations. The figures above are based on the supposition that only the larger items received in the morning mail are cleared the same day; the smaller ones being cleared the following day. It is, therefore, very important for branches to remember the necessity of using the mail services intelligently with a view to saving interest; in other words, if a large item is cashed during the day, to see that it gets out

AVERAGE TIME OCCUPIED IN CLEARING BETWEEN BRANCHES

	N.S.	P.E.I.	N.B.	Que.	Ont.	Man.	Sask.	Alta.	B.C.	N. Y. Bost.
Nova Scotia	2	3	2	3	4	6	6	6	7	2
Prince Edw. Isl.	2	1	2	3	4	6	6	6	7	2
New Brunswick	2	2	1	3	3	6	6	6	7	2
Quebec	3	3	2	2	2	5	6	6	7	2
Ontario	3	3	3	2	2	4	5	5	6	3
Manitoba	5	6	5	4	4	2	3	3	5	6
Saskatchewan	6	7	6	6	5	3	3	4	5	6
Alberta	6	7	6	5	5	3	3	2	3	6
British Columbia	7	7	7	7	6	5	5	4	3	7

1 day's interest at 6% = 1/64, approximately.

Therefore, the cost of interest (say) between points in Ontario and Manitoba is 4/64 = 1/16, if sent to a correspondent the item would be 8 days outstanding, or 8/64 = ½ of 1% for interest, as it would take the same time to clear the return remittance.

INTEREST ON $1,000

Days	2%	4½%	6%	Decimal Values of	64ths	1/32nds
1	.0548	.1233	.1644	.15625	1	....
2	.1096	.2466	.3288	.3125	2	1/32
3	.1644	.3699	.4932	.46875	3	....
4	.2192	.4932	.6575	.625	4	1/16
5	.2740	.6164	.8219	.78125	5	....
6	.3288	.7397	.9863	.93750	6	3/32
7	.3836	.8630	1.1507	1.09375	7	1/10
8	.4384	.9863	1.3151	1.250	8	1/8
9	.4932	1.1086	1.4795	1.40625	9	....
10	.5479	1.2329	1.6438	1.5625	10	5/32
11	.6027	1.3562	1.8082	1.71875	11	....
12	.6575	1.4795	1.9726	1.87500	12	3/16
13	.7123	1.6027	2.1370	2.03125	13	....
14	.7671	1.7260	2.3014	2.18750	14	....
15	.8219	1.8493	2.4658	2.34375	15	1/4

FIGURE 57

by the first mail even if a special letter is necessary.

Tho in the above examples we have not included any charge for the transmission of funds on the individual item, this expense must eventually be met in some form or other in the adjustment of balances between branches, either by remittance of legal tender or bank notes, etc. Express charges run from 30 cents to three or four dollars per one thousand dollars.

The above facts establish conclusively that the cashing of checks at par at the branches is a constant source of loss to a bank and that outstanding items in the course of collection or in transit from a more serious and unavoidable expense for which a bank should be compensated.

6. *Cost data.*—The loanable value of the balance maintained must be determined by each individual bank for itself according to its net earnings. It can be arrived at in various ways but, generally speaking, it averages between four and four and a half per cent.

Two cents per check is considered a low cost per item. Mr. F. W. Thomas of Toledo, an expert in banking cost accounting, places the cost of an ordinary check at two and a half cents while he computes a savings bank check at six and a half cents. Mr. Bordwell of San Francisco, figures that a clearing house check costs 1.22 cents and an out of town item 2.7 cents for bookkeeping only. A customer's check costs 3.13 cents, or 2.87 cents if the customer supplies his own check form. A Chicago bank makes its calculations at 1.516 cents per check, but this figure does not include anything for overhead charges, for management, check blanks and other incidental expenses. It is simply for clerical work, rent, light and heat. The other figures are over all.

The English banks not only charge the customer for postage, check books and the like, but expect a reasonable balance to be maintained; generally a minimum of about £100 in the city or £50 in a country branch.

In arriving at the actual cost per item, it is necessary to include, in addition to the cost of clerical work, the cost of the supervision of the manager and accountant, the apportionment of the rent, stationery, light, heat, and vault and safe combination; also an apportionment of head office expenses. This involves extra work, but once a basis for per item cost is established in an office, it will serve for the consideration of all accounts for the year. Even if the bank considers only the salaries of the men actually engaged in handling checks and deposits—namely the teller and ledger-keeper—the cost per check just under this one expense, will be found surprising.

It is seldom realized by a customer, or even by the manager himself, that a check form on safety paper costs $3.50 per thousand or one-third cent each.

