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BANK FAILURES IN CANADA.

M. A. Thesis.

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Introduction.

A study of bank failures must include more than mere history to be of interest and of value to the student of economic problems. Bare facts, especially those relating to financial disasters, are interesting, but of equal importance is the relation of failures to economic conditions and to contemporary legislation. The causes of failure are primarily important and a consideration of possible remedies is our ultimate object.

The history of Canadian Banking lends itself nicely to a division into periods that precede and seemingly lead up to, the decennial revisions of the Bank Act. It has been thought advisable in the following study, to review a period's bank failures; to determine the loss to creditors and owners; to point out the causes and possible remedies; and lastly, to show the effects on contemporaneous legislation.

The fact that the Dominion Government is at present discussing the revision of the Bank Act makes the question of bank failures of much interest. Three very disastrous bank failures in the last eight years:—the Ontario Bank, the Sovereign Bank, and the Farmer's Bank, are evidence that there is yet room for improvement in the system of which we are so proud.

CHAPTER 1.

The History Before Confederation.

1. A consideration of the early history of banking in Canada will serve as a setting for the later study of bank failures. While history records a large number of bank disasters before Confederation, the material available is so unsatisfactory, and the circumstances under which the institutions existed are so varied, that little of value would be derived from a study of these failures. Before 1841, the financial business in Canada was handled by several banks which had received their charters from one of five different sources. Two or three banks existed under Royal Charters; and others were chartered by the Provinces of Lower Canada, Upper Canada, New Brunswick and Nova Scotia.

In Lower Canada, as early as October, 1792, a demand was felt for more specie in circulation and for a legal tender.[1] The currency was in a most unsatisfactory condition, and had been so ever since the capitulation of Quebec. Attempts to found banks of issue were made, but nothing was done until June 23, 1817, when a company of persons in Montreal, without the consent of the Province or any legislative body, opened an office and commenced a banking business.[2] The Bank of Montreal, which was thus established, was the first bank of discount, deposit and issue opened in Canada and it is today the greatest bank in all North America. As yet, the venture was but a private partnership, for royal assent was withheld, but the example was soon followed by the Quebec Bank and the Bank of Canada. These three institutions petitioned for incorporation and in 1821 the charters were presented by the legislature for royal permission. Branches were opened and soon a regular banking business in all its phases was being carried on. In 1825, during a period of depression, the affairs of the Bank of Canada received a set-back, for there was not only a rapid decline in deposits, but also in the general business. When the charter had expired in 1831, this bank discontinued its trade.[3] However, other banks were incorporated to meet the growing demands of business and the fabric of Canadian banking was well begun.

2. The early history of banks in Upper Canada is quite similar. The demand for a government institution to regulate the issue was prompted by the great need of reform in the currency. The residents of the Howe District, now the site of the city of Toronto, were insistent in their demands for the incorporation of the Bank of Upper Canada. Hence, by the proclamation of the royal assent, on April 21st, 1821, the act of incorporation, which had been passed in 1819, became law.[4] An institution, using the same name, was commenced in 1822 in Kingston, but when the funds had become locked up in dishonest loans and poorly managed business, it suspended payment and shortly afterwards announced that it had failed.[5] During the years 1830 to 1837, Canada experienced a period of expansion. The Commercial Bank of the Midland District, the Gore Bank, and the Bank of the People received charters and commenced business. Accordingly, the demands of the country were met and banking business in Canada was commenced.

3. All was going well when a set-back was experienced on account of the suspension of specie payments by American banks on May 11th, 1837.[6] The banks of both Lower and Upper Canada were affected. On the 18th of May all the Lower Canadian banks suspended payment. In Upper Canada specie was imported and everything that could be done was enacted to prevent a financial panic. The legislature met on June 19th, and passed a bill to the effect that a bank could suspend payment if it wished. The Commercial Bank of Midland District, the Agricultural Bank and the Farmer's Bank all received permission to suspend payments for a period.[7] The Bank of Upper Canada would have closed its doors but the Lieutenant-Governor would not hear of the government bank refusing to redeem its circulation, and the Gore Bank followed the same policy.[8] However, the demand for specie became so insistent that both these institutions had to suspend payment in March, 1838.[9] The banks of Lower Canada resumed redemption in 1838

and after a little trouble those of the Upper province re-opened for business in November, 1839.

4. When the Upper and Lower provinces became known as the Province of Canada, the banking business had settled down into more normal channels. In 1841 the following banks were operating in the province:- The Bank of British North American; the Bank of Montreal; the Bank of the People; the Commercial Bank of the Midland District; the Bank of Upper Canada; the Farmer's Bank; the Gore Bank and the Quebec Bank. Their total capital was $2,325,000, the circulation amounted to $921,000, and there was on deposit $811,000.(10) Business was in a flourishing condition for the banks had recovered from the trying losses of '37. A demand grew up for more banking facilities and this led to the agitation which in turn resulted in the Free Banking Act of 1850. The chartered banks doing business at this time apparently were insufficiently equipped with capital, and only partial success had met their efforts to secure more. Moreover, there was an agitation for the incorporation of smaller banks in lesser towns. The Act of 1850 permitted the establishment of new banks and authorized them to issue notes after a deposit of provincial securities had been made with the Receiver General.(11) However, it was soon apparent that this system was a failure for there was a lack of guarantee for the immediate convertibility of the notes on demand. In 1866 the Free Banking Act was repealed and the Provincial Note Act was passed.(12) Out of the five originally "free banks," which availed themselvesoof the privilege, but one, the Molson's Bank, has survived. The other four soon dropped out of business.

5. The granting and amending of charters was continued, particularly after the agricultural and commercial stimulus of the period 1855, when reciprocity with the United States was in force. Then came the bad crop of 1857 and the season of financial stringency. Several banks failed. For instance, the International

and Colonial Banks, recently chartered institutions, failed in 1859.[13] Their operations were principally in the United States and consisted chiefly of note issue. The disasters were due to aberrations from sound banking principles and while there was a scandal because of the dishonest methods that were revealed, there was practically no loss to the Canadian public. However, this experience showed how easy it might be for a bank to acquire dangerous privileges. Another bank, the Banque Jacques Cartier, failed shortly before Confederation but no important effects were experienced.

Of more importance, however, was the failure of the Commercial Bank of the Midland District. It was an old institution and a strong one, for it was capitalized at four million dollars.[14] The Commercial Bank was a victim of not only the stress of events but also of its own mismanagement. Its funds became tied up in the stock of a United States railway company and it soon became difficult to redeem its circulation. All the deposits were withdrawn and on account of the shortage of cash, the doors could no longer be kept open. Accordingly, although solvent, the institution had to suspend, and the whole business was sold to the Merchant's Bank.

6. For this present study, the failures enumerated have been of practically little importance. However, this cannot be said of the disaster that befell the Bank of Upper Canada in 1866. As suggested before, this institution was the oldest in Upper Canada and as it had the support of the government, it seems strange that it should fail. So thoroughly woven into the fabric of Canadian finance was this bank, that its failure spread shame and ruin throughout the whole province. The blind, popular faith in banks was dissipated when news of the failure of the Bank of Upper Canada reached the ears of the public.

The trouble began in 1857 when heavy losses, due to land speculation, were experienced. Business failures in '58, caused by the crises of '57, affected the bank most severely. These losses placed the institution in a precarious position, for the in the past several years, bad practises of the management had impaired the capital of the bank. High dividends had been paid, losses were not written off, extravagant bonuses had been made to shareholders; in short, the whole internal organization was defective, for the management had been blind and reckless.(15) Failure would have overtaken it sooner but for the general belief that it was a strong institution. It was the government bank and was thought to be in a flourishing condition. This confidence meant business and it is no wonder when it failed the public were amazed.

It seems that, added to other forms of poor banking, the Bank of Upper Canada had loaned large sums to men of good family, lawyers and politicians, who wished to go into business, irrespective of their ability. The directors thought that blood would tell and that a gentleman was a proper person to whom any amount of money could be loaned.(16) Each of their failures during the financial crisis, was an additional blow to the bank.

In 1858 an experienced banker was employed to try to revive the business. The paid-up capital was reduced and the business reorganized. However, in 1862, it was noticeable that the public were suspicious for the trade was then falling off. In 1864 and 1865 no dividends were paid and it was realized that it was impossible to save the bank. A large amount of the assets were valueless and a big part of the resources was tied up in land. The stock and capital were again reduced. The final collapse followed a most foolish piece of banking policy. Drafts upon London for one million dollars, drawn by local Grand Trunk Railway officials, were returned dishonored and the Bank of Upper Canada closed its doors October 22nd, 1866. It had died gradually, after the incursion of losses, falling off of business and reduction of deposits.

The bank in its entirety was assigned to trustees, but difficulty was found in realizing on the assets. In 1870 the institution was transferred to the control of the crown which paid seventy-five percent of the estimated value for the securities held by the bank. The Canadian creditors lost $310,000, the shareholders, $3,170,000, and the government $1,000,000.[17] The Government was not eager to enforce the double liability, for in as much as most of the shareholders were in financial difficulties, the operation would have taken years. The tatal loss of about five million dollars was enormous for that period of Canadian development. The effect was felt in every little hamlet in the province and the faith in banks was badly shaken.

The failure was a warning to directors to watch the organization and development of banks. The Act of 1870 provided that unearned bonuses and dividends be paid no more. Loans on land were regarded now as very risky, and for a bank to lend on real estate soon became unlawful. The first important failure in the history of Canadian banking was a bad one and its experience proved of great value to the other banks then doing business. Moreover, the disaster made room for several good banks and soon after Confederation in 1867, a period of expansion gave birth to certain institutions which today are among the strongest banks in Canada.

7. This brief sketch of banking and bank failures before 1867 gives us a background for our real study, the failure of banks doing business under the Dominion Act. Henceforth the banks were to come under one jurisdiction. The variety of their failures and the different effects on legislation may be noted with interest.

At the time of Confederation there were in all twenty-eight chartered banks doing business in Canada. Eighteen of these, chartered by the Province of Canada, were doing business in Ontario and Quebec. Five and four were operating under Nova Scotia and New Brunswick charters respectively, while one institution, the

the Bank of British North America, was doing business under a Royal Charter.

These banks all came under the Dominion Act and were joined from time to time by newly-chartered institutions. After Confederation there appear periods which may be divided into a season of expansion and one of depression. The bank failures in these periods will be noted and circumstances peculiar to contemporary financial conditions will be mentioned. We will try to arrive at the causes of the failures and the proper remedies. Finally, the reasons for the failures and the location of the blame will be related up to the decennial revisions of the bank act.

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CHAPTER 11.

Bank Failures, 1868 to 1881.

1. Immediately after the Confederation there followed a period of six or seven years of prosperity and expansion in Canadian banking.[1] Between 1868 and 1874, many new institutions were incorporated and chartered. Most of them were small and local, but others were of more importance. However, in spite of the prosperity of the period and the splendid opportunity for success, no less than nine of the banks chartered in this period failed before the year 1888.[2] The twenty-seven[3] older banks operating in Canada, under Provincial and Royal charters, also contributed to the list of failures during the period now under discussion.

Following the years of prosperity ending in '74, there was a serious depression and as a result many bank failures occurred. We will include in our study both the period of expansion, '68 - '74, during which many banks started business, and the period of depression '74 - '81, in which a relatively large number of them and of the banks chartered before Confederation, had the misfortune to fail.

2. One Canadian bank closed its doors shortly after the passing of the Dominion Act. The Commercial Bank of New Brunswick, with its head office at St. Johns, failed November 10th, 1868.[4] This institution was but a small concern, having at the time of suspension only $600,000 subscribed capital.[5] This bank was chartered before Confederation, but it was doing only a local trade. The assets were considerably in excess of the liabilities, and although it suspended payment, the institution was creditably wound up. The business of the Commercial Bank had not been brisk and the directors thought it advisable to terminate its career. After the noteholders, depositors and other creditors were paid in full, a small dividend remained for the shareholders.

The second of the failures after Confederation was the Bank of Acadia with headquarters at Liverpool, N. S. Its career was very short and fortunately so.

The Bank of Acadia was a fraudulent concern, the capital of which had been wiped out, although nominally there was a capital of $500,000, with $100,000 paid up.[6] The business was of such a poor nature that a commission had to be paid a concern to float the notes.[7] The bank existed but four months, failing April 18th, 1873. As none of the debts were paid, it is fortunate that the total liabilities were only $106,000.[8] The notes of the Bank of Acadia were worthless but this failure is the only instance in Canadian banking history where this is true. The failure was due to poor business ability, particularly in respect to the relation with a Boston firm of doubtful credit with which it was involved.

Another of the banks lately chartered failed in 1877. The Metropolitan Bank, with offices in Montreal, ran a very reckless course during its six years of existance. Risks at high rates of interest were accepted and bank stock was received as security. The officers thought that they possessed modern methods but their ambition proved the ruination of the bank. During the crisis of '74 and '75, the Metropolitan Bank suffered large losses.[9] As the value of the assets was depreciating, the shareholders decided to wind up the bank.[11] The liquidation was very creditable, both noteholders and depositors being paid in full.

The next failure, although also that of a small institution, was a more serious disaster. The Mechanics Bank of Montreal had been in business since before the Confederation but it had been a blot on the Canadian system. A small and undesirable discount business had given the bank a bad name and the circulation had been kept up only by improper methods.[12] Previous to 1876, Molson's Bank had given their aid, but in that year this support was withdrawn. As a result a 40 percent reduction had to be made in the capital and although the doors were kept open the subsequent existence was neither worthy nor legitimate.[13] The

Mechanics Bank suspended payment in May, 1879, and the inquiry showed a bad condition of affairs. The shareholder's double liability was invoked, but even then only 57½ percent was paid to noteholders and depositors. In connection with this failure it might be noted that this was the last case in our banking history where the noteholders of a defunct bank were not paid in full.

The Bank of Liverpool in Nova Scotia failed in October, 1879. Hard times had forced it to suspend in '73 and it was with some difficulty that it was re-organized.(14) More losses in 1876 resulted in a material reduction of the capital. The Bank of Liverpool was related to the same American firm with which the Bank of Acadia had been involved. The Boston concern owned one-quarter of the stock of the Bank of Liverpool, having paid for it with worthless promissory notes. ~~Ath~~ At the time of suspension, in 1879, the liabilities were $136,000; of which the circulation was only $4,000.(15) The Bank of Nova Scotia purchased all the assets of the bank and redeemed the notes which had been issued. Liquidation was slow; the debts were not materially reduced and the shareholders did not pay their double liability. While the noteholders did not suffer, the other creditors lost over $132,000; for depositors received nothing.(16)

August of the same year saw the failure of the Consolidated Bank of Montreal. This institution, in spite of the fact that it was but four years old, was doing a splendid local business. The subscribed capital was $2,091,000, with $2,080,000, paid up. The assets and liabilities were $3,077,000 and $1,794,000 respectively. A new manager was appointed in May, 1879, and heavy losses, amounting to $1,420,000 were discovered. The bank was re-organized and the capital reduced forty percent. However, business was falling off and as a lot of the paper held as security was worthless, the directorate thought suspension and liquidation the best way out of the difficulty. Both noteholders and depositors were paid in full. A broker in

Montreal paid $260,000 for the assets and agreed to pay all outstanding debts.[18] The stockholders secured about a 25 percent dividend on their holdings. Hard times and the poor business ability of the management were the causes of this failure.

