THE ROYAL BANK OF CANADA
MONTHLY LETTER

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OUR BANKING SYSTEM

THE primary operations which banks perform in the community are the receipt of money, the re-lending of it to borrowers, and the facilitating of exchange. Through these services the banks assure the profitable use of all the purchasing power of the community, and channel into everyday use the savings of individuals while safeguarding those savings.

It is with the banks' functions in present-day life that we shall be here concerned, though they represent but faintly the long and vital contributions the banks have made to Canada's growth and to our way of life.

To many persons, banking seems much more complicated than it is in reality. A man acquires a claim to cash by selling his goods or his services; this is offset against the claims which others acquire against him by providing him with things he wants: that is the essence of commercial life. Our banking system provides a clearing house, through which sales and purchases are registered and are cancelled against one another.

Banking is not a fixed thing. It starts with a simple transaction between two persons, and it develops as the needs of other people and of the community develop. You can trace the evolution of our banking system and Canada's growth in almost parallel lines.

First, we had a local economy, in which little settlements needed no banking facilities. Then trade widened, and people couldn't carry with them the cash needed in their dealings. Finally, there came the industrial development in whose service the banks expanded from small local concerns to the present large institutions with branches throughout Canada and in many foreign countries. It has been a rapid and recent thing, this growth of banking, but it has been no more spectacular than the growth of Canada itself.

So important a thing as money — the medium of exchange of all our services — could not be left without some regulation, and so there has grown up a whole body of legislation to protect those whose property it is and those who use it, and, indeed, the banks which handle it as intermediaries.

The Rise of Banking

Banking as we know it in Canada today had its beginning 133 years ago when the Bank of New Brunswick was the first bank to operate under a charter. The adventures and the development through these years are well told by A. B. Jamieson in his book published by The Ryerson Press, Toronto, this year. Mr. Jamieson, who retired from the Head Office of this bank in 1946 after 43 years of experience in Canadian Banking, has designed his book not only for students of banking but for all those who are interested in the vital forces which entered into the building of Canada. The first part of *Chartered Banking in Canada* deals with the history of our banking system, and in the second part the author tells understandably about the practice of banking.

Canada has today a banking system which is the envy of many other nations. For half a century our banking has been attended to by a comparatively small number of banks of substantial size. From 1792, when a private concern tried unsuccessfully to launch upon banking, we developed through a total of 26 banks at the time of Confederation to the present eleven chartered banks.

Canada is relatively a small country in population, but it has two banks with assets of more than two billion dollars each. It surprises persons from abroad to learn that we have banks ranking with the greatest financial houses of the world. A list prepared in October 1953 showed that in terms of total assets, The Royal Bank of Canada stands ninth in the world. Inside Canada the rank of our banks as shown by assets is revealed by a government return of September 30, 1953 to be:

The Royal Bank of Canada	$2,783,235,826
Bank of Montreal	2,361,090,936
The Canadian Bank of Commerce	1,894,040,495
The Bank of Nova Scotia	946,432,863
Imperial Bank of Canada	604,002,760
The Bank of Toronto	560,391,918
The Dominion Bank	514,194,011
Banque Canadienne Nationale	508,861,522
La Banque Provinciale du Canada	192,602,090
Barclay's Bank (Canada)	32,868,880

Other Financial Concerns

While this Monthly Letter is about our banking system, it must not be thought that the chartered banks have a monopoly of dealing in money and credit. Far from it. They are only one element in Canada's financial system, which includes the Bank of Canada, the chartered banks, the Industrial Development Bank, the savings banks, the insurance companies, the trust, mortgage and loan companies, the investment dealers, and others. The eleven chartered banks are the commercial banking system, having the function of acting as depositories for surplus funds and to assist in keeping the wheels of production, industry and business moving.