For the average branch in Eastern Canada a per item cost of 2 cents per check is accurate enough for general purposes, or to put it another way, a steady average balance of between 50 and 60 cents per check issued should be maintained. An account, for instance, which issues one thousand checks per annum should maintain a balance thruout the year of between $500 and $600 to cover the out-of-pocket expenses of the bank in operating the account.

7. *An account analyzed.*—In order to illustrate some of the more elementary features of cost accounting, the following brief analysis will be useful. The account shows an average weekly credit balance of $7,000 for the year, average amount of items in transit $5,300, average amount of checks cashed at par at other branches $600, number of checks issued seven thousand.

GROSS EARNINGS

Interest on the average balance at 4½% $7,000	$315	
Exchange received on items deposited or collected	325	
	$640	$640

LESS VALUE OF WORK DONE

Interest value of items in transit average $5,300 at 5%	$265	
Interest on checks crossed at par and paid by branches, average outstanding, $600 at 5%	30	
Collection charged paid to other banks	78	
Office charges on 7,000 debits to the account at 3 cents each	210	
Total cost	$583	$583

This leaves a net profit to the bank of $57.

Even with the large balance of $7,000 it will be noticed that there is constantly outstanding $5,900, consisting of $5,300 of items in transit, and $600 of checks paid at par by other branches. This leaves the real balance practically $1,100 instead of $7,000. It is well to remember that the bank must base its holdings of cash reserves on the larger or book balance, which will reduce still more the net balance of $1,100.

The rate of interest, four and a half per cent, is based on a net earning power of five per cent less ten per cent for cash reserve.

The "exchange received" is self-explanatory, but attention is drawn to the fact that the schedule of exchange charges is evidently insufficient. In making the rate, full allowance was not made for the length of time the items would be outstanding. The total cost for collection, interest and commissions was $343, or $18 more than the exchange collected, and were it not for the free balance of $7,000 the account would be operated at a serious loss.

The most satisfactory way of obtaining the average amount of items in transit is to multiply each item by the number of days it was outstanding, and divide the total amount by the number of days under consideration. This will give the average daily amount outstanding.

In the accounts of customers who have the privilege of crossing checks payable at par at another branch, particular attention should be paid to the date such checks are cashed at the other branch, and the interest during the time taken in transit, made an expense against the account. The correct treatment is shown in the above statement. This is necessary because the amount of such checks in transit not only affects the amount of the credit balance but, in addition, some customers do not arrange to provide funds for their checks until they are about due at the bank. In many cases they do not even provide the funds then, until their attention is called to the matter. Par privileges should not be accorded to accounts of this nature. They should be granted only to accounts which keep a credit balance commensurate with the work done, in addition to having ample funds to cover outstanding checks.

Altho the account shows a profit, it is not a normal one, as there is a serious weakness shown in the rates of exchange charged. A slight drop in the deposit balance would turn the profit into a loss. An examination of the cash items deposited will show on what points the rate of exchange is inadequate, and an adjustment should be made accordingly. Conditions in a customer's business are constantly changing. The nature of the items deposited varies accordingly. An exchange rate that is satisfactory one year might not be so the next.

8. *Method of analysis.*—The work of analyzing an ordinary account is not very onerous, especially if systematically followed out. The course of the deposit balances is the main information required. Wholesale and other accounts depositing a large num-

ber of cash items involve more work, especially if the data for the whole year is required. Usually, however, the transactions for a month are sufficient for all general purposes.

The amount earned on an account depends principally on the value of the credit balances maintained. For purposes of analysis the minimum weekly credit balance is the one which should be considered. Any money on deposit *less* than a week has no loanable value to a bank so far as an individual account is concerned. It may be contended that under the law of averages, and considering the accounts as a whole, the average weekly or even daily balance is of value, but in an analysis no account should depend for strength in any particular on another account. For purposes of comparison, however, the average monthly balance should be considered in the general sizing up of the account.

If the account shows debit balances during the period, the exact number of days overdrawn and the amount at credit should be shown.

Debit balances do not enter into the value of a deposit account. The net discount or interest earned thereon is considered as part of the profits accruing from the general loanable funds of the bank, and cannot, therefore, be regarded as a benefit derived from any individual account. Furthermore, in the analysis, credit is accorded the account for any loanable funds supplied.

The average debit balance, however, is of value for purposes of comparison, and can be easily ascertained on the basis of the interest debited to the account during the period.

If interest is allowed on the credit balance or any part of it the amount of interest credited should be taken into account as part of the expenses. Care should be taken to see that the interest credited covers the whole period under analysis.