The fourth Bank to fail in the year 1879 was the last failure in the period now under discussion. The Stadacona Bank, situated in Quebec, failed in July.[19] It was one of the younger banks and adverse fortunes had discouraged the shareholders. They decided to close their doors so the affairs of the Stadacona Bank went into voluntary liquidation. The assets were nicely in excess of the liabilities and all creditors were paid in full. The proprietors recovered about 90 percent of their investment.

There were two bank failures of minor importance in this period but their history has not been recorded. The Westmoreland Bank, a New Brunswick concern, failed shortly after Confederation. The double liability was paid and the institution was creditably wound up. The Bank of Prince Edward Island with offices in Charlottetown was an organization chartered by the Province before 1867. This charter had not expired when the bank suspended in November, 1881. Accordingly it was not doing business under the Dominion Act and is, therefore, not worthy of any more attention.

3. In drawing our conclusions from the study of the period from 1868 to 1881, it is an interesting fact that five out of seven of the banks which failed secured their charters and commenced business in the season of prosperity from '68 to '74. This fact, coupled with the knowledge that fraud and dishonesty was present in only one case where the bank was a new one (The Bank of Acadia) would lead one to believe that the banks which failed died natural deaths. They were organized in a time of expansion and they suspended during the period of financial stringency that followed. The Metropolitan Bank was too ambitious and suffered for the risks

that were taken. The Bank of Liverpool and the Stadacona and Consolidated Banks went under because of the depression of hard times. The charters of two of the banks that failed during this period, dated before the Confederation. The Commercial Bank of New Brunswick shared the fate of a small, local institution. The Mechanic's Bank had an undesirable business, maintained only by fraudulent means. Summing up the causes for the seven failures of this period, we may note that hard times accounts for four, fraud is responsible for two and over-ambition for the one remaining.

On account of the relatively little capital that was invested in the banks that failed, it may be said that the Canadian public did not suffer from bank disasters during this period. The Commercial, Metropolitan, Consolidated and Stadacona banks paid all creditors in full. In three cases the depositors suffered. The Banks of Acadia and Liverpool paid them nothing and the Mechanic's Bank paid only 57½ percent of the claims. In two cases the noteholders suffered. The notes of the Bank of Acadia were worthless and the Mechanic's Bank could meet but 57½ percent of their circulation. These facts sould bad but on account of the comparatively small business done by these banks, the public felt no great loss by their failure. Runs on the other and larger banks[20] during the failures of '79 were cordially met and a bank panic was averted.[21]

4. The failures of the period 1868 to 1881 had one very important effect on banking legislation. A need for a safer bank currency had arisen. The Bank of Acadia, which failed in '73, was unable to redeem its circulation and the Mechanic's Bank paid only 57½ percent to its noteholders in '79. In-as-much as the circulation of a bank averaged from one-sixth to one-tenth of its total assets, it was felt that the difficulty would be overcome if a prior lien was given in favor of holders of an insolvent bank's notes. It was also thought that

..islation to this effect would do away with the depreciation in the value of notes which followed the failures in 1879. Notes had fallen to a discount and although ultimately redeemed those who could not wait had to sell at a loss. The Bank Act of 1881 contains the clause "the payment of the notes issued by any such (chartered) banks and intended for circulation, then outstanding, shall be the first charge upon the assets of the bank in the case of its insolvency." (22) This change was one of the most important in the Act and we may conclude that if the Bank Act had been thus at the time of Confederation, no holder of a Canadian bank note would have suffered loss.

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20. It will be remembered that the following banks were then doing business:- Bank of Montreal, Imperial Bank, Merchant's Bank, Bank of British North American, Ontario Bank, Bank of Commerce, Dominion Bank, Bank of Hamilton, Bank of Ottawa, Molson's Bank, La Banque Nationale, Bank of New Brunswick and others.

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CHAPTER 111.

Bank Failures, 1881 to 1888.

1. In the eight years following the bank failures of 1879, there was but one failure in Canada. Speaking generally, the period was a prosperous one for financial institutions, trade and industry were rapidly increasing and the banks opened numerous branches. They were brought into closer relations with the country's needs, particularly those of the agricultural sections. Greater caution and prudence was now the practise of the banks and as a result we find a cessation in the history of failures. More attention was paid to the soundness and security of the business taken. Regret for the mistakes in the time of expansion of the Seventies had furthered the progress of sound banking principles. The monthly reports were changed so as to more fully indicate a bank's condition and fresh penalties were imposed for violations of the Bank Act.(1) In short, the banks generally shared in the better times of 1880 to 1883. The reaction came in the financial stringency of 1884-87.(2) After 1888 the business of the Canadian banks again displayed normal activity.

2. The failure of the Exchange Bank of Canada on September 15th, 1883, was the only bank disaster during the period of prosperity. It had nearly failed in '79 with the two other Montreal banks but it managed to resume business before the allotted time of three months was up.(3) One half million of capital was written off in '81 but it seemed that business was gone and that failure would soon overtake the Exchange Bank. The directors were wealthy and by a manipulation of the stock it was kept high, but the business done was poorly managed and in April, 1883, they called on the Dominion Government for help.(4) Two deposits of $200,000 and $100,000 were made on the personal security of one of the directors. Some of the stock was owned by prominent Conservatives who claimed that the advances were made to ward off a financial crisis. The Liberals of the day claimed that it was done to escape the double liability. A member in the House of Commons called

it a political concern and claimed that the Exchange Bank awaited the disaster that befell all political banks.[5]

However, the efforts of the Government were wasted. The managing director had no sense of respectability or honor for, as the condition of the bank became worse, he made reckless speculations.[6] His desperate efforts to save the institution involved him to the extent of $226,000, for he had been speculating personally. When the bank failed in 1883 the authorities were unable to find him. The nominal assets were $3,335,000, and the liabilities $2,431,000.[7] In two months the liquidators paid the circulation of $380,000 in full. The capital of $500,000 and a rest of $300,000 were wiped out by the losses. Double liability was collected from all who could pay and then only 66½ percent was returned to the depositors and other creditors.[8]

Defects of the system, commercial conditions, competition and losses were not the causes of the failure of the Exchange Bank. It was due to shameful dishonesty, and disregard of duty on the part of the management. A scandal ensued but as this all happened during a period of general prosperity, there was no panic. The public felt that nothing more than fraud was responsible.

3. The reaction from the western boom and general progress was felt between 1884 and 1888, and no less than five banks failed in these years; all but one in the year of 1887. The Maritime Bank, situated in St. Johns, failed on March 8th, 1887. The president was a merchant, a manufacturer, a politician and a broker and he played high with the funds of the bank.[9] In the first eight years of its existence, 1872-1880, the Maritime Bank lost $600,000 through "en bloc" loans and through failure to scatter risks.[10] The customary reorganization took place in 1883 and the paid up capital was reduced 64 percent to $247,000. Although a more capable manager was engaged and in spite of a large government deposit, the course of the Maritime Bank was not prosperous. On the books were heavily overdrawn

accounts with nothing against them but the assets of bankrupts. Heavy advances had been made to a lumber concern that had proved unsuccessful. Finally, in 1887, the bank had to suspend payments. The liabilities, at the time of failure, were fortunately but $1,409,000.[11] It took two years to redeem the circulation of $314,000. The claims of the two Governments were paid but ordinary creditors received only 10.6 percent. The double liability call failed to produce one-half of the face value of the shares at the time of suspension.[12]

The Picton Bank in Nova Scotia is another example of the small and unnecessary institution. When some of its largest debtors failed in 1884 and 1886, the Picton Bank suffered dangerous lock-ups in connection with its ready cash.[13] Dividends had ceased and in 1886 20 percent of the paid-up capital had to be written off. In September, 1887, it became necessary to suspend, and the bank, still solvent, was put into voluntary liquidation by the directors. At the time of suspension the paid-up capital was but $200,000, and the total liabilities only $74,000.[14] The debts were paid in full and 35 percent of the reduced capital was saved.

The third of the failures in the year 1887 was the Bank of London in Canada. The bank enjoyed but a brief life for it received its charter in 1883. The story of the failure reveals another course of dishonest management. The fortunes of the institution were blighted by the sinister influence of a speculating president,[15] who was personally connected with the Ontario Investment Association, to which funds were loaned until the reserve of the bank was wiped out. Perceiving the poor condition he completed arrangements for the sale of the bank to the Bank of Toronto, and departed for some corner of the United States.[16] After all debts were paid $90,000 of the paid-up capital of

$241,000 was saved for the owners.

The liquidation of the next institution that comes under our notice was not so creditable. The Central Bank, also a young institution, suspended on November 16th, 1887, and a most discreditable business was wound up.(17) One and two percent, an extraordinary rate of interest, had brought in large deposits to the Central Bank. Promises were made to small towns surrounding Toronto that a branch would be located there if a certain amount of stock were subscribed. Business was pushed and a large circulation put out. Some customers, particularly directors and brokers, received very large advances and the manager lent large sums of money elsewhere on insufficient security. The nefarious schemes and scandalous methods, in the endeavour to get business, sunk the $500,000 capital and the amount of the double liability. The evidence taken at the Central Bank trial which followed showed negligence on the part of the directors. They were misled by the falsehoods of the manager into believing that all was well with the institution over which they should have had control.(18) The noteholders were paid in full and the other creditors received 99 2/3 percent. If more reasonable salaries had been paid to the liquidators on this failure, the other third of a cent might have been saved to the creditors.(19)

The last of the failures during the period 1881 to 1880 was that of the Federal Bank. As was revealed at its reorganization in 1884 this institution had an enterprising and ingenious method of increasing its capital. The bank had held six thousand of its own shares and the Commercial Loan and Stock Co. was accustomed to borrow the funds of the bank to purchase stock which was then returned to the bank.(20) This was nothing less than a serious evasion of the Bank Act. When the general-manager resigned in 1884, this condition of affairs was discovered and the machine which had manufactured $600,000 new capital was destroyed. The public found out that something was wrong and in July, 1884, two million dollars had to be secured from the other banks to meet the run that occurred. Losses in a Michigan lumber transaction and bad loans in Manitoba necessitated a reduction of the capital by half, or to $1,250,000.[21] After this it seemed that there was to be no more prosperity for the Federal Bank. In 1885 the stock was discredited and fell below par. In January, 1884, the bank was called upon to redeem $210,000 of notes and to pay $1,421,000 of deposits. The banks of Toronto came to the aid of the Federal Bank, furnishing the money to pay off all liabilities on the one condition that the bank would wind up with open doors. The Toronto banks were content to wait for repayment until after the liquidation of the assets. This was done to avoid another failure, for coming after the disasters of the Maritime, Picton, London and Central Banks, it would have undoubtedly caused a bank panic. This is an instance where the Canadian banks used their cash reserves to prevent a condition in which three or four times the amount of their rest would have been needed to still the popular clamor for payment.[22] The shareholders of the Federal Bank were saved from compulsory liquidation and were given an opportunity to liquidate to advantage. Besides this, the business community of Ontario was protected from the costly derangement incident to a banking panic and a sudden contraction of discounts.

4. A feature of the failures of this period, that is worthy of notice is the fact that all were banks of but a few years of business. The Exchange, Maritime, Picton and Federal Banks commenced operations in the period 1870 - '74, while the Central Bank and the Bank of London received their charters

as late as 1883. These failures illustrate the concentration tendency in Canadian banking history. The new, local bank cannot successfully compete with the branch of the larger institution. More branches, not new charters, meet with the growing needs of our country.

When endeavouring to sum up the causes for the failures of any period, although it was a season of hard times and depression, it must be kept in mind that ordinary ability and caution would, even in a bad period, avert a bank disaster. This is particularly true if the institution was of a respectable size. A financial depression is a period of trial to the management of a bank, and those that are poorly or fraudulently managed have the poorest chance to survive. Therefore, while remembering that the years under discussion were years of hard times, we will look for a moment at the more immediate and peculiar causes of the failures.

Of the seven banks of the period, one, the Picton Bank, was a very small institution, and when several of its largest debtors failed, it suffered dangerous lock-ups of cash resources, which placed it in such a crippled condition that it was only a matter of time before it would have to close its doors. The Picton Bank lost in the struggle for the survival of the fittest. The causes for the failures of the other six institutions were dishonesty and recklessness. The Exchange Bank was poorly managed and its president speculated in a most reckless manner. The cause of the failure of the Maritime Bank was the inability of the manager. Heavy loans were made on insufficient security, and to recuperate for the losses incurred, speculation, with its usually disastrous results, was tried. The story of the Bank of London is also that of a dishonest and speculative president. The Central Bank was an institution of dishonest methods and nefarious schemes, and these never prosper. The Federal Bank had a dishonest manager and when this most damning circumstance is connected with a host of bad loans, failure and disaster is the logical outcome.

We may say that the failures down to and including 1887 have been due to faults of practice and not defects in the system.[23] Legislation has not prevented bad management and fraud and has not saved the shareholders from loss, but laws are not expected to do so. The value and security of the system can be seen from the losses to creditors and the Canadian banking system has minimized their ~~xigkdx~~ risks. No holder of a Canadian bank note suffered in the period now under discussion, or since 1881. In three instances, the depositors were not paid in full, although one of the banks (The Central Bank) was able to pay 99 2/3 percent. The Exchange and Maritime Banks paid 66½ percent and 10.6 percent respectively. In conclusion, although several banks did not meet all their debts, a noted authority states that in the twenty-seven years previous to 1890, that the total loss to noteholders, depositors, government and all other creditors, due to bank failures, has been less than two million dollars, or one percent of the liabilities of the Canadian banks at the expiration of that period.[24]

It might be significant to notice that only $163,552 was lost to the noteholders.[25] This sum is all that has been lost on bank notes since Confederation, and as no more will ever go unredeemed, on account of the first lien clause and the redemption fund, we may make the statement that, whereas, we have today in Canada a bank circulation of over $94,500,000,[26] only $166,552 has ever been lost to noteholders of banks operating under Dominion Acts since 1867.

5. The ultimate security of the Canadian bank note circulation had been put beyond all question by the legislation of 1881, which made the note-

holder's claim a prior lieu. However, the bank disasters of 1883 and 1887 showed that there could be a serious interruption in the matter of immediate convertibility. After both the Exchange Bank and the Central Bank had failed, the notes fell to a discount of 10 percent.[27] This meant severe losses to those who could not afford to wait for the ultimate redemption. In connection with the Maritime Bank it was two years before the liquidators were ready to redeem the circulation. As a consequence the bank notes brought as little as 40 percent at one time.[28] This trouble had as it's direct result the establishment in the Act of 1891 of the bank circulation redemption fund to prevent discount upon the notes of a failed bank between the time of failure and redemption.[29] Each of the Canadian banks paid into this fund 5 percent of their average circulation. When the liquidators of a bank could not make arrangements for the redemption of notes within two months after the failure, money was paid out of this fund to the holders of the bank's notes. The paper of a suspended bank draws 6 percent until the time set for its redemption. It was felt that this change in the Bank Act would prevent the discount that had resulted after some of the failures in the period we have just reviewed.

The Maritime, London and Picton Banks were all very small institutions and there was a growing tendency towards making the conditions of obtaining a charter more severe. The increase of small banks, some started by persons of little responsibility, had been productive of financial episodes for which the country had small relish. We find in the Bank Act of 1891 new requirements regarding the chartering of banks.[30] As before, the subscribed capital had to amount to $500,000, but it was then required that $250,000 be paid up and deposited with the Minister of Finance for four weeks. After that officer was satisfied that all the requirements were met, he issued to the bank the certificate authorizing them to commence business. Good evidence of the value of this feature of the Act of 1891 is procured from the evidence from the period of 1868 to 1881. The Bank of Acadia, a fradulent concern of that time, had practically no capital at all. While nominally its capital was \$500,000 with \$100,000 paid-up, it was shown during the investigation after the failure that real capital did not exist.