These banks supply the short-term working capital, payroll accommodation, money for the purchase of materials, loans against goods in process of manufacture, and loans to farmers, lumbermen, fishermen, marketing agencies, and individuals. Others, like the Industrial Development Bank, investment dealers, mortgage companies, and insurance companies, furnish long-term money for capital investment, "Adventure money" is usually supplied by the public through purchases of stock. There are co-operative organizations which promote thrift and lend money in small sums to members.

Added to all this outside competition is the competition between the chartered banks. It is stiff and serious. Operating as they do under a statutory rate ceiling, every bank tends toward the same rate of interest on loans, and competition is forced into the realms of quality of service, skill, efficiency, and speed of service. In these fields there is even competition between branches of the same bank.

Competition is based upon the right, inherent in the Canadian way of doing business, to go to any other bank when one fails to satisfy. Indeed, if the present banks fail to provide satisfactory service, the laws of Canada provide for starting new banks. Any group of responsible men who can get together a very modest capital, may qualify for a charter and open a bank.

Banking is a business, and like any other business it is subject to the vicissitudes of trade and the vagaries of fortune. Just to run a bank costs big money. The banks' payrolls run to more than $125 million a year; interest to depositors costs $61 million a year; taxes amount to about $33 million a year. Adding together salaries, interest, taxes, and other expenses including depreciation of premises, gives a sum of $285 million paid out by the banks in a year, an average of $15.32 for every dollar received by shareholders in dividends.

Chartered Banks

Canada's banks are called chartered banks because every one of them operates under a charter granted by the federal government under certain conditions and with certain restrictions. A bank's charter is issued under authority of The Bank Act, passed by the Parliament of Canada, in which are laid down the conditions under which the banks must operate. The first comprehensive Bank Act was passed in 1871.

Briefly, the Act authorizes a bank to take deposits and to deal in, discount, and lend money on commercial paper, stocks, bonds and debentures of municipal and other corporations, and on federal, provincial, British or foreign public securities.

A distinctive feature of our banking system is the fact that bank charters expire and come up for renewal every ten years. They are not renewed until Parliament makes a clause-by-clause examination of the Bank Act and considers any amendments proposed.

There is no other business in Canada subject to such scrutiny, and Mr. Jamieson says: "In no other country is a similar practice followed." He points out that in 1900 the government offered to make the bank charters perpetual, but that the banks, after full discussion, resolved to ask that charters be renewed for ten years only. They made this request because they believed that the banking system would be all the better for being flexible, able to adjust itself to the needs of the country and the people as these changed over the years.

Under the Bank Act, the individual banks are managed and supervised in such a way as to command confidence. The public is represented by the Minister of Finance, who works through the Inspector-General of Banks. This officer of the Department of Finance receives monthly statements of bank conditions; he is required to examine every bank at least once a year, and he may examine the books of any bank at any time.

Every bank has an Inspection Department of its own, whose staff makes a thorough examination of every branch at least once a year, without notice of when it will be done.

In addition to all this supervision and checking, an independent audit of every bank is made yearly by two auditors appointed by and responsible to the shareholders. These auditors can be selected only from a list approved by the Minister of Finance. They must be professionally and legally qualified, and not members of the same firm.

All these safeguards — the decennial revision, inspections, examinations, and audits — are pretty complete in themselves, but in addition the Bank of Canada keeps closely in touch with all banking developments.

While the aggregate supply of money is determined by the central bank, it rests with the chartered banks to provide the individual credit requirements of commerce and industry and of the public generally. This eliminates all the many dangers and abuses inherent in a system which would distribute credit through a government monopoly.

The Banks' Management

The chartered banks are owned by some 66,000 shareholders, about 75 per cent of them Canadians. They come from every walk of life; farmers and ranchers, lumberjacks and miners, stenographers and businessmen, teachers and clergymen, forming as representative a group of Canadians as can be found anywhere.