9. *Exchange received on items deposited and collected.*—Gross earnings are derived from the value of the credit balance and from the exchange received on items deposited and collected. Profits on special transactions, such as letters of credit, foreign exchange, circulation and the like should be shown separately.

In an ordinary deposit account there are comparatively few items deposited drawn on out-of-town points, and the rates received for these are generally remunerative. However, in the case of wholesale merchants and other distributors who deposit a large number of cash items, the rate of exchange charged is generally low and frequently unremunerative, unless the destination and interest cost of the items has been taken into consideration in making the rate.

Therefore the first data to examine in this connection is the schedule of rates under which the account is operated. To the practised eye the weak points in the arrangement, if any, will at once become apparent.

It would, of course, be impossible to consider each item individually. The best method is to divide Canada into provinces or sections. The figures given for each province, etc., should be multiplied by the average number of days which items remitted to each section are outstanding. The result will represent the amount of items in transit outstanding on the basis of one day, and when divided by the number of days in the period will give the average amount outstanding. It is a simple matter for any branch to make a schedule showing the average time between the deposit of an item and the receipt of the relative clearing returns from various points in the country.

A statement should be made of checks drawn on banks in the same city, the returns for which are not received until after clearing the following day. An account could easily deposit $50,000 of local checks and have only $5,000 to $10,000 balance at the end of the day. In other words, the bank would be lending $45,000 overnight without interest. If this occurs daily, as it does to a great extent, it is a serious burden on the bank.

In allowing for the time an item is outstanding, it must be borne in mind that the loss of interest does not cease until the actual clearing returns are in the hands of the bank. Items sent to correspondents, therefore, are not finally disposed of until the relative settlement checks have been actually cleared at Montreal or Toronto, or on whatever central point the draft is drawn.

The gross amount of exchange received, less the correspondent's commission and interest value of the time in transit, will show the net profit or loss on exchange. An account should also receive credit for the net exchange received from collections and discounts. Interest is not an expense in connection with exchange on collections, but in arriving at the net exchange on discounts the time occupied in remitting or returning the items should be taken into account.

The basis of rebate, if any, in connection with cash items or discounts should be looked into carefully, as this is a fruitful source of loss.

10. *Checks paid at par at other branches.*—Reference has already been made to the loss sometimes entailed in granting this privilege. In the case of checks cashed at par by another branch, the ledger-keeper should make, in the ledger account opposite the entry of the check, a memorandum showing the date of encashment. The check becomes a charge against the account as soon as it is paid by the other branch. The analysis of some accounts in regard to items in transit and checks paid at par will frequently afford surprising results in the dissolving of apparently substantial balances.

11. *General remarks.*—The question of cost accounting for banks offers a large field for study and investigation, and it is impossible in a volume of this nature to deal exhaustively with the subject. However, the broad fundamentals have been touched upon in the hope that the information and suggestions given will be sufficient to arouse the interest of the reader

and induce him to make a further study of what is an intensely interesting subject. Every manager should make himself thoroly acquainted with the costs and expenses at his own branch and with the operation of every account, in order that he may find out whether the time spent by himself and the staff in operating each account is compensated for by the balance at credit, or other collateral advantages.

The analysis itself is purely mechanical. The real test is to decide whether an adjustment of the rates should be discussed with the customer, or whether the collateral advantages of the account outweigh any unsatisfactory feature disclosed by the analysis. Business men as a rule are not unreasonable when an issue is put squarely before them. Few would refuse to make some adjustment of an account if they were shown that it was working a palpable injustice to the bank. The tactful manager could take advantage of a favorable opportunity to suggest to a customer slight changes which would place the account on a more satisfactory basis. Various methods are available; the balance might be increased, the exchange rate adjusted or, in the case of a small checking account, a flat rate of fifty cents or one dollar per month could be made.

It is preferable to submit the account to a rigid analysis and thus allow leeway for the consideration of collateral benefits, rather than to make a less exhaustive analysis and run the risk of overlooking some unfavorable feature. After an analysis is completed, consider carefully all the advantages of the connection. The customer's side of the question should also be impartially considered; he may have cause for complaint, and analysis is invaluable in either case. When the results of an investigation indicate unsatisfactory conditions it is generally advisable, unless the unfavorable feature is very outstanding, to defer any action until the fact has been confirmed by a subsequent analysis.

REVIEW

If you were determining whether or not an account was profitable to a bank what factors would you consider?

Of the eight classes of accounts enumerated which are desirable, which are neutral and which are undesirable?

Why is it a bad plan to check against saving accounts?

What elements of expense are incurred in making an exchange charge to a customer? Give an illustration.

Analyze an account so as to show gross earnings and the expense of keeping the account.

What changes would you suggest if an account had proved unprofitable?

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