The failures of Canadian banks had another effect upon the legislation of 1891. The Dominion Government had experienced a hard time in getting any payment after the failure of the Exchange Bank in 1883. Accordingly the Government claim was made a second charge upon the assets of a suspended bank. Several penalties were added to the list in regard to infringements of the Bank Act by any of the officials. Five years' imprisonment was made the penalty for making false returns to the Minister of Finance. Several of the managers of the banks that had failed had been in the custom of loaning money to brokers, directors and to special loan companies. The act of 1891 made undue preference an offense punishable with imprisonment for two years.

Before passing to the next period 1893 -1905, it will prove interesting to note the success of the calls made on the double liability of shareholders. When the Picton, London and Federal Banks failed, the institutions were still solvent and accordingly the shareholders were not asked to make up any deficiency. The double liability was only partlycollected from the shareholders of the Exchange and Maritime Banks. By reason of this, only 66½ percent and 10.6 respectively were paid to the ordinary creditors. After the Central Bank failed 99 2/3 percent was returned to the depositors and this was made possible by the success which attended the call on the double liability of the shareholders. The condition of the affairs of this bank was so bad that the results might have been very serious had not the shareholders made up the

the deficiency to the creditors.

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CHAPTER IV.

Failures between 1893 and 1905.

1. The value of the circulation redemption fund had its first test when the Commercial Bank of Manitoba failed July 3rd, 1893. Although the institution was run with a view to the development of the country it was extremely subject to local influence. Accordingly when there was no trouble over acceptance of its notes at par after the failure, the efficacy of the recent banking legislation was proven.

A firm of financial agents and private bankers in Winnipeg secured a charter in 1884 for the Commercial Bank of Manitoba.[1] A man by the name of Macarthur, who was at that time local manager of the Merchant's Bank was appointed president and general-manager. His policy was aggressive from the beginning. Reckless development of business was the result and the bank soon took on an insecure position, all on account of the foolish enterprise of a single individual. Macarthur believed in the development of the country and the failure is ~~xx~~ directly attributable to his ill-advised or incapable administration of the bank's lending resources.[2] The available funds were soon tied up and to conceal the condition of affairs false returns were made to the Department of Finance at Ottawa.[3] The hard winter of 1892 brought matters to a head. Circulation came in for redemption and large deposits were withdrawn.[4] Soon no more paper could be redeemed and as correspondents would no longer aid [5] the bank had to suspend. There were nominal assets of $1,854,000 to meet liabilities amounting to $1,344,000.[6] The authorized capital was $2,000,000 with but $740,000 subscribed and only $552,000 paid-up.[7] A reserve fund of $50,000 was probably fictitious. Circulation, due to heavy withdrawals had run up to $419,000.

Liquidation was proceeded with immediately. The notes of the defunct bank never fell to a discount and on September 16th those held by the public were redeemed. Canadian banks held the notes at the set rate of interest until the liquidatôr got the affairs of the bank in better shape. Realizing on the assets proved slow work and for some time the depositors and other creditors received only an 80 percent dividend.(8) Ultimately, however, the debts of the institution were paid in full,(9) and in all probability the owners may recover 25 percent of their investment.(10)

The location of the blame in connection with this failure is not a difficult matter. Reckless enterprise and careless loans will always place a bank in a precarious position. When the institution is but a small one and when it puts too much attention on local affairs, such a procedure is extremely dangerous and in the case under discussion it culminated disastrously. The failure does not throw discredit on the Canadian Banking laws, for nothing can prevent a man from tying up a bank's funds in poor investments and bad loans. As long as bank shareholders and directors place their interest in the hands of over-ambitious and reckless managers, so long will there be back failures, if there is no competent supervision. Directors must keep a watchful eye on managerial activities.

2. The history of the failure of the oldest French bank in Canada is a story of a few years of reckless management after half a century of sound banking. La Banque du Peuple, which received its charter in 1835, suspended on July 16th, 1895. The public believed the institution to be a strong one and their confidence received a rude shock when the news of the disaster was spread. There are also special circumstances in connection with this failure which make it both unique and interesting. As La Banque du Peuple was doing business under a Royal Charter, there was only a single liability on the part of the shareholders. The directors of the bank, however, had unlimited liability.(10½)

For a few years before the suspension there had been considerable friction between the directors and the general-manager, a M. Bousquet.[11] This gentleman was personally interested in several outside enterprises, and advanced large loans to them out of the bank's resources. Some of these advances were unwise and excessive.[12] The directors complained and threatened but it seems that they did nothing for which they are much to blame. In the first week of July , 1895, when Bousquet resigned, the public became suspicious and large withdrawals of depôsits were made. The directors were alarmed and invited the other banks to an investigation. To keep the doors open a million dollars was advanced La Banque du Peuple, but so insistent was the run that this sum lasted barely a week.[13] Meanwhile, the investigation had revealed an alarming state of affairs. There were overdrafts owing by directors and others to more than 20 percent in excess of the paid-up capital.[14] The liabilities amounted to $6,820,000, and against them were nominal assets of $8,663,000.[15] However, in-as-much as large overdue debts and real estate comprised most of the assets and as the value of these was overestimated, the inquiry showed that at least two-thirds of the bank's capital of $1,200,000 was lost.[16] Over one-half million dollars had been loaned where real estate only was the security.[17] Suspension took place July 16th, 1895.[18]

Liquidation was proceeded with immediately. Circulation to the extent of $787,000 was, of course, redeemed first. Under the terms of a compromise only $300000 was collected from the unlimited liability of the directors. It soon appeared that payment of depositors and other creditors would be show work. Accordingly on the 7th of October an arrangement was made whereby the depositors were not paid for two years; so as to allow the liquidators to more advantageously realize on the assets.[19] The depositors were to be paid from percent interest. In one year the liabilities were reduced to $2,866,000 and the assets to $4,398,000, nd a dividend of 50 percent had been paid to the depositors.[20] By 1810 the creditors had been paid $75\frac{1}{4}$ percent of their claims and the affairs of La Banque du Peuple were wound up.

For a cause for the failure we have to look again to the manager. To loan with a lavish hand, to friends with poor security, inevitably ties up funds and places a bank in an unstaple condition. Bousquet of La Banque du Peuple had out loans that could never be returned. Foolish business of a few months destroyed a banking house that had stood for over half a century. The heavy loans and the overdrawn accounts, amounting to more than the capital itself, placed the institution in the unfortunate position discovered by the investigation of the other Canadian banks. The time had already come in the history of Canadian banking when there was a demand for inspection of head offices and a constant check on managerial activities.

3. In point of the inadequacy of the assets, the failure of La Banque Ville Marie was even worse. The second French bank to fail in the period now under discussion had its head office in Montreal. The public was informed on July 24th, 1899, that it had suspended payment. The bank authorities told the press that the failure was due to a theft of $58,000 from the strong box of the institution.[21] It seems that the paying teller had been speculating in bucket-shops and when losing had helped himself from the reserve held for redemption of circulation. He was tried for theft and sentenced to the penitentiary and the accountant who was charged with criminal knowledge of the offense was let off on suspended sentence.[22] However, financiers of the day asked themselves the question, why should the loss of $58,000 necessitate the closing of the doors of a bank with a capital of one-half a million.[23] The directors' excuse for the suspension was that it was done to anticipate a run on the bank when the public knew of the loss. But the investigation of the curator, appointed

by the Banker's Association, brought to light the real cause of the failure. The facts disclosed instigated further criminal proceedings; this time against President Weir. It was shown that the bank had been most fraudulently managed. Among other facts, the notes in circulation were considerably in excess of the amount authorized by law and to keep this matter quiet the note circulation had been understated in the monthly reports to the Government.(24) The courts took the view that the management of La Banque Ville Marie had committed gross frauds, and for his share, President Weir received two years in the penitentiary.(24½)

La Banque Ville Marie had been in difficulties before. Back in 1878 payment was suspended and the examination that ensued showed that heavy losses had been incurred.(25) Accordingly the capital of one million dollars was reduced by half and business was resumed. Competition in later years had made enterprise necessary, and the president, in his endeavours to keep the bank on its feet committed several irregularities. He had opened twenty branches, far too many for the amount of business that was being done. The directors must have known of the excessive note issue and the poor condition of the bank's finances. They were only too glad to make use of the opportunity afforded by the theft, to suspend payment and wind up affairs. At the time of suspension the assets were $382,000, while the liabilities, mainly because of the $1,504,000 circulation, amounted to $1,766,000.(26) The excessive note-issue, which had to be redeemed first, was the cause of the disgraceful liquidation. On one-half of the paid-up capital no double liability could be collected, for the bank itself owned these shares. The noteholders were paid in full but the depositors and other creditors received only 17½ percent.(27)

On account of the, comparatively speaking, local business, no general effect on banks or Canadian finances was felt.

4. The last failure in the period 1893 – 1905 was that of the Bank of Yarmouth, which closed its doors March 5th, 1905.(28) It was the suspension of

the smallest bank in our system that broke in upon the six years of quietness and prosperity in Canadian banking history.(29) The Bank of Yarmouth was domiciled in Nova Scotia and as it had carried on but a local business, it had not ~~xx~~ expanded. When it failed the liabilities to the public were only $479,000.(30) The main and perhaps the only cause of the failure was the large loans and advances to one mercenary house.(31) W. H. Redding and Sons, of Halifax, boot manufacturers, had for years been receiving financial aid from the Bank of Yarmouth. This firm owed the bank in 1805 $490,000, a sum out of all proportion to the bank's means. The paid-up capital was $300,000, and the reserve was only $35,000.(32) To put through a loan of such dimensions, particularly with a firm of doubtful standing, was more than poor banking; it was criminal.

On March 3rd, Redding and Sons failed and it is easy to understand that could only be a matter of days when the Bank of Yarmouth too would close its doors. The Union Bank of Halifax was approached with a view to amalgamation, but nothing was done.(33) Accordingly, the bank had to suspend payment two days after the manufacturers with whom it was, financially at least, so closely related. At the time of suspension deposits were $266,000, and circulation $50,000.(34) A curator was appointed and he called upon the shareholders to pay the double liability. The nominal assets were large ($820,000) but much of this was composed of worthless securities of the Redding Company.(35) The double liability call was successful and both noteholders and depositors were paid in full. The affairs of the defunct institution were taken over by the local banks in Halifax.(36)

The report of the curator disclosed some remarkable facts. To keep the stock of the bank in a healthy condition and to inspire confidence in the shareholders and general public, the directors authorized payments of dividends when there were no profits.[37] This meant a serious impairment of the capital. To hide the relationship with the company of Redding and Sons the losses were fraudulently concealed in the monthly reports to the Department. Bills drawn by Redding and Sons on persons having no existence, were purchased by the bank.[38] The cashier-manager, T. W. Johns, was arrested anx charged with infractions of the Bank Act.[39] Poor business ability was originally responsible for the large loan to the local manufacturer, and in an endeavour to save what they had already sunk, more was loaned. If the Bank of Yarmouth wished to continue business, this piece of foolish recklessness had to be covered up and dishonesty and fraud were resorted to by directors and manager. This nearly always spells ruin to a financial institution. There is no remedy for the trouble peculiar to the failure of the Bank of Yarmouth, for as long as bank managers do dishonest deeds and as long as directors act like dummies, so long will banks fail, no matter in what system or under what laws. (Is it only the 2 kinds that fail?)

In connection with the failure of the Bank of Yarmouth there is an interesting feature. The directors kept the state of affairs secret from the shareholders and in doing so had lost for them large sums of money. After the failure, therefore, the shareholders secured legal advice and sued the directors for the losses in capital due to the improper declaration of dividends and to the last few loans to Redding and Sons. After the case had gone through several courts, the Supreme Court of Nova Scotia decided that the directors had been guilty of malfeasance and breach of trust and that they should repay the dividends that had been unlawfully declared, plus the losses in the Redding account since August, 1904.[40] However, in July, 1908, a settlement was arrived at between the shareholders, liquidator and

and directors. The latter repaid to the bank the sum of $32,000.[41] For our present study the important point in connection with this matter is that the courts of Canada are ready to hold directors of banks liable for impairment of capital of any unlawful means.

5. The record of Canadian bank mortality from 1893 to 1905 has been concerned with the troubles of small and more or less insignificant banks. This shows the tendency in Canada towards concentration. The rapid increase in the number of amalgamations also speaks loudly of this fact. An increased number of branches of big banks will meet the Canadian need more easily and successfully than will a number of newly-chartered institutions. On account of the fact that none but the comparatively small banks failed, we may conclude that there has not been any large loss to creditors. A banking authority states that since 1881 there has been no loss to noteholders and that depositors have lost about three million dollars.[42] During the period 1893 to 1905 there were four bad failures and in two instances the creditors suffered. Of course, the circulation of the banks that failed was promptly redeemed. The other creditors of the Commercial Bank of Manitoba and the Bank of Yarmouth were also paid in full. The first-named institution had the most creditable wind-up for there was no need to call on the double liability of the shareholders. It was due to the success of this call that the creditors of the Bank of Yarmouth were paid in full. The two French banks, Les Banques du Peuple ~~(and)~~ et Ville Marie paid 75½ percent and 17½ percent to their depositors. If ~~the~~ La Banque du Peuple had not been doing business under a Royal charter and, therefore, had been subject to the double liability clause, it is probable that the creditors claims could have been met. In connection with La Banque Ville

Marie, because the bank itself owned one-half of its own stock, the call upon the double liability was only partially successful and this meant that only a small part of the debts were paid.

The two words "unwiseloans" would cover the causes for the four failures of the period between 1893 and 1905. The banks were all small and business had to be pushed to keep pace with the larger competitors. This meant that sound banking principles were sometimes forgotten. The manager of the Commercial Bank of Manitoba was over-ambitious and some of his loans turned out disastrously. La Banque du Peuple had a bad habit of loaning to friends on insufficient security. La Banque Ville Marie pushed out and secured trade when a more conservative bank would have held back. The Bank of Yarmouth loaned a single concern a larger sum than its own capital and when this amount was lost, suspension soon followed. Poor management will always send a bank to the wall in the fight for the survival of the fittest.

6. Bank failures, previous to and during the period we have just studied, had considerable effect on the Bank Act 1901. La Banque Ville Marie, in particular, exhibited fraudulent methods that legislation could correct. It will be remembered that it's note issue was very excessive and it was felt that some regulation should be made. The circulation redemption fund of the Act of'91 had made the Canadian banks joint guarantors of each other's notes and in the following year the Canadian Banker's Association was formed. The Goverment saw the advisability of allowing the Association to supervise and the Act of 1901 gave them inquisitorial powers.(43) The more minute monthly reports that the Banker's Association saw fit to demand made it extremely difficult for a bank to over-issue as did La Banque Ville Marie. This same institution had, after the failure, issued its own notes to favored depositors

thus creating a special privileged class with prior liens. The Act of 1901 made it unlawful for any bank to issue its own notes after suspension. The new act also gave the Canadian Banker's Association power to appoint a curator who would investigate the affairs of all suspended banks. Often when the assets of a bank are so invested that immediate realization is ~~xxx~~ impossible and when depositors and other creditors are rapidly calling for settlement, a bank has a hard time to keep off suspension. There are three possible forms of prodedure: securing of assistance, amalgamation, or failure. Bank failures in Canada had grown too numerous and the 1901 Act made it possible for two banks to amalgamate without waiting for specific permission from the Crown.