The par value of bank shares is fixed by The Bank Act at $10, changed from $100 at the 1944 revision to encourage wider diffusion of ownership. No shareholder makes a fortune out of his investment: the dividends he received in 1952 were only 4.96 per cent of his equity. The equity is the total of the par value of the stock, the premium the shareholder paid over and above the par value of the stock, and some undivided profits left in the business over a long period of years.

Directors are representatives of the shareholders, electe by ballot at the annual meeting. They appoint the management of the bank, and otherwise act as do the directors of any commercial company.

Like the bank itself, the directors are limited as to what they may and may not do. The majority must be British subjects domiciled in Canada; no man may be a director of more than one bank; directors are liable in criminal law if they help in giving any creditor of the bank an unfair preference over other creditors, or if they knowingly or even negligently sign any return containing a false or deceptive statement.

Directors have no "edge" on the general public in the way of obtaining credit. No director may be present at a board meeting when an advance in which he is interested is being discussed and decided. The published return of the Minister of Finance for September 30, 1953 shows that out of total loans aggregating $4,306,685,687, loans to bank directors or firms in which they were partners, or loans for which they were guarantors, amounted to only $15,850,557, equal to .37 per cent.

Executive and Staff

Responsible to the Board of Directors for management of the bank is the President. Mr. Jamieson says in *Chartered Banking in Canada:* "In the earlier days of chartered banking the presidency was seldom regarded as a full-time position, and usually, although not always, was held by someone other than a trained banker. ... With the tremendous growth of business in Canada during the last quarter century has come a corresponding expansion in the resources and liabilities of the banks, greatly increasing the responsibility placed upon the heads of these institutions. In consequence, during this period the tendency among bank directors has been more and more to look upon the presidency as a full-time position and to elect a trained banker to fill it."

This policy of promotion within the bank, even to the topmost position, means the opening up of wide opportunity for young men in banking. Practically all general managers and presidents started as juniors in small branches. By the time they reach maturity they are well equipped with human and business understanding.

Banks provide a good deal of money, in addition to the contributions of the staff themselves, to remove from employees the fear of unemployment, of sickness, and of a penniless old age. They contribute heavily to pension, life insurance, health insurance, and other plans.

The manager for whom an employee works reports regularly on his qualifications, and supplementary reports are made by the inspectors in the course of their annual visits. These are reviewed and weighed by supervisors and by the staff department at Head Office, so that they may promote persons of ability, and move them into departments where they can do their best work most happily.

Strength of the Banks

The chartered banks have been put to an acid test at least five times within recent memory: the crash of world markets in 1929; Britain's going off the gold standard in 1931; the closing of every bank in the United States in 1933; the outbreak of war in 1939; and reconstruction following 1945. During all these upheavals no Canadian has had to fear for the loss of a single dollar of his bank deposit.

The public has justified confidence that the banks will honour their obligation to repay their deposits, and this confidence is the key-stone of our banking system. It is soundly based upon a number of factors: the past record of the banks, the legislative provisions concerning them, and the principles under which they are managed.

One of these principles is that the banks always maintain in cash and in readily realizable form a certain proportion of the assets which are the counterpart of the deposits, and they keep the balance in certain types of assets of varying degrees of liquidity. "Cash reserves" or "bank cash" are the terms used to describe assets which are absolutely liquid, and first thing every morning there is laid on the desk of the chief executive officer of the bank a report of this figure at that moment.

Cash reserves over the banking system average ten per cent all deposits, in the form of notes of and deposits with the Bank of Canada. The Bank Act stipulates only five per cent, but the banks keep twice that amount.

After setting aside this ten per cent, earning nothing at all for the bank, a further percentage of depositors' funds is kept in short-term investments, upon which the yield is low. After that comes investment in bonds of medium-term, and after that the well-understood business of lending to individuals, businesses, industries, municipalities, school districts and governments.

Everyone knows the danger of conducting his affairs, either in business or in home management, without reserves, and it is natural that institutions with so great responsibilities to the public as have the chartered banks should be careful to provide adequate protection. The constant anticipation of the demand for cash, and variation of the reserve in accordance with it, is a most important part of the banker's work, and is given the keenest attention by the chief banking officers.