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CHAPTER V

The Ontario Bank Failure.

1. Early in October, 1906, the Royal Bank of Canada opened negotiations for the purchase of the Ontario Bank. The business of the two concerns was overlapping and it was thought to be in the interests of both to amalgamate. It was considerably surprised to discover that the Ontario Bank had undergone large pecuniary losses involving the complete loss of its capital.[1] To save a disaster, the Royal Bank made an offer for the stock of the ill-fated institution, but the arrangements were never completed; for a revolution in Cuba, where the Royal Bank operated on a considerable scale turned its thoughts and resources elsewhere. The directorate of the Ontario Bank were advised to look to the other Canadian institutions for assistance in liquidating with open doors.

On Friday, October 12th, when a considerable quantity of the bank's stock was offered on the Toronto Exchange, the market price fell rapidly.[2] On the evening of the same day, the directors of the Ontario Bank held a conference in Toronto with the general-managers of the other banks. The result was that the Bank of Montreal was invited to cope with the situation. The banks of Ontario, in propostion to their capital, backed the Bank of Montreal with a guarantee up to $2,500,000. This institution was to take over all the liabilities of the Ontario Bank. Mr. W. E. Stavert of the Bank of Montreal was appointed curator and the Canadian Bankers' Association, as provided by the Act of 1900,[3] appointed an Advisory Board to act with the curator in the liquidation of the failed bank. The Bank of Montreal paid $150,000 for the good-will of the business.[4] Signs informing the public that the business would be taken over by the Bank of Montreal were placed on all the branches of the Ontario Bank early Saturday morning, October 13th. The commendable decision of the Canadian Banks to have the institution that had failed liquidate with open doors is responsible for the fact that, although the Ontario Bank was an old concern doing a large business, there was no banking panic, and no run on any of the branches.

2. The case of the Ontario Bank is a splendid example of the effect of incompetent management and of the failure of directors to supervise. It has been said that the Ontario Bank fiasco was the fruit of sheer incompetence.(5) In 1895 Mr. McGill had been appointed general-manager, but it was not until 1901 that any apparent trouble arose. In that year he started speculating in United States securities and to cover up the diversion of moneys and the frequent losses, he inflated the current loans column in the monthly statements to the Department of Finance. The first sum lost was in the neighborhood of $200,000, but soon the substantial sum of $1,416,857 was in the hands of New York brokers, and not out on current loans as the reports indicated.(6) Mr. McGill, in his own defence, claimed that he received but little help from his directors and that he thought that this speculation was in the interests of the bank.

These diverted sums of money appear in the bank's books, as loans to New York brokers; but when a commission went to New York after the failure, they received a denial of the fact that any brokers had borrowed money.(7) Evidence gathered in that city, showed that McGill had put the bank's funds in the hands of these men; that he had bought in rising markets and lost on the decline. At the shareholders' meeting in 1908, it was stated that, in many purchases, Mr. McGill had been the victim of fraud.(8) As before mentioned, the manager had to falsify the monthly reports, so as to deceive the shareholders and directors. On October 19, 1906, McGill was prosecuted by the Canadian Bankers' Association, in concert with the Provincial and Dominion Governments, for unlawfully making to the Minister of Finance statements and returns which he knew to be false. The court, on this charge, sentenced him to five years in the penitentiary, for it was proved that he was more than incompetent; even criminally guilty.[9] President Cockburn of the Ontario Bank was prosecuted at the same time, under the charge of signing false statements during the years 1905 and 1906, but in-as-much as it was shown that he had done his duty fairly well and was not guilty of roguery, he was acquitted.

Accordingly, one might say that the chief cause of the Ontario Bank disaster was the incompetence and recklessness of the general-manager. He was foolishly and criminally responsible for the loss of almost all the capital of the bank through speculations which he thought might retrieve the fortunes of the institution he represented. The immediate cause of the suspension, as above outlined, was the ascertainment of this fact by the agents of the Royal Bank, when negotiations for the purchase of the Ontario Bank were opened.

The directors were astonished when the actual condition of affairs was revealed and here is the key to another but minor cause of the failure. The incompetence of the directors was not the cause of the calamity but their negligence allowed the dishonest course of their manager to culminate in ruin. Mr. McGill's trial brought to light the fact that the directors of the Ontario Bank exhibited a lamentable failing to appreciate the importance of their duties.[10] While they were not criminally negligent yet they did not fail in their functions as officers of the bank. And even after the unstable condition of affairs was pointed out by the directors of the Royal Bank, they should not have been in such a hurry to place the Ontario Bank into the hands of the other Canadian banks. Knowing, as they did, that the trouble was not due to the lack of regular business, the directors and president should have made some attempt at least to save the situation without a failure.

3. Curator Stavert and the Advisory Board proceeded with the liquidation of the Ontario Bank immediately after the failure. The shareholders, as a body, were not pleased with the sudden sale of their interests to the Bank of Montreal.(11) At their first meeting after the suspension, they appointed a committee to get all possible information from the curator and other sources as to the financial condition of the bank. The committee were also to secure legal advice as to the right of the shareholders to recover from the directors what they had permitted to be improperly diverted from the capital account. The balance sheet of the Ontario Bank for November 30th, 1907, was presented to the shareholders at their annual meeting held December 12th.

Balance Sheet, November 30th 1907. (Thousands omitted.)(12)

Assets.

Bonds and Stocks (Estimated)	310
Real Estate	292
Circulation Redemption Fund	70
Overdue Debts (Estimated)	491
Rediscounted bills	950
Balance	2157
Total	4271

Liabilities.

Balance due other banks	1910
Circulation	133
Deposits	27
Rediscounted bills	950
Reserve (Estimated	150

(Liabilities:- continued)

Capital		1500
	Total	4271

The report indicated further that there had been a loss of $230,000 in trading in the bank's own shares; that $1,784,000 had been lost in trading in other securities; and that bad debts to the extent of $312,000 had been written off. The estimated loss on debts was $620,000, and on current loans, $150,000; altogether, taking in a few minor items, a total of $3,205,251.06. $700,000 had been transferred from the rest account and $294,000 from the profit and loss account, while insurance realized $51,000. Subtracting these sums from the total of losses, we have a net loss of $2,157,546.18.

Sir Edward Clouston, the General-Manager of the Bank of Montreal, made the statement that the liquidation of the Ontario Bank was proceeding without any loss to either the noteholders or the depositors. (14) A noted authority quotes that the liquidation of the Ontario Bank was a profitable venture for the Bank of Montreal. The decision to liquidate with open doors under the name of some other Canadian bank meant practically no expense to the creditors in-as-much as realization on assets was concerned.

The shareholders of the Ontario Bank were informed at the 1808 meeting that liquidation showed that a part, if not all, of the double liability would be called upon. (15) During the thirteen months, commencing May, 1907, the total assets had declined from $3,832,000 to $2,657,000, and the liabilities had decreased from $3,576,000 to $2,501,000. (16)

Liquidation had not proceeded very rapidly during the early months of 1908 and on September 16th, the shareholders met to discuss the condition of the bank's finances and the advisability of appointing a liquidator to wind up the affairs of the bank. (17) The report showed that the value of the remaining assets was $1,624,000, and the liabilities were $2,405,927, or a loss of $781,927. This, plus the capital of $1,500,000, made a deficit of $2,281,927. The shareholders and directors appointed the Royal Trust Company as liquidator and of this choice the creditors approved.(18) Liquidation proceeded more rapidly and it was announced in November, 1911, that the sum of $1,123,000 had been received from the shareholders of the Ontario Bank on the call of 95 percent of the double liability.(19) As the full amount of assessable stock had a par value of $1,292,200, the amount called would total $1,227,590, so that all but about $100,000 had been paid. It was stated that there was a small return in prospect for the holders, as the sum in hand was more than enough to cover the unsettled liabilities.

There had been an effort on the part of the shareholders of the Ontario Bank to sidestep the double liability. They entered a claim against the Bank of Montreal to the effect that, at the time of suspension, there had been a complete sale of all the assets to that bank, and that, therefore, this institution could not call on the double liability. Official Referee Kappele held that the Bank of Montreal was entitled to rank as a creditor of the Ontario Bank for amounts advanced under the agreement by which it had carried out the liquidation.(20) The shareholders were thus called upon to pay the shortage so that the liabilities could be met. However, they appealed and the decision of the referee was upheld. The courts decided that there was no sale, for the Bank of Montreal would not so hurriedly buy up so large a business, nor did the shareholders and directors, at that time, want a complete sale but merely the best way out of the difficulty.(21) The Court of Appeal upheld this decision in April, 1910, and this result was in turn upheld by the higher courts in November of the same year.(23)

4. When the shareholders met in November, 1906, just after the failure, a committee was appointed to secure legal advice as to their power to recover from

the directors. A claim was filed in December, 1907, in the suit of the Ontario Bank vs its directors, to the effect that the directors had, at the time of suspension, represented to the shareholders that they had a reserve of $700,000, over and above the capital and that the sum of $66,861 stood to the credit of the profit and loss account. The claim stated that the directors and president had not taken care to preserve the funds and assets of the bank and that they did not prevent the impairment of capital by the payment of unearned dividends to shareholders. (24) However, as not all of the defendants were then in the country, the suit was not pressed and in 1908 a committee was appointed to decide whether or not the shareholders would prosecute the directors. (25) But whereas, previously, only $187,500 had been claimed, now the claims amounted to $400,000, based on the following items:- Capital impaired by alleged improper dividends, $783,247; loss in speculation, $1,773,100; and loss in purchase of the bank's own shares, $270,663. (26) The defendants in this action were:- G. R. R. Cockburn, D. MacKay, R. D. Perry, R. Harcourt, R. Grass, T. Walmsley and J. Flett.

The committee decided in February, 1909, to continue the action. (27) They were doubtlessly influenced by the decision in the Bank of Yarmouth case in which it was held that the directors were responsible. (28)

5. In connection with the disaster, at present under discussion, it is not a difficult task to lay the blame at the right doors. Briefly, each of the general-manager, the president, directors and shareholders are to blame for the failure of the Ontario Bank. The shareholders exhibited an extraordinary lack of interest in the affairs of the institution, reposing too trustworthy in their faith in their officers. The manager was incompetent and incompetency led him into criminal actions in his effort to save the situation. The president and directors were too negligent and easy-going and hence were sued after the failure

by the shareholders.

All will admit that General-Manager McGill must bear the greatest burden of condemnation. He was incompetent and reckless and through heavy plungings in New York stocks he lost all the capital of the bank. To cover this up and to have the bank appear to be in a flourishing condition, he purchased the bank's own stock; he announced unearned dividends and he falsified the monthly reports to the government.

Directors are always responsible, and those of the Ontario Bank were negligent in their duty. They allowed the payment of improper dividends and were aware of the bank's purchase of its own stock. Lastly, the foolish speculation and false statements of the manager would never have taken place, or at least continued, if the directors had held an inspection of the head office. For these facts they are morally responsible.

6. For a remedy for these misdeeds, a compulsory inspection of head office and manager's books by the directorate will suffice. The directors and president must be aware of what the officers of an institution are doing with its funds. They must not go ahead blindly, with no knowledge of the bank's inner workings. Reports should not satisfy them; they should see for themselves. To make directors more responsible, negligence, should be a nominal offense and dealt with accordingly.

The miserable fiasco of the Ontario Bank failure stands as a lesson to Canada, that was not soon forgotten. The disaster was the first big failure in later years and one would think that this example would be enough to prevent any future dishonest manager from carrying out his fraudulent designs.

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14½. Johnson, J. F., The Canadian Banking System, p. 124, National Monetary Commission, 1910.

15. Monetary Times, March 7th, 1908.

16. Monetary Times, July 11th, 1908.

17. Monetary Times, September 19th, 1908.

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20. Monetary Times, April 23rd, 1910.

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22. The Official Referee held that the agreement was binding upon the Ontario Bank and its shareholders. The Court of Appeal held that the transaction had been beneficial and advantageous alike to all parties. It had been entered into in good faith by the directors and the arrangement was not beyond their powers. 21, O. L. R., 1; 15, O. W. R., 913; 1, O. W. N., 668.

23. The Privy Council held that there was no sale by the Ontario Bank of the whole or part of its assets within the meaning of the Bank Act, that it was an arrangement which was within the powers of the directors to enter into, and

that it was binding; that the Bank of Montreal was entitled to make proof of its claim against the estate of the Ontario Bank. Appealed Cases 82; 80, Law Journal of the Privy Council, 83; Appealed Cases 96; 103, Times Law Reporter 436; 27, L. T. R., 55; 31, C. L. T. 36.

24. Monetary Times, December 7th, 1907.

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CHAPTER VI.

The Failure of the Sovereign Bank.

1. The character of the Sovereign Bank disaster presents several variations from that of later Canadian bank failures. It's organization occurred during the last period of prosperity and it had an equal chance with other new banks. Farther, the cause of the failure was not criminality on the part of an official but merely rash ambition. The general-manager was aggressive, energetic, and seemingly successful but he took some unjustifiable risks in the matter of enlarging the bank's business.(1) It has been ably said that the Sovereign Bank was born of, lived on the fruits of, and died as a result of ambition.(2) D. M. Stewart, who became the first genera-manager, organized the Sovereign Bank on April 23rd, 1902.(3) The charter had been secured in the previous year. The assistance and interest of the Dresdner Bank of Germany and the J. P. Morgan and Company of New York, as shareholders, was enlisted. The capital authorized was four million dollars. The organization of the bank is unique in Canada. General-manager Stewart, although of good banking ability, was too ambitious. He departed from the paths of experience by rapidly increasing the number of branches, and taking in an enormous business too quickly. It was he who introduced into Canadian banking the payment of quarterly dividends.(4) He placed branches, some of which were fictitious, all over Canada.(5) A dividend of six percent was declared in 1905 and continued until the failure in 1908. To show the remarkable growth of the Sovereign Bank, it is only necessary to glance at the following table.

Comparative Growth of Deposits.(6)
(Millions omitted.)

Bank	April, 1906	April, 1907.
Sovereign Bank	11	15
Bank of Montreal	88	90

Quebec Bank	8	8
Bank of Nova Scotia	19	20
Bank of B. N. A.	17	19
Bank of Toronto	22	24
Union Bank	17	21
Bank of Commerce	67	76
Royal Bank	17	20
Dominion Bank	32	34
Bank of Hamilton	21	23

The long-established banks in Canada did not like the methods of the high finance artist, and soon there was friction. After six years of the policy of energetic and rash expansion, the Sovereign Bank decided that it had overstepped itself and a change, that has an important bearing on the failure that came six months later, was made.

Previous to the annual meeting of the Sovereign Bank held on June 11th, 1907, the president, R. Macdonald and the Manager, D. M. Stewart, had resigned. Evidently they had become cognizant of the unstaple condition of the bank and wished to sever their connection with it. Their successors, A. E. Jarvis and F. G. Jemmett, presented an alarming report to the meeting of the shareholders. (7) It explained that the bank had been too ambitious and had grown too fast, and that the new management would be more conservative. The new officers recommended that $700,000 be written off as bad debts; that the value of securities and premises be reduced $200,000; that $541,000 be set aside for accounts in liquidation and that a further contingent fund of $800,000 be made for unsatisfactory advances. (8) This necessitated the writing off of the whole of the rest fund ($1,230,000.) and a million dollars of the capital.

The previous management had pushed things too rapidly. In 1906, sixteen new branches had been foolishly opened and in the following year, twenty-seven.(9) Enormous loans had been made to a United States railway and a large quantity of money had been sunk in the Alaska Central Railroad.(10) General-Manager Stewart, knowing the bank was in deep water, had placed, in Februzry, 1906, 15,000 additional shares of the Sovereign Bank with the Dresdner Bank of Germany.(11) The directors too, at that time, made an effort to aid the bank. They authorized the bank to loan them personally, sums of money, with which the institution's stock was purchased. These deals kept the Sovereign Bank stock in a healthy condition on the market.

The story of these facts was placed before the shareholders at the 1907 meeting and the action advised in the report was authorized. The bank then proceeded with its business, supposedly in a strong position. But, before continuing the history let us consider whether there is any significance for our study of the failure in this reduction of capital and writing off of bad debts. Before Stewart resigned, large loans were given and accounts were opened concerning which the directorate knew nothing. Numerous new branches were opened and as all this meant a heavy drain on the resources of the bank, it soon became in an unstable condition. The head officials recognised this and resigned. When the new officials made a thorough investigation these facts were perceived and they decided that a large amount would have to be written off the bank's books. Some blame may be placed upon the directors who should have known the condition and enquired into the remedy. However, at the bottom of the trouble was the foolish ambition and reckless enterprise of General-manager Stewart and upon him most of the blame must rest.

One might ask what effect did the facts disclosed at the re-organization have upon the future business of the bank and therefore upon the failure?

Briefly, the confidence of the public was lost and when a period of stress occurred, the Sovereign Bank was in no condition to successfully tide over the depression.

2. On January 18th, 1908, the branches of the Sovereign Bank opened up for business under the names of several of the chartered banks of Canada. The following statement was handed to the press that same day by President Jarvis. (12)
"For some time there has been a strain on our resources, caused by the unnatural conditions of the last four months, and there has been a strain on our deposits which has made it difficult to liquidate our loans. These most stringent conditions make further business unprofitable. We asked the leading bankers to verify our statement and they said the assets could pay the liabilities ; and Saturday morning all the branches opened as branches of other banks."
In explanation, Mr. Jarvis stated that in October, 1907, there had been a panic, followed by a financial stringency, in the United States. In November and December the effects had been felt in Canada. Liquidation of the loans of the Sovereign Bank ceased and deposits decreased. Circulation was presented for redemption very rapidly and the cash reserves became so low in January that the bank's clearings could be met for only a few days. On January 8th, Mr. Jemmett and Mr. Jarvis went to New York andsaw the J. P. Morgan and Company from whom they received help to meet the clearings, while a plan was carried out for the liquidation of the bank with open doors, by the assistance of the Canadian banks. (13) It seems that those in charge made every effort to prevent the disaster. After the re-organization in May, 1907, the directors held forty-six meetings and worked hard to save the bank. (14) They all believed the bank would have come out on top and it is generally conceded that it would have survived if the times had been financially normal. However, the bank's liabilities were large; the assets were locked up and they were constantly short of cash.

Three unfortunate facts account for the cause of the failure of the Sovereign Bank. First, the rashness of General-manager Stewart, in the matter of expansion. It was very expensive opening new offices, particularly those which never paid. The second cause was the heavy loans to the two railroads. The directors also are responsible for this, for they are to blame for their negligence. Lastly, we have the financial stringency of the times which put a strain on the bank's resources and made it necessary to seek assistance in order to keep their doors open.

One of the Canadian financial journals states that "the scientific elimination of the Sovereign Bank from the active banking history of Canada, illustrates the art of unconsciously getting rid of the unnecessary. The Sovereign Bank has been very radical; it was a disturber and an innovator. It has been a fester on our banking system for the other banks were not friendly to it. In June last a million capital and all the reserve was wiped out and last week the whole thing was gobbled up by a dozen big brothers. The absorption has only been a matter of time. As an event in the financial world the liquidation of the Sovereign Bank is unique." (15)

The Sovereign Bank, as stated before, procured help from New York while a plan was formed by means of which they could liquidate with open doors. Three Canadian bankers were invited to investigate the situation and the result of their enquiry was the statement that the assets would meet all the liabilities. (16) Accordingly, on January 17th, the other Canadian banks were approached and they agreed to take over the business of the Sovereign Bank. On the following morning, as outlined, all the branches of the defunct bank opened under new names. The thirteen assisting banks guaranteed all liabilities, and a suspension was averted. The action of the board in making the indenture was approved by the shareholders at the annual meeting held March 16, 1908. (16½)

A committee of shareholders was appointed to co-operate with the board in carrying out the liquidation of the bank and the number of directors was reduced to five.

A general statement of the agreement with the other banks is as follows: (1) A cash advance of $3,750,000 for the redemption of circulation and sundry liabilities. (2) The assumption of the deposits of the Sovereign Bank, which were something over ten millions. (3) A discount of all advances made by the defunct bank to its customers except at Toronto and Montreal. (4) W. E. Stavert was appointed sole trustee for the purpose of realizing on the liquid assets of the bank. (5) J. Henderson, Assistant General-Manager of the Bank of Toronto; A. D. Braithwaite, Manager of the Bank of Montreal at Toronto; and A. Laird, Assistant General-Manager of the Bank of Commerce were appointed to act for the banks interested in the absorption. (17) (6) The following banks were concerned; Bank of Montreal, Canadian Bank of Commerce, Bank of Hamilton, Trader's Bank, Western Bank, Eastern Townships Bank, Merchants Bank, Bank of Nova Scotia, Bank of Toronto, Imperial Bank, Dominion Bank, Merchant's Bank, Bank of British North America, Royal Bank, Standard Bank and the Bank of Ottawa; sixteen in all. (18)

The Sovereign Bank liquidated as follows: (1) The deposits to be taken up by other banks. (2) $3,750,000 call loans on stock to be paid or taken up by other banks. (3) $11,120,124 commercial loans to be paid or taken up by other banks. (4) $2,000,000 bonds and stocks to be sold. (5) $600,000 real estate and premises to be sold. (6) $3,000,000 capital, to share in proportion to the amount realized from assets over liabilities.

For the present study this absorption is the important point. It is marvellous that a bank, one of a nation's thirty-four, with a capital of three million dollars and a deposit account of eleven, could give up business without any crumbling of the national financial fabric. The press did not say that the Sovereign Bank had failed but that it had simply gone out of business. Our banking system in Canada must be of the best for in no other country could this happen without a panic. The directors quietly got assistance in the matter of liquidation and the public did not know that anything was wrong with the Sovereign Bank until it was a thing of the past.

Many have attributed the failure of the Sovereign Bank to the fact that it was vitally connected with the Chicago and Milwaukee Electric Railway and with the Alaska Central Railroad. President Jarvis admitted to the shareholders at the 1908 meeting that more than two millions had been loaned to the Alaska Central.(19) In fact, the bank were the virtual owners of this road. The Chicago and Milwaukee Electric secured large loans from Mangger Stewart whenever it wished, and it was not until a million and a half had been loaned this way that the bank tried to do anything in the matter of collection. However, in-as-much as we believe this failure due to rash enterprise and to foolish loans and as these railways received only a portion of the resources of the bank that were wasted, one could not say that the bank's connection with the two railroads was the chief cause of the disaster. But at the time of liquidation much depended upon the value of these loans, as the chief assets of the Sovereign Bank.

3. H. M. P. Eckardt, the well-known authority on banking, has stated that the liquidation of the Sovereign Bank had been effected by the transfer of certain accounts to other banks.(20) The remaining accounts, comprising one million of current discounts and four million of past due bills, were not desired by the Canadian banks and would have to be liquidated by degress. The last part of this statement is very true for the liquidation of the assets of the Sovereign Bank has taken a long time. At the annual

meeting, 1908, therewere no sensational developments. The bank's liabilities, during the period from May 31, 1907 to the end of the year had been reduced from $19,492,000 to $16,174,000; and from then to July 14th, 1908, had dropped to $10,199,000, all with corresponding reductions in the assets. (21)

(22)
Bank's statement for December 31st, 1907, and May 31st, 1908
(Compared)
(Thousands omitted.)

Liabilities.

	December 31st, 1907	May 31st, 1908.
Circulation	1888	260
Deposits	11215	863
Loans (other banks)		8023
Balances due	2970	1045
other liabilities		6491

Liabilities decreased 5,975,000

Assets.

	December 31st, 1907.	May 31st, 1908.
Cash	664	3199
Deposit with Government	120	120
Notes, Checks	787	110
Bonds, stocks	2271	2562
Loans	14709	9547
Real Estate	640	700
Other assets	15	7

Assets decreased $6,167,000.

It was explained to the shareholders at the meeting held July 14th, 1908, that only $1,312,500 of the $3,750,000 cash, received from the other banks for redemption of circulation, was used. The report of General-manager Jemmett stated that the surplus over all liabilities was about three million dollars but that all of this might be lost, during liquidation. However, he thought that the bank's assets would pay off the creditors and that there would be no call on the double liability of shareholders.[23] The staff of the bank had been reduced from ~~34~~ 384 to 26 and they were steadily realizing on the majority of the assets. Mr. Jemmett showed that much depended on the bank's investments in the Chicago and Milwaukee Electric and the Alaska Central Railways. If these proved good, and the directors had every faith in the latter, there might be a return of 50¢ on the dollar to the shareholders. At this same meeting of the shareholders, a committee of three was appointed to co-operate with the board in carrying out the liquidation of the bank. The number of directors was reduced from ten to five.

In October, 1909, as a legal formality, the control of the Alaska Central Railroad passed from F. G. Jemmett, trustee for the stockholders of the Sovereign Bank, to the Alaskan Northern Railway, a new company formed for the purpose.[24] The Sovereign Bank held $2,500,000 of the $3,500,000 issued bonds of the road. This collateral had been accepted by the bank as security for the large loans made to the railway.

Liquidation proceeded very slowly. The report which was read to the shareholders at the annual meeting held July 12th, 1910, showed a profit and loss balance on the assets' side of $1,313,850.33.[25] The bank officials laid before them the story of the liquidation, placing emphasis on the most promising asset, the Alaskan Northern Railway. There was at that time no intention to call on the double liability of the shareholders. Practically nothing was done until the year 1911. The January bank statement for that year showed that the total liabilities of the Sovereign Bank were $4,204,515, and that the assets amounted to $5,735,080.[26] Realization on assets had proved slow work; creditors had become more insistent and a new phase in the history of the Sovereign Bank was soon begun.

Several litigations which took place during the liquidation of the Sovereign Bank threw some light upon the nature of some irregular proceedings which the former directors and general-manager had indulged in. Before proceeding with the last period in the history of the failure now under discussion, this diversion will prove of interest. In February, 1909, a charge was laid against W. G. Browne, late manager of the Sovereign Bank at Montreal.[27] It was based on the fact that the reports of July, August and September of 1906, showed clearly that in June, omissions had been made in both the assets and liabilities' columns. Evidence showed that during the year 1906 the head office of the bank was in Montreal and that, therefore, Mr. Browne had charge of the reports. It was proved that current loans in Canada in the June report were one million dollars too low.[28] Items under Dominion notes, amounts due agents etc., were omitted and thus a balance was retained. Both in June and in August and September, 1906, it was shown that the assets were short, $1,070,000, the exact amount of one of the large loans concerning which perhaps Stewart alone was cognizant. The magistrate in acquitting Browne said that the defendant had been deceived and was not in any sense a criminal but at a second hearing the Grand July found a true bill.[29] To a student of bank failures this evidence is important, for large loans have to be concealed in some way and this often leads the official of the bank into trouble.

As outlined previously, the bank directors, at one period, had ~~through~~ thought it advisable to purchase their own stock and to do this they had procured loans from the Sovereign Bank. In January, 1909, Curator Stavert brought in a test case against the directors of the bank to determine whether the bank was entitled to collect the amount of these notes, about $400,000. (30) In May, 1910, the action was dismissed. (31) But the Court of Appeal handed down a judgment during September, 1911, that the directors of the Sovereign Bank were liable. (32) The judge explained that at least one of the directors was guilty of a gross breach of trust and that the others should have repudiated Stewart's illegal acts. (33) They should have insisted upon a restoration ~~of~~ to the bank of the funds which had been so illegally diverted. They received loans from the bank and were nominal purchasers of the shares and accordingly were parties to the breach of trust. (34) It was held, therefore, that their overdrafts would have to be paid. This decision is important to our study for two reasons. It means that the liquidators may sue the directors for nearly half a million dollars that previously did not figure in the assets column. It also shows that directors who do not inquire into the state of things when they know their institution is in an unstaple condition, are liable to the owners of the bank. The directors of the Sovereign Bank must share in the responsibility for the disaster. They did not supervise, and, therefore, must take some blame for the manner in which the funds of the bank were exhausted.

4. Returning to the last chapter in the history of the Sovereign Bank failure, we find that many of the bank's creditors were demanding payment in the beginning of the year 1911. The liquidators decided that something would have to be done or that a call on the double liability of the shareholders would have to be made. To avoid this alternative, a new company known as the "International Assets, Limited," was formed to take over the assets of the Sovereign Bank which had failed from years before. (35) The liquidators placed the proposition before the two largest shareholders, the Dresdner Bank and the J. P. Morgan and Company, in April, 1911. They

agreed to the formation of the new company and the shareholders, at the annual meeting in July, confirmed the purchase of the equity of redemption in the assets by the International Assets, Limited. (36) (37) The shareholders of the bank bought stock at par in this new company, which was capitalized at three million dollars, the amount of the double liability.

The new organization purchased the claims of the banks which had assisted the Sovereign Bank at the time of failure. Bonds were paid for one-half of these claims and cash for the remainder. (38) For the equity of redemption in Sovereign Bank assets, one million of the stock of the International Assets was given. This deal made the new company the only creditor of the defunct bank. By July, 1911, $2,000,000 of the three million capital had been subscribed by the old shareholders of the Sovereign Bank. (39)

n The two railways, the Chicago and Milwaukee Electric and the Alaskan Northern are the chief assets of the new company. They represent over three millions of investments With regard to the Alaskan Northern, formerly the Alaska Central, 496 miles of track had been laid and great things were expected in the matter of development. The Chicago and Milwaukee Electric had for some time then been in the hands of receivers but Chicago and Toronto men united in1911 to secure control of the road. In the meantime, the receivers had gone on with the construction and operation and it was believed that it would soon have a good business. (40)

Even as this essay is being completed (March, 1913) there are statements in the daily press to the effect that 12½ percent of the stock of the International Assets has not been subscribed by the shareholders of the Sovereign Bank. This means that the sole purpose of the new company will be defeated. The assets of the bank cannot be realized on in a short space of time. The International Assets, Limited, was formed so that the liquidation could proceed slowly and to the advantage of the shareholders. This scheme has apparently fallen through and as the creditors must be met, a call will have to be made on the double liability.

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CHAPTER V11.

Three Smaller Failures.

1. During the last few years (since 1906) there have been six bank failures in Canada. Three of these were very important and had serious effects upon the business community. The failures of the Ontario and Sovereign Banks have already been discussed and a study of the failure of the Farmer's Bank will follow the present chapter. In the period 1908-1910, three less important banks had the misfortune of being forced to close their doors. The causes of these failures may not be at all similar to those which resulted in the suspension of the larger banks. In connection with the small banks we may find that the trouble was not always dishonest or fraudulent management. In the struggle for existence, the minor institution has a hard time continuing its business operations.