Deposits

It has been pointed out that the Canadian banking system stands ready to pay out to every depositor in cash all or any part of his deposit.

Ask any banker what is the first and most indispensable concern of a bank and he will say there is only one answer: "Take care of the depositors' funds". All bank lending has to be done with an eye first to the safety of the funds of the depositors.

Deposits are divided into two classes, current and savings. In our chartered banks there were at the end of September, 1952, individual savings accounts numbering 7,700,214, with total deposits of $4,900,880,316 payable in Canada in Canadian currency. On the same date there were 1,129,239 current accounts, representing a dollar total of $3,025,956,668.

Because current accounts are active and subject to wide fluctuations, and because a great deal of work is entailed in keeping them up to date, it is not usual to allow interest on balances. Some accounts, wherein the balance is not sufficient to offset the cost, are subject to a service charge calculated to reimburse the bank for the out-of-pocket expense involved in operating that account.

Savings accounts represent the accumulations of small savers who do not enter the investment market, and they are also used by those who are accumulating funds to invest. Canadian banks have consistently encouraged savings.

There is little formality about the opening of a savings account. No one need hesitate to enter the bank because his resources are small. Any member of the staff will gladly help to fill out the simple form; the teller will accept the deposit, whether of $1 or $100, the ledgerkeeper will ask the new customer to supply a sample of his signature, and a pass-book will be issued showing the amount of the deposit.

This amount is an obligation of the bank, which it will meet by paying the sum either on a withdrawal slip presented by the depositor or on the authority of a cheque issued and signed by the depositor. By far the largest part of all payments in Anglo-Saxon countries is made by cheque, and though not required by law to do so the banks in Canada allow chequing against savings accounts. A certain chequing privilege is allowed without charge for bank book-keeping involved, but if the number of cheques issued is excessive in relation to the minimum credit balance, a small charge is made.

Extending Credit

Banks do not institute loans: the initiative must come from the borrower. A bank would not take a million dollars, for example, put it into the hands of Mr. John Doe, and say in effect: "Here is a million dollars: go and start a factory."

This does not mean that the banks are unwilling to make loans. The price that corporations and individuals are willing to pay for accommodation provides a big part of the revenue the banks need to meet their obligations.

While it is inevitable that bankers are subject to error the same as all other humans, it is seldom that a worthy and deserving applicant for a loan fails to obtain consideration. There is sometimes a person whose ideas about his merits for a loan differ from the ideas of his banker. It may be said, however, that this does not often happen. The banker knows that the prospective borrower is free, under this system of ours, to go to any or all of the other chartered banks with his application, and if he has judged hastily or turned down the loan without reason, his bank loses the business.

Variety of Loans

Banks extend credit to producers, to business, to industry, to individuals, to municipalities, to institutions and to governments for their legitimate needs. Farm co-operatives, the wheat pools and dairy pools use the banks' facilities. Countless people and institutions are using bank credit regularly.

The scope and intensity of the banks' lending for constructive purposes is shown in a return made to Parliament, dated September 1952. It dealt with loans of all sorts in Canada. Loans to farmers amounted to 10.3 per cent of the total. Loans to grain dealers and grain exporters came to 5.8 per cent. Loans to municipal governments and school districts represented 3.2 per cent, and to provincial governments .2 per cent. Loans to wholesale and retail merchandisers were 15 per cent of the total. Loans to the forest industries were 4.2 per cent; loans to construction contractors 4.9 per cent. There were other loans to mining, fishing, fish-packing and curing, public utilities, churches, hospitals, charitable, religious and educational institutions, and so forth. These figures show that loans to help primary production, manufacturing and distribution form an important part of the credit service which banks provide to the people of this country.