There was no excitement in financial circles on April 28th, 1908, when La Banque de St. Jean went into voluntary liquidation. This bank had but four branches; the head office being at St. Johns, Quebec. La Banque de St. Jean had been organized thirty-six years previous, with an authorized capital of \$1,000,000, one-half subsrcibed and \$316000 paid-up. (1) The operations were quite local for the bank was somewhat of a family affair; most of the stock being held by the president, Hon. P. Roy. It seems that just before the suspension the deposits had steadily decreased and that the funds were tied up in worthless loans. The directors met and decided it would be best to go into liquidation. A curator was appointed by the Bankers' Association and the work of realizing on the assets was started immediately. According to the curator's report, at the time of suspension, taking into consideration all the securities, there was a deficit of \$259,369 if the bank had been called upon to pay the depositors. (2) So foolishly had the resources of the bank been dispersed, that only 14 cents on the dollar could have been handed out. Half a million of assets which had figures in the returns to the Department as current loans were found to be worthless. Mr. Roy, the President, and his two managers were arrested and charged with infractions of the Bank Act. (3) They had falsified the monthly reports by including worthless securities and by generally inflating the assets of the Bank. Further investigation caused them to be re-arrested for conspiring together by deceit and falsehood and other fraudulent devices, to defraud the shareholders and customers of La Banque de St. Jean. (4) It was shown that Mr. Roy was most incompetent and dishonest. His loans were worthless and his monthly returns were mis-statements. President Roy had been the real manager for he transacted most of the large business and he is more or less directly responsible for the failure. (5) His incompetence which made necessary fraud and false returns placed him in the penitentiary. (6)

The liquidator's statement sixteen months after the failure showed that the realized assets totalled but $73,000. Loans, doubtful or bad, amounted to $631,000 and the shareholders' double liability if all collected would bring in $656,000; altogether, a total of $1,399,498. (7) The liabilities at that time were only $585,000, but it was extremely doubtful if much could be realized either from loans or double liability. The shareholders, numbering 142, nearly all held less than one hundred shares and they were in rather poor financial circumstances. Of course, there was no loss to noteholders but whether anything is paid to the other creditors (8) depends upon the success of the double liability call.

The cause for the failure was undoubtedly the incompetence and fraud of the president. As the institution was but a small one, it could not do business long under these circumstances. As for the question of remedy, both the culpable parties, the local bank and the fraudulent president, were eliminated.

2. The least important bank failure of recent years was that of the Bank of St. Hyacinthe on June 23rd, 1908. (9) The trouble was due to excessive loans to The Southern Counties' Railroad, a local railway company. This road was sold to the Delaware and Hudson Company and pending the result of a suit in this connection the bank of St. Hyacinthe ran very short of funds and had to suspend. (10) At that time the capital stock was but $331,000; other liabilities amounted to $1,182,000, and the assets were nominally $1,580,000. (11) The circulation amounting to $250,000 was promptly redeemed and a 25 percent return was made to the depositors. The result of the suit against the railway company will determine whether all the claims of the creditors will be paid. Liquidation was very slow for by November, 1909, the assets had only been reduced to $1,049,000. (12) The competition of large financial houses in Canada means the elimination of the small, local bank, and we may conclude that the Bank of St. Hyacinthe simply died a natural death.

3. The Canadian Bankers' Association were informed during the first week of March, 1910, that the Bank of St. Stephens, a small institution of one office in New Brunswick, was in difficulties. The directors had held a meeting on March 7th, and decided to place the bank in the hands of the Association. (13) A curator was appointed and an investigation commenced. There was no excitement in connection with the suspension and the depositors made no run. The St. Stephens Bank had been established thirty years previous, with an authorized capital of $200,000, all paid up. (14) The concern was very local for it had never expanded or tried to take in any outside business. The small number of 152 shareholders held the two thousand shares.

The investigation brought to light the fact that there had been no dishonesty or wrongdoing in regard to the management of the failed bank. The causes were found rather in poor business judgment and the keen competition of the big banks.

Trade was more and more diverted from the local institution and in the search for new business some imprudent investments were made. For instance, a large sum had been loaned to a western mine. The St. Stephen's Bank lost in the ~~[illegible]~~ fight for the survival of the fit.

One month after the failure the curator issued a report to the effect that all moneys received had been expended for redemption of circulation and to pay the Provincial Government deposit. A liability balance of $108,000 stood on the profit and loss account and it was announced that the $641,000 loans, which comprised practically all the assets, might not all materialize. While the losses would undoubtedly absorb the ~~xxx~~ reserve of $55,000, the double liability might not be called upon. (15) Two months later the Bank of British North America purchased the assets of the failed bank.

4. In drawing conclusions from the failures of the three banks just reviewed, we may note that no heavy loss was felt by creditors. At the time of writing liquidation had not been finished but only the depositors of the Bank de St. Jean are likely to suffer. The double liability call was only partly successful. The creditors of both the Bank of St. Hyacinthe and the St. Stephen's Bank will most likely receive payment in full. If necessary, in these cases a call will be made on the double liability of shareholders. In-as-much as fraud was present in only one case, the failure of three very small and local banks in the last few years in significant of the fact that financial operations in Canada can best be undertaken by large institutions with numerous branches. Many amalgamations have taken place lately in bank circles and this also speaks loudly of that fact. Large loans and risky business have to be undertaken in a developing country and concentrated bank capital alone can do this successfully.

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CHAPTER V111.

The Farmer's Bank Failure.

Part 1.

The Early History.

1. The last failure in the history of Canadian banking, that of the Farmer's Bank, demands a considerable portion of our attention. There are circumstances peculiar to this financial disaster which give it a prominent place in the list of bank failures in Canada. The Canadian banking system comprises thirty-four institutions, few of which are small banks. Therefore, when one of the few large banks.[1] fails in a period of comparative prosperity, it is a serious matter and an incident deserving of special attention.

In connection with the organization of the Farmer's Bank it was specifically stated in the prospectus of the provisional directors that it was a farmer's bank and that it was promoted with the idea of furnishing better banking facilities to the rural communities.[2] With this bait the promoters did their soliciting and found their subscribers among the farmers of Ontario. The class of shareholders and the amounts of the subscriptions indicated that the subscriptions represented what might be termed "ignorant money." It was the small investor who suffered and in all likelihood most of them knew nothing of the double liability. This, coupled with the facts that the amount lost to the Canadian public was large and that such a contingency might as easily happen again, make the failure of the Farmer's Bank on December 20th, 1910, a particularly black mark in the history of Canadian banking.

On May 27th, ~~1908~~ 1904, J. Ferguson, A. Fraser, J. Watson, A. S. Lown, J. Gallagher and T. Urquhart, representing the Farmer's Bank as provisional directors, received a charter authorizing them to organize.[2½] The life of this charter had to be prolonged twice in the two ensuing years before the directors and promoters could secure subscriptions for the required amount. (3) At this period, W. R. Travers, formerly of the Merchant's Bank, was actively engaged as promoter and general-manager. As the required $250,000 deposit had to be secured, the situation was becoming desperate for the directors. Abbut $211,000 of subscriptions for stock had been collected; but as organization expenses had been abnormally high, there remained a total of only $170,000 towards the government deposit while $250,000 was necessary before a certificate authorizing the commencement of business, could be issued. (4) General-Manager Travers approached the Trust and Guarantee Company of Toronto with something over $100,000 of shareholders' notes. For these he received a loan of $81,000 for thirty-five days. (5) $80,000 of this, plus the $170,000 paid-up subscriptions composed the $250,000 deposit which was presented to the Department of Finance seven days later, on October 23rd, 1905. Travers gave the Minister, Hon. W. S. Fielding, evidence that was then satisfactory, that all was in compliance with the Bank Act and on November 30th, the certificate was issued. (6) The Farmer's Bank opened its doors for business in February, 1906.

Even in this early history of the bank we find that there was trouble. From the beginning certain subscribers had noticed irregularities and had become suspicious. Many believed that they had subscribed to $1000 whereas later they discovered that $10,000 worth of stock was opposite their names. They sought to have their subscriptions cancelled but the courts refused to support the attempt. Others, who had never been even approached found that they held stock. There were several complaints and the wrongs were, in some cases, righted. A few of these men got together and secured legal advice. Mr. McCarthy, their counsel forcibly drew the attention of the Minister of Finance to the "rotten" condition of the newly-organized bank. McCarthy asked to stay the granting of the certificate but later, when the plaintiffs had been bought off and their notes returned, he withdrew his objection.[8] These facts were not laid before the Treasury Board when they passed on the Farmer's Bank certificate.[9] It appeared in the discussion in the House of Commons after the failure that two members of the legislature had pointed out to the Finance Minister that something was radically wrong in the affairs of the new bank.[10] These men had secured some hints that other than bona fide subscriptions had been introduced in the deposit to the Treasury Board. The facts that have been related show us that at the outset the Farmer's Bank was guilty of fraud and dishonesty. They evaded the law in regard to the certificate and although this was corrected later (for the $250,000 was soon afterwards subscribed,[11]) suspicion and bad business followed the Farmer's Bank right up to its failure.

2. Since the failure there has been much discussion as to the sulpability of the Finance Minister and Treasury Board as regards ~~of~~ the poor start of the Farmer's Bank. The events that transpired will be treated rapidly and then we may form our own conclusion as to where the blame must rest. Mr. Fielding, in the House on March 15th, 1911, stated that owing to several warnings he had received as to the unsoundness of the new Farmer's Bank, he had written Mr. Travers, and had received the assurance that the Bank Act had been complied with in every particular. ~~They consulted~~ Having consulted the Minister of Justice on the point, he had prepared the certificate. The day after Travers received back his deposit, the Minister received strong hints from Sir. E. Clouston, president of the Canadian Banker's Association that the money that had been lodged with the government could not be regarded as paid-up capital.[12] Some blame Mr. Fielding for not taking action, but he stated that he did not think the Department had power to revoke the certificate and to call back the cheque returning $245,000 of the deposit to Mr. Travers.[13]

Some time later the Department was again advised that not all was right with the management of the Farmer's Bank. In April, 1907, Mr. Vankoughnet, of the Milton branch wrote the Minister to the effect that the General-Manager was sending to the branches notes, in payment of capital stock, for discount and that they were to credit head office. (14) This figured in the Government returns as paid-up capital and circulation was issued to that amount. One of these notes was forwarded to the Department but beyond a promise nothing was done. Still another communication was received by the Government. Mr. Knight, Secretary of the Canadian Banker's Association, pointed out that a deposit receipt for $100,000, issued by the Farmers' Bank in its own favour was being offered for sale in New York. (15) Mr. Hotchkiss, the Insurance Commissioner of that city, wrote the Department asking for an investigation into the relations existing between the Farmers' Bank and the People's Mutual Life Assurance Company, of New York. (16) Lastly, as will be explained in another chapter, the monthly returns the Farmers' Bank handed in would havebeen a warning to a careful observer. To the financier of today, these returns speak loudly of the coming disaster, but, of course, to the Minister of Finance, at that time, they did not mean so much. Later on, the remarkable changes in the subscribed and paid-up capital will be pointed out. (17) Facts that should not have escaped the notice of the Department. In December, 1908, Deputy Minister Boville drew Travers's attention to the low proportion between the cash reserves and the immediate liabilities of the bank. Travers, as usual, had an explanation and the matter was dropped. (18) This state of affairs should have demanded the attention of both the Department and the Association. The heavy loans to directors, increasing at the same time as the deposits; the high current loans and the extra-ordinarily low call loans; and the rapid growth of over-due debts with a continued margin in favor of assets over liabilities, (19) all should have warned those responsible that something was radically wrong with the management of the Farmer's Bank. If there had been competent examination of the monthly reports, the Farmer's Bank would have been checked up shortly after it started out on its adverturous career.

Before continuing the history, it might be well to point out the relation of the poor commencement of the Farmer's Bank to its failure, and to ascertain who is culpable for this unhappy beginning. When looking back over the history of the failure, one is prone to notice every irregularity and to attach some blame. In connection with the granting of the certificate by the Minister of Finance certain things happened which make it easy to lay blame at his door, but his carelessness was by no means a cause of the failure which followed later. We must bear in mind throughout this discussion, that the man behind the trouble was General-Manager Travers. We will show in another part of the chapter,[20] that he was dishonest and of course is to be the one most severely censured. For his share in the affair, he is today serving a sentence in Kingston. More vital to our present task is the question "Whose carelessness allowed Travers' dishonesty to go unchecked?" Hon. G. E. Foster, representative for North Toronto, made a somewhat lengthy speech in the House of Commons, January 23rd, 1911, on this aspect of the problem.[21] Although, on account of difference in political views, his testimony was biased, yet there is much truth in his words. He stated that no harm could have been done before the certificate was granted. The Government, through the Department, gave this certificate. A bona fide subscription of $500,000 is required and $250,000 of this must be paid-up in cash and in the hands of the Department. He asked "Who is to judge whether or not this $500,000 is bona fide subscription and whether or not the $250,000 had been paid up and is paid in?" The Government is the judge through the operation of the Treasury Board. The Bank Act does not tie up the Treasury Board and this office is the vital one. Things must be done "To the satisfaction of the Board."(23) Affidavits from men interested should not satisfy in this case. The Government was warned several times. Continuing, Mr. Foster said that even after the granting of the certificate, since the Department had every assurance that something was radically wrong, they had power to take away the life of the Bank. The Member laid some blame also at the feet of the Canadian Bankers' Association. The latter knew of the fraudulent conditions. It was suggested, however, that they were tired trying to minimize the results of the bank failures in the past. The Monetary Times of February, 1911, states "It would have been to the credit of the Bankers' Association had their opposition been strong enough to strangle the Farmers' Bank on the day of its fraudulent birth."(24) It has been said in this connection that "The whole question is whether the Department should prevent such abuses or leave things to take their course."(25)

A logical question might be asked at this point. If the Farmers' Bank had been managed honestly from the date of certificate would the failure have occurred? In other words, what is the contribution of the circumstances of the organization of the bank, to its failure? Mr. Fielding, the Minister of Finance, stated in the House on March 15th, 1911, that although the notes of the subscribers had not been paid to the required amount, they ultimately were paid up and the bank had the cash later if not at the time of the certificate. In short, the irregularity was corrected. ✱✱ This may be true but certainly right from the beginning a handicap was laid on the bank and to some appreciable degree helped bring about those circumstances which culminated so disastrously.

3. Much has been said regarding the relation of the Farmers' Bank and

its failure to the Keeley Mines. Many, indeed, would lay the whole blame for the failure to the large investment in that property. Accordingly, a discussion of the history of the relation existing between the two institutions may profit us in our study of the failure.

Dr. Beattie Nesbitt, the first president of the Farmer's Bank, secured a loan of $25,000 from the bank in June, 1908, and paid the first installment on the property known as the Keeley Mine, the first mine discovered in South Lorrain. (26) Earlier in the year Nesbitt had procured an option on the property for $300,000. Soon after Mr. Wishart, one of the bank directors, Travers and the Farmer's Bank entered into all the benefits received by the option. (27) It was at this stage that Nesbitt was able to make his first payment on the mine. The Keeley-Jowsey-Wood Mines was formed, with Wishart President, Nesbitt Vice-President and Travers, Third Director. Nesbitt received part of the capital stock for ~~his~~ his option. (28) In December, 1908, a charter was secured and the stock placed on the market. The mine was capitalized at $2,500,000 and the shares had a par value of $5. President Wishart held $500,000; Travers, $500,000 and as General-Manager of the Farmers' Bank $1,000,000. Dr. Nesbitt had $499,995, worth of stock and a man named Ovens, the only shareholder, held one share. (29) Early in 1910, Travers affirmed that in order to be handled in the interests of the bank, he, as General-Manager would have to acquire the property and the loans to the Keeley Mine began. (30)

It is admitted that the relation of a bank with a mining proposition, no matter how good, is improper. The outcome of the Keeley Mines was so important to the Farmer's Bank that we will try and show the results of the relation. Poor management turned what was a valuable piece of property into a veritable "white elephant." The Keeley Mine was valuable and if properly run would have made good profits for its owners.(31) The fatal mistake was the installation of an expensive imported plant. Great pains were taken to secure luxurious housing for the employees. Everything that would enhance its selling power was done and thousands of dollars were sunk into the mine before a single shipment of ore had been made. The trouble was that no returns were coming in for the enormous loans. The resources of the bank were being exhausted. Although some believed that the Keeley Mines might have worked the salvation of the bank,(32) Manager Travers must have known that the Farmer's Bank would be in an insolvent condition long before any adequate returns could come from that source.

Amounts sometimes exceeding $50,000 were loaned to the Keeley Mines, until $535,000 was sunk in that company.(33) It is interesting to note that at that time the paid-up capital of the Farmer's Bank was only $564,806.(34)

The law states that advances more than $10,000 cannot be made to an institution without a special permit from the Board, but nothing was found in the minutes of the board of directors to show that anything was loaned to the mine.(35) When the bank had gone into the liquidator's hands after the failure, that gentleman's report showed that $1,156,000, or more than twice the amount of the paid-up capital, was sunk in the Keeley Mine.(36) The report also stated that the mine and bank were linked in four ways. (a) Current loans and overdrafts amounting to $321,000. (b) Call loans of $300,000. (c) A special loan of $621,000 for which $1,000,000 of the mine's bonds were held as security. (d) Stocks and bonds of $535,000. Nearly all of these relations were direct violations of the Bank Act.

We have seen that financially the bank and the Keeley Mine were practically one and the same institution. To some degree they were identical in the matter of personnel. Dr. Nesbitt, the vice-president of the mine was the president of the board of directors of the Farmer's Bank. Travers, the third director and controller of the mine by virtue of stock held, was general-manager of the bank. The two institutions were thus inseparably connected.

Some editors in discussing the causes for the Farmer's Bank failure put the Keeley Mine at the bottom of the whole trouble. To the mind of the present writer this is not quite true. Circumstances connected with the incorporation undoubtedly placed a heavy handicap on the bank right from the beginning of its operations. Through fraudulent management and imperfect supervision, it was already in an unstaple position. The heavy illegal loans to the Keeley Mine so crippled the bank's lending power that it was practically in an insolvent condition. As will be detailed in the next section, complicated conditions, arising from internal troubles due to the mismanagement of the bank hastened and it might even be said were instrumental in bringing about the failure. Yet the effect of the Keeley Mine relations must not be minimized for they put the Farmer's Bank in such a condition that, for over a year and a half, it was necessary to falsify the returns made to the Department. (37)

Part 11.

The Management of the Bank.

4. At the very outset the affairs of the Farmer's Bank were poorly managed. It has been said that the organization alone cost nearly half a million dollars. (38) The legal expenses amounted to but $1068. while $68,650 would have nicely covered what might be termed legitimate organization expenses. $42,871 was paid out as commission alone. Travers and Lindsay together received over $34,000 for disposing of stock. (39) This appears to be rather a high commission. The sum of $11,760 went to the provisional directors; a most extravagant remuneration in view of their light duties. Previous to commencing business, bills

receivable amounted to $175,830; the Union Bank had $12737 on their books against the Farmer's Bank and entirely unaccounted for was an item amounting to slightly over $100,000. (40) In all probability this last was the fund upon which frequent cheques to provisional directors and management were drawn. As has been detailed the Farmer's Bank were indebted to the Trust and Guarantee Company to the amount of $80,605. All these items, coming under the head of expenses, total up to $435,936. It is very seldom that organization expenses of a Canadian bank amount to more than $100,000. (41) The facts just presented are ample proof that right from its inception the Farmer's Bank was fraudulently managed. A bank with a dishonest management may succeed for a time but ruin and disaster nearly always await it.

Previous to the obtaining of the certificate in November, 1906, an incident occurred that nearly ended the history of the Farmer's Bank. As stated before, several of the shareholders, who found that their names had been freely used in the matter of possession of stock, secured legal ad vice and tried to have the affairs of the bank wound up. They had ascertained that the institution was being carelessly managed and they had wished to secure the amount they had subscribed. Mr. McCarthy, their counsel, warned the Minister of Finance, and asked for a stay of the granting of the Certificate. (42) Travers looked into the matter, bought off the plaintiffs (43) and after Mr. McCarthy's objection had been withdrawn, he assured the Minister that all was in compliance with the Bank Act. The certificate was then issued.

A transaction with a company of insurance men in the United States, although not carried out had a bad effect on the stability of the stock of the Farmer's Bank. Mr. Levis of Kentucky and a friend, Knabe, who had an option on the Federal Life Insurance Company of Hamilton, Ontario, wished to secure control of the Peoples Mutual Life Insurance Company of Syracuse, N. Y., and to combine the two concerns. (44)

The last mentioned company was in rather a comatose condition and presented a splendid opportunity for a good insurance man. One hundred and fifty thousand dollars was needed to buy it out. Tevis entered into an aggangement with Travers, Manager of the Farmer's Bank, for a loan of this amount. Travers was to deposit his own bank's notes in the National Bank in Syracuse until good securities could be given him. Tevis was to secure control of the People's Mutual Life, sell some of its securities and pay off the loan. In consideration for the loan, Tevis, acting for the insurance company was to purchase $100,000 of the Farmer's Bank stock at a good price. (45) The transaction was never completed. Travers and his accountant took the money over and deposited it in the First National Bank of Syracuse. Tevis and friends had not securities satisfactory to Travers and the cash was left in Syracuse for ninety days, to give an opportunity for those interested to secure adaquate securities. A deposit receipt was left in trust with the National Bank to give to Tevis when the securities were handed over. In some manner this receipt was secured by those putting through the deal and was offered for sale. One hundred and fifty thousand dollars of the funds of the People's Mutual Life Insurance Company was taken and distributed among those interested. Against this shortage on the books of the company was the deposit receipt of the Farmer's Bank. Mr. Hotchkiss, Superintendent of Insurance for New York State, caused the arrest of the directors of the Insurance Company and tried to force the Farmer's Bank to pay the receipt. Manager Travers ignored his demands and the Minister of Finance received a letter demanding an investigation. (46) The Farmer's Bank was in a strong position if the matter went to court, for the loan to Tevis was very irregular. Although this transaction did not cost the Farmer's Bank any sum of money, the Canadian press pointed out that the bank was undertaking questionable and unwise business. And the alleged obligation of the bank on a deposit receipt for $150,000 had an effect on the stock quotations. The important point for our study in connection with this transaction is the fact that Travers was willing to undertake doubtful business if he thought there was an opportunity for abnormal profits.

The relation that existed between the Farmer's Bank and the Trust and Guarantee Company of Toronto was so close that it is worthy of our consideration. The first transaction has been mentioned before. Travers lacked $80,000 of the $250,000 cash deposit which had to be in the hands of the Minister of Finance before the certificate was granted. In spite of the fact that the Bank Act states that this deposit shall be paid-up capital, (47) Travers went to the Trust and Guarantee Company to negotiate a loan. (48) He handed them as security $100,910 in Farmer's Bank notes and also tendered his personal note for $81,000, the amount of the loan. This loan was for thirty-five days, interest at ten percent. As an inducement the Trust Company received a bonus of $1000. (49) For this piece of business Travers, the President and Manager of the Trust and Guarantee Company, were all tried for hypothecating Farmer's Bank notes, an illegal proceeding. (50)

At the Lindsay trial in December, 1910, just before the bank closed its doors, the particulars of more proceedings came to light. In 1909, Travers made an arrangement with the Trust and Guarantee Company by which the Farmer's Bank could get funds from time to time to meet clearing-house obligations. For which consideration Travers handed them, as deposits, bank notes and other securities. (51) One of our financial journals stated that at one time Travers took as much as $50,000 in notes to this company. (52) This served a double purpose for it also kept these notes out of circulation. Late in 1909 Travers asked the Trust Company for $75,000. (53) He explained that the manager of one of his branches had gone over to another bank and had enticed away large deposits. For the safety of the bank he needed the money and as extra security he tendered bonds of the American Piano Company. He got the loan. The same plea was used a few months later, in

..., 1910, and on security of $1,000,000 in Keeley Mine bonds he secured ...100,000 to tide over a stringent period. (54) On this occasion Manager Morden of the Trust and Guarantee Company advised Travers to suspend for he claimed he might as well fail one day as another. (55) After the failure of the Farmer's Bank the Trust Company issued a statement to the effect that they thought that the business wax legitimate. (56) Travers came to them with good collateral and got the money he said he needed to cope with the situation of unfair competation facing him.

The history of these transactions explains that Travers and the Farmer's Bank were hard pressed to keep above water at nearly all stages of the bank's career. The one fact, that loans were needed time after time to meet clearing-house obligations, is significant and prophetic of the coming disaster; particularly when coupled with such a calamitous affair as the Keeley Mine proved to be. Several incidents of less importance may be mentioned here. Some of the officers of the bank had been dishonest, ~~nffx~~ and the resultant trials did not prove advantageous to the Farmer's Bank. This isparticularly true of the last case, during the progress of which the alarming condition of the bank was disclosed, resulting practically immediately in the suspension of payments by the institution. When Travers was placing his branches throughout the rural communities he made it a point to pick out the clever and popular farmers' sons for his managers. This brought business, but at least in two cases proved disastrous, both for the young man concerned and for the bank itself. The manager of the branch at Athens was a farmer's son and his previous knowledge of banking or financial transactions was nil. (57) He did merely as he was directed by General-Manager Travers. Some of his operations were illegal and he was sentenced to three years' imprisonment. In 1911, during the trial of Travers himself, it developed that this young man was but following directions and even at the time that this article is being written there is a movement on foot to secure the pardon and liberty of the young manager. At the time of this conviction the teller of the Athens branch was dismissed on account of some shortage and somewhat later an officer in head office was discharged for the same reason.

What proved to be the immediate cause of the closing of the Farmer's Bank's doors was the facts disclosed at the Lindsay Conspiracy Trial in December, 1910. A charge was laid, by the Farmer's Bank, against three of their employees in the branch at Lindsay.(58) It seems that they had warned customers of the unstable condition of the bank. They were informing their friends that the bank which had only $567,000 paid-up capital, had invested over half a million in a Cobalt Mine.(59) The Farmer's Bank prosecuted them for conspiracy. During the trial, the public learned of the bank's real position, and during the run that followed the Farmer's Bank suspended. Travers bitterly complained that Judge Harding of the Lindsay Trial and the press were to blame for the failure.(60) We grant that they gave the publicity which was the immediate hastening of the suspension but they have nothing to do with the cause of the failure.

Bad management of the Farmer's Bank got it into troubles of seemingly small importance, particharly financially, but they proved to be of a serious nature. To a financial concern good-will is a strong and much valued asset, while public prejudice spells calamity. The vague rumors regarding the unstable condition of the Farmer's Bank cost it the confidence of the public. The stock declined in value and speculators became timid. All felt that "hands off" in connection with the Farmer's Bank was the safest policy. This meant no business for Travers and his managers and the insolvent position, into which the Keeley Mine transactions had placed the bank, seemed to be a permanent condition. The bank could not have kept its doors open without continuing to fabricate the monthly reports to the Department. The only remaining incident in the history of the Farmer's Bank was the suspension which had to come the first time the rumors that were about were substantiated. The Lindsay Trial, although it had nothing to do with the failure, was the immediate cause of the suspension.

5. Before studying the facts and finances of the failure a glance at the manipulations undergone by some of the items in the monthly reports to the Government will prove of interest. Immediately after the suspension, several of the officers of the Farmer's Bank were charged with and tried for falsifying the returns to the Department. It appears that Manager Travers and possibly others in the service of the bank, deliberately made up these reports with the express purpose of deceiving the Government and the people of Ontario. The Farmer's Bank soon after it's inception became actually insolvent and truthful reports would have placed it in the hands of a curator. Travers, however, thinking that he might yet work the salvation of the bank through the operation of the Keeley Mine, sent in returns which led the Treasury Board and the Department of Finance to believe that the bank was doing a nice business and was in a flourishing condition. We will note the apparent stable condition the bank was in so far as the monthly government reports of the time indicated. The following are the more important items in the reports for the fourteen months previous to the suspension.

Monthly Reports of the Farmer's Bank.

Before Suspension.

(61)

(Thousands omitted)

1909	Deposits Payable on Demand.	Deposits Payable after notice	Call loans in Canada	Current loans in Canada	Circulation	Assets	Liabilities.
Oct.	248	1375	611	1014	429	2699	2090
Nov.	286	1377	616	1006	362	2676	2065
Dec.	240	1407	623	1035	326	2648	2051
Jan.	188	1395	534	1214	364	2612	1995
Feb.	254	1343	530	1181	349	2612	1993
Mar.	269	1375	496	1056	375	2687	2067
Apr.	264	1346	490	1056	338	2607	1986
May	265	1308	496	1057	416	2641	2017

June	274	1305	515	1087	396	2650	2054
July	184	1276	513	1088	472	2662	2046
Aug.	195	1280	517	1084	519	2711	2094
Sept.	213	1313	491	1087	525	2773	2153
Oct.	214	1278	489	1145	455	2670	2051
Nov.	215	1100	394	1145	429	2616	1997

From this table it will be noticed that the assets were always nicely above the liabilities and just before the doors of the bank were closed, they exceeded them by over $619,000. The facts are that, in December, 1910, when the suspension occurred, there was a nominal deficiency of $436,011.93.[62] In connection with this fact ~~that~~ the editor of a financial paper made the statement that while figures cannot lie, liars can figure.[63] Even in 1910, when the Farmer's Bank was in a very poor condition, deposits remained high in the returns to the Department. A statement was given out nineteen days before the failure that $1,314,000 was deposited with the Farmer's Bank.[64] One million, six hundred and forty-eight thousand was the high water mark for the whole of the bank's career.[65] This should have been a warning to those interested that the returns were being falsified for during the later months of 1910, subscribers, depositors and even the general public knew the bank was in poor shape. This must have resulted in withdrawal of a large amount of deposits.

At first, Travers concealed the padded accounts and losses by putting heavy valuation on certain ~~xxxxxxx~~ stocks and bonds he possessed. In connection with one transaction $75,000 cash was paid for $535,000 of Keeley Mine stock. Of the remainder of this stock, $156,000 was added to Travers's personal account and the rest was used to cover up losses.[66] Again, the $500,000 mine stock given the bank as a bonus for financing the Keeley Mine, got any value Travers saw fit. This was used to cover up losses or when necessary to present a profit large enough to pay dividends.[67] In regard to the subscribed and paid-up capital, there were some odd manipulations. Even the monthly reports show this. In the report dated October 30th, 1909, the subscribed capital was quoted at $996,000.(68) Just one year later the report for October shows decrease of 41 percent. The amount was but $584,500.(69) Why the enormous shrinkage in such a short time? The Department of Finance is to blame for not noticing this and enquiring into the cause. An interesting feature of the case is that nearly all the drop occurred in the last month, that of October, 1910.(70) One year previous to this, the capital accounts revealed peculiar transactions. For three years the subscribed capital had been normal; December, 1906, $577,600; August, 1907, $621,700; and February, 1908, $638,700.(71) But in the month of March, 1908 there was an advance of 56 percent to even $1,000,000.(72) The difference between subscribed and paid-up capital previous to this had been normal too, but in the month of the enormous increase in subscribed, paid-up capital increased only 7 percent.(73) But one year later in October, 1909, the paid-up capital jumped to $996,000, an increase of 75 percent over the previous $566,396.(74)

The cause for this was doubtless the activity of Manager Travers among several wealthy men in the United States. He evidently saw that this large amount was not going to be paid and accordingly we find reductions in November, 1909, and February and March, 1910.(75) The climax was reached in October, two months before the failure, when the paid-up capital dropped from $969,599 to $584,500, a decrease of 38 percent.(76) A significant coincidence in connection with this shrinkage is the fact that $385,000 the amount of the decrease, is the exact amount subscribed in trust by M. D. Chapman of New York.(77) In the report of December, 1909, it was stated that this man held unpaid shares but it seems that Travers had counted them as paid, in his later monthly returns. This transaction should have escaped detection and the investigation that naturally would follow.