Current loans are usually made under a "line of credit", which means that the borrower estimates his probable credit requirements for the ensuing year and then obtains approval from his bank for a "line" of that amount. As need arises throughout the year, advances within the authorized credit are made by the bank.

Commercial "letters of credit" provide a different medium, one through which a substantial part of Canada's import trade is financed. Through their foreign branches and their close connections with foreign banks, the Canadian banks are in position to issue letters of credit for use in practically every country in the world with which normal trade is carried on.

Facilitating Trade

In these and other ways of making loans the banks satisfy a great variety of credit requirements and facilitate the trade of the country. They lend to an individual to buy his coal or to pay his doctor's bills; to a farmer to put in his crop, to buy binder twine, and to pay the labour to harvest his crop; to the grain dealer so that he may buy the farmer's grain at the elevator; to insure the transportation and marketing of the crop. In much the same way the banks lend to every other form of primary production and to the agencies which transport, process and market the commodities produced.

Small personal loans are made salaried people and wage-earners for many purposes. Some people use them to make house or property improvements, to buy equipment and appliances, to pay medical and other professional accounts, to pay taxes, for travel and recreation, to buy clothing and motor cars. Loans are seldom below $50, rarely exceed $1,000, and the average runs between $100 and $500. More than half the total number of bank loans in Canada are for amounts of $500 or less.

The banks' facilities in extending credit are available to every worthy citizen, regardless of his monetary worth or the size of his business. Our banking service is rendered impartially. It takes no cognizance of a man's politics.

Every application for credit is considered on its merits. The most important question a bank manager asks is this: "Can and will the applicant repay this amount in accordance with the terms of the loan?" Character is of considerable weight in arriving at the answer.

Next comes an appreciation of the borrower's management ability. As Mr. Jamieson points out, a man may be absolutely honest and have the best of intentions but if he is unable to manage a business capably he is usually a poor credit risk.

Every branch manager has authority to make loans up to a certain maximum without the need for reference to higher authority. There are no set rules about the maximum, which is fixed for the branch manager individually on the basis of his experience and judgment.

Above the maximum, a manager must refer the application to his district supervisor, who, too, has a discretionary limit. More than ninety per cent of all bank loans in Canada are made by the men in the field without any reference to higher authority.

Managers and supervisors try to be helpful to the borrowers as well as businesslike for their bank. Many cases are on record of applicants for credit expressing their gratitude for having been refused a loan. Events had convinced them of the soundness of the bank manager's judgment.

Section 88

Looking backward, it is apparent that it would have been quite impossible for Canada to have developed in the way Canada has developed without Section 88 of the Bank Act.

This is a distinctive feature of Canadian banking, foreshadowed in 1859 by an Act called An Act Granting Additional Facilities in Commercial Transactions, the first step toward the "pledge" section of the Bank Act.

The section permits loans to specified classes of people on the security of merchandise in their possession. Loans may be made to manufacturers on the security of goods manufactured by them or in the process of manufacture or procured as raw materials to be manufactured. Wholesalers may obtain loans on the security of products of the farm, forest, mine or fishery. Farmers put up as security their threshed grain or their livestock or they may obtain money for the purchase of seed-grain, fertilizer or binder twine on the security of the crop to be grown or harvested. At the 1944 revision of the Bank Act provision was also made for making advances to farmers for the purchase of implements, equipment or a farm electric system on the security of the goods purchased, and for loans for the alteration, improvement or development of the farm, on the security of agricultural implements owned by the farmer, or, in certain cases, by way of mortgage or hypothec on the property being improved. Fishermen may obtain credit on the security of fishing vessels, fishing equipment and the fishermen's catch.

It will be seen that this feature of Canadian banking, with its provision of credit through all stages of production, has contributed greatly to the comfort and prosperity of individuals as well as to the speedy and sound development of the country.

Branch Banking

Another outstanding feature of Canadian banking, specially adapted to the nature of our country, is its system of branches. Branch banking brings the knowledge, resources and facilities of great institutions to remote towns and villages, giving their people the same sense of security they would enjoy if they dealt with the chief offices of the banks.

The head offices do not accept deposits or make loans. It is to a branch that a customer goes to transact banking business.

The eleven chartered banks have more than 4,000 branches. Of these 3,923 are spread over Canada from Atlantic to Pacific, and as far north as Port Radium, in the Northwest Territories, 40 miles south of the Arctic Circle, where we opened Canada's farthest north chartered bank branch in 1952.

The number of branches per bank operated within Canada varies from 724 which is the largest number (The Royal Bank of Canada) to the single branch of The Mercantile Bank of Canada. In branches abroad, The Royal Bank again leads, having 69 branches out of a total 115.

The advantages of a branch banking system are many, but one in particular is that it permits the use in one branch of excess funds from another. If the deposits of one branch are in excess of its loan and cash requirements the excess is credited to head office, which may then credit it to other branches where the loan requirements exceed deposits, or may invest it in securities.

The diversity of lending risks provided by the branch system relieves the bank of the danger to which unit banks are exposed through crop failures and other local disasters.

Foreign branches have an important function in Canada' import and export trade. A country like this, in which t foreign trade turnover amounted to $8,386 million in the twelve months of 1952, finds it inestimably valuable to have domestic banks with foreign branches ready to serve commercial needs of importers and exporters.

Besides exporters receiving payment in funds other than Canadian, and importers who have to make payment in such funds, there are many others who want to sell or buy foreign exchange, so specially trained staffs have been set up by the banks. The foreign exchange and banking arrangements departments at head office organize the required facilities and control the operations. They assemble information on markets, they arrange letters of credit, and they expedite in many other ways the flow of goods and services that makes Canada the world's third greatest trading nation.

Subsidiary Services

Custody of funds and extension of credit are the great and most important functions of the banking system, but the banks go farther afield in their service to people.

They cash all federal government cheques—tens of millions of them every year—without charge at any branch anywhere in Canada. They cash all coupons detached from federal government bonds, and there are millions of them. They provide safekeeping services and facilities for the preservation of valuables and important documents. They sell drafts and money orders for safe transfer of money payments in Canada and abroad. They accept payment of bills for telephone service, electricity and gas: issue travellers' cheques: provide letters of identification for customers travelling outside Canada, and letters of introduction to banks in the countries being visited. They are bookkeepers for their customers. Where so arranged, they will make up payrolls in envelopes for their customers, or pay wages for customers by crediting the employee's account from a list supplied them, or even pay a customer firm's wages in cash in the banking office.

This Monthly Letter tells only a small part of the services banks give. Scores of thousands of people have found it worth while, before undertaking any material change in their lives, to talk it over with their bank manager, who is always ready to serve them.

To all this service there is added a priceless benefit: the inviolable secrecy with which customers' affairs are conducted in the banks. Every employee on entering the service of the bank must sign a declaration of secrecy concerning customers' affairs, and in some banks the importance of this is emphasized by requiring staff members to renew the declaration year by year.

The confidence of the customer is regarded not only with reference to his account, but in other matters. Neither the branch manager nor any member of his staff knows, for example, the contents of a customer's safety deposit box, nor can it be learned by outsiders except by due process of law taken with the customer's knowledge.

This is Canadian Banking

The Canadian banking system is a product of evolution, and it is still pliable. Day-to-day improvements, conforming to the needs and whimsies of customers, and the every-ten-year revision of charters, keep the banks moving in tune with the development of business and culture in Canada.

A bank is principally a business institution, established to give services which people need and are willing to pay for, at rates which will yield a modest return to the shareholders on the money they have invested.

Canadian bankers know that their banks can prosper only in so far as the people of Canada themselves prosper. Their dominant interest is in high production, stable and reasonable prices, facility of exchange of goods and services, ready marketing externally of Canada's surpluses, high employment, and the preservation of Canada's high standard of living.

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