The facts just related have an important significance. It was the dishonest statements in the monthly returns that allowed the Farmer's Bank to continue business and therefore to continue losing money. Being insolvent, it should have had to suspend operations, lest more money would be lost to the public. The glaring fact remains that this bank did business while financially unsound. What is the prevent the same thing being done again? Of what value are the monthly returns? Any of our banks of today may be falsifying the reports and hourly going deeper and deeper into a financial hole from which they will not be able to clamber out. Their intentions may be good and they may expect to put the bank on its feet again by the successful operation of one of their ventures, but money of stockholders and depositors would be in danger. There is no check on the head office of our Canadian banks and these monthly returns to the Government come from the head office. It seems that the Department of Finance are not in a position to check up these reports. They may be correct or they may not. This appeals to the writer as the fact above all others to be remembered in connection with the failure of the Farmer's Bank. The Government monthly returns are valueless in the matter of ~~firms~~ detecting internal fraud in our banks and there appears to be no check on a fraudulently inclined general-manager. → pt of thesis to reliance upon fraud for failures

Part 111.

The Suspension.

6. On Monday, December 19th, 1910, the Farmer's Bankcould not clear $20,000 of its paper at the Toronto clearing house.(78) The publicity given the affairs of the bank by the Lindsay trial started a steady withdrawal of deposits. Help from the other banks was not forthcoming and Manager Travers notified the chairman of the clearing house of the inability of the Farmer's Bank to clear. On the following morning, December 20th, the bank closed its doors and a statement was issued by Travers to the effect that due to the publicity, caused by the Lindsay Conspiracy Trial, a run had been started on the bank and that a s a consequence, so that they could prepare for the unusual demands the bank would be closed for a few days.(79)

Mr. A. B. Patterson, chairman of the Toronto clearing house, notified D. Coulson, of the Toronto district of the Canadian Bankers' Association who in turn informed the President, Sir E. Clouston. Mr. J. Knight, secretary of the Association left for Toronto and G. T. Clarkson was appointed curator. (80) The Canadian Bank Act grants a bank that has suspended ninety days as an opportunity to liquidate its debts and recommence business. (81) But hardly ever does a bank once close it's doors and three months later resume business. (82) It was soon discovered that the Farmer's Bank could never open its doors again. The curator's first statement showed a nominal deficiency large enough to warrant the appointment of a permanent liquidator.

One might well ask what was the real cause of the suspension? The run of the bank which resulted in the suspension was started by the publicity the Lindsay Conspiracy Trial gave to the affairs of the Farmer's Bank. The facts disclosed showed the insolvent condition which in turn was due to bad banking and fraudulent management. Bad banking, with the insolvent condition as its result was the real cause of the failure. We have stated before that the publicity due to the Lindsay Trial was but the immediate cause of the suspension.

7. G. T. Clarkson, who had been appointed curator by the Canadian Banker's Association ~~xxxxxxxxx~~ was made interim liquidator by the courts. (83) He went most carefully into all matters concerning the finances of the failed bank and presented the following statement, in the second week of January, 1911. (84)

Interim Statement of the Curator of the Farmer's Bank.

Liabilities.

Deposits, drafts, etc.	$1 281 774.91
Preferred claims	569 987.07
Capital Stock	584 500.00
Total	2 436 261.98

($81,688.05 of secured claims received no ranking.)

Assets.

Government Notes, specie, etc.	$140 709.23
Gov't deposit	20 250.00
Stocks and bonds	113 895.00
Surplus in Trust Co.	81 688.05
Interim valuation of current loans	241 434.84
Premises	246 172.47
Keeley Mines	1 156 100.46
Total Assets	2000 250.05

It appears from this statement that there was a nominal deficiency of $436011.93, and furthermore, if the Keeley Mine proved valueless, an additional loss of $1,156,100.46. would result. Therefore, it seemed quite probable that the deficit would amount to over one and one-half millions. This statement is quite different from that prepared by Travers a few weeks previous. In the government report of November 30th, the liabilities read $1,997,000, while the assets were quoted at over $2,616,000.(85)

The important point for our present study is that the failure of one of our banks meant a loss to the Canadian public of something between half a million and a million and a half. The value of the Keeley Mine will determine the exact amount. The stockholders and depositors, the majority of whom were of the rural communities, have lost practically all their ready money. Some of the shareholders will have great difficulty meeting their double liability. The amount of money lost to the country was large enough to warrant the thorough investigation that followed, but the fact that hurts most is that so much of it came out of the pockets of the smaller class of farmers, who when offering their savings thought that all banks were absolutely safe. A member of the House(86) voiced the sentiment of many a student of Canadian finances when he affirmed that it was a shame that a financial institution that had the trust of all was allowed to run for years with a banking oss of about $780,000 when it should never even have been allowed to commence business. He said that it had given rise to a broad feeling of unrest and he felt that the matter should be carefully looked into and the defects in our supervising system remedied.

Liquidation of the assets of the Farmer's Bank was at the time of writing, progressing very slowly. Total assets, exclusive of the Keeley Mine amounted to $213749 according to the report of Liquidator Clarkson, February 27th, 1913. (87)
Total liability of the bank amounting to $2,089,251 is divided as follows:

Liabilities, Feb. 27th, 1913.

Shareholders	$532,599
Depositors	1171,058
Circulation & Gov't deposit	373,186
Miscellaneous	21,414.

Mr. Clarkson stated that unless the Keeley Mine was disposed of to advantage, there existed no possibility of any returns being made to the depositors. (88)

8. Several events subsequent to the failure throw light on the causes of the disaster, and they will aid us in drawing conclusions as to who are the culpable parties. The trials of the officers and the agitation caused by shareholders and depositors will form the subject matter for this section. On the day after the failure W. R. Travers, general-manager, was arrested on three charges of maladministration of the bank. (89) The charges were laid for sending false bank returns to the Dominion Government, for stealing $40,000 and for making false entries in the bank's books. (90) Twenty thousand dollars bail was fixed and Travers was allowed his liberty. On the 27th of December Travers was excluded from the bank's premises by Curator Clarkson for removing papers. (91)

The former manager affirmed that they were but personal papers concerning the Keeley Mine. On January 13th, 1911, when Travers came up for trial he plead guilty to all three charges and was sentenced to six, six and five years, the sentences to run concurrently. Magistrate Dennison, when imposing sentence, said that the trouble would never have happened if there had been government inspection of head offices.[92] He said that there was no check on a bank manager except that which came under his own control.

J. H. Munro, the President of the Farmer's Bank was charged with making false returns to the Department.[93] During this trial, Fitzgibbon, Traver's accountant, who made out the returns, stated that Mr. Munro had no reason to believe the reports were false.[94] He said that the returns were correct if the valuation of certain securities was accepted. Munro was acquitted of the charge but the judge intimated that in the future bank presidents in Canada would do well to take a more vital interest in the affairs of the institution which they represented and served.[95] In this connection it has been said that Munro should have shown more strength, for he knew that something was wrong. The law said that he was not guilty but he certainly did not satisfy the moral obligations attached to a bank president.[96] There were several other trials, ~~mere~~ none of which, however, resulted in a conviction. They were the direct result of the strong sentiment that the matter of Canada's most serious financial disaster be probed to the bottom. W. J. Lindsay and Dr. B. Nesbitt were charged with conspiring to obtain a certificate from the Treasury Board, permitting the Farmer's Bank to commence business.[97] Nesbitt was also charged with making false returns. The four provisional directors were charged with conspiring to obtain $10,000 of the bank's funds.[98] Messrs. Wilson and Morden, with Travers, were tried for conspiring to give the

Trust and Guarantee Company undue preference over other creditors of the Farmer's Bank.(99) The president of the Trust Company was charged with hypothecating bank notes.(100) In connection with all of these charges, there were no convictions and they are now dropped. They show us, however, the strong feeling at the time of the failure. People felt that the culpable parties in the Farmer's Bank disaster should be brought to justice.

When the shareholders of the Farmer's Bank met after the failure, it was decided to contest the double liability.(101) Their plea was as follows. The charter was obtained by an evasion of the Bank Act. Therefore, the Farmer's Bank was not legally incorporated. Consequently the bank had no legal existence and, therefore, the double liability could not be enforced. Some of the shareholders went so far as to try and hold the Minister of Finance liable. They charged him and others in the Department with negligence.(102) Notwithstanding the protests, a few months after the failure, notices were sent to all shareholders informing them of the liquidator's ruling that the double liability must be paid.(103) There were 852 names on the list of shareholders, the great bulk being those of farmers in Ontario. Five hundred and ten shareholders have filed a defense against the claims of the liquidators that they should be placed on the list of the contributors to the double liability.(104) The Farmer's Bank Defence League, an organization of shareholders formed November 20, 1911, issued the statement that their case would go to the Privy Council before they would pay the double liability.(105)

The depositors, too, prepared to make a fight for their rights. In Toronto, on September, 25th, 1911, they formed themselves into the Farmer's Bank Relief Committee with the purpose of securing one hundred cents on the dollar for all depositors.(106) Their idea was to present the matter to the Dominion Government. They petitioned to the effect that the shareholders knew that any investment was speculative and that, therefore, they should agree to the double liability.(107)

In the meantime, there had been considerable discussion in the House as to the advisability of appointing a Royal Commission to enquire into the granting of the certificate to the Farmer's Bank. Several members of the opposition endeavored to show that the Department of Finance was guilty of gross negligence and they wished to bring those responsible to justice. The idea was to get at the origin of the trouble and to see that those to blame, no matter of what office, were punished or censured. One member claimed that liquidation alone would not be able to throw light on the question. (108) Some blame should rest on the Minister of Finance and others in the Government. He claimed that the time between the cash deposit and the granting of the cerificate was too brief and that anyway Mr. Fielding had received several warnings. For these reasons, he asked for a Royal Commission. Another member claimed that there had been a transfer of favors between the Liberal whip, Mr. Calvert and Manager Travers. (109) In March, 1911, it had been pointed out to the House (110) and to the public (111) that some one high in authority was delaying the Traver's trial. The prisoner had been carried off to Kingston Penitentiary in the midst of his trial and a reason was demanded. It was also noted that the frequent adjournments were not in the interests of justice. However, at the time of those demands, nothing was done, for the motion for a Royal Commission was defeated in the House, on March 16th, 1911. (112)

Nevertheless, later developments and a change in the Government, altered the situation. In 1910 the Conservatives in the House, for more or less political reasons, had endeavoured to have an investigation. With the advent of ~~the~~ a Conservative Government in 1911, there arose a demand from both shareholders and depositors to have a Royal Commission appointed. On February, 1912, it was announced in the House that a Royal Commission had been issued to

Sir W. Meredith, Chief Justice, empowering him to inquire into the circumstances connected with the organization and operation of the Farmer's Bank.(113) Those who suffered by the Farmer's Bank disaster felt that the time was ripe for an appeal to the Government. If the Royal Commission found that the failure was caused or influenced by the carelessness of the Department of Finance, it was thought that the Government should reimburse the shareholders and depositors.(114) In January, 1913, a memorial was prepared to be presented to the Privy Council. This memorial recites the history of the organization of the bank and sets forth many reasons why those who lost their savings in the bank should be reimbursed. The shareholders wished to be relieved from their double liability and the depositors hoped to receive their claims in full. The memorial points out that under the maxim "The King can do no wrong," the sufferers are disabled from seeking relief in the courts. It is pleaded that parliament, as an act of moral justice and clemency should reimburse the people who have suffered such great financial loss through negligence and maladministration of the Government of Canada.(115) It is generally understood that action by the Government will be determined upon the finding of the Royal Commission.

Hobbe

9. In concluding our study of the Farmer's Bank failure, we offer a discussion of the causes and remedies. All will admit that the immediate cause of the suspension was the publicity given to the affairs of the bank by the evidence taken in the Lindsay Conspiracy Trial. However, this was not one of the real causes of the failure and accordingly will not be taken account of in our conclusions. The Farmer's Bank had a poor commencement, things went from bad to worse, it reached an insolvent condition and all that remained were the circumstances that were to ~~xx~~ bring about the failure. The provisional directors had not the business capacity to secure a certificate without breaking the law and at the outset, by reason ofthe expensive organization,

putting the finances of the bank in an unstable position. Some of the shareholders and others became partially cognigant of the instability and the confidence of the business public was gone, a most severe loss. To redeem the bank from its poor condition, all the assets were sunk in the Keeley Mine. This concern proved of no value and the bank was in a state of insolvency. The monthly reports were falsified, the condition was kept a secret and the doors of the bank remained open. The Farmer's Bank continued in its disastrous career until an incident disclosed its condition to the public and the inevitable run and suspension followed. There was nothing in the financial condition of the time to cause a failure. The trouble was peculiar to the Farmer's Bank. The causes, briefly put, were as follows:- The illegal securing of certificate, the loss of public confidence, the expensive organization, the dishonesty of the management, the poor banking ability and dishonesty of Manager Travers, the negligence of the directors and lastly the carelessness of the Department of Finance and the Canadian Banker's Association, neitherof which, it seems, perceived that the Farmer's Bank was robbing the people. All these causes are more or less responsible for the failure. The one that contributed most to the disaster, was ~~xxx~~ undoubtedly the dishonesty of Manager Travers.

So much has been said regarding the negligence of the Finance Minister and the Department in regard to the issuing of the certificate of the Farmer's Bank that it is only fair to quote from the report of the Royal Commission which was handed to the press a few days before this essay was completed. Sir William Meredith, when dealing with the granting of the certificate to the bank, said: (116) "There is, in my opinion, no grounds for supporting the contention that any improper influence was used to induce the Treasury Board to give the certificate, or to induce the Minister of Finance to recommend the granting of it. The most that can properly be charged against the Department of Finance is an error of judgment." Dealing with the general question as to the reasons for the failure of the Farmer's Bank, the commissioner said.(117) "Notwithstanding the irregularities on the part of Travers, and his misconduct in connection with the application for the certificate, the evidence satisfies me that if the bank had been prudently and honestly managed, there is no reason why it should not have succeeded. While it is true that if the certificate of the Treasury Board had not been granted, the money of the shareholders and depositors would not have been lost; the efficient cause of that loss was the recklessness and fraud of those entrusted with the management of the bank and not the granting of the certificate. The subsequent management of the affairs of the bank was characterized by gross extravagance, recklessness, incompetency, dishonesty and fraud, and has resulted in the entire loss of the paid-up capital, and the whole of the deposits, and, after allowing for all that can be extracted from the shareholders on their double liability there will be a loss amounting to no less than $1,866,437, making a record unparalleled in the history of any bank in Canada." In passing, we might remark that the finding of the Royal Commission makes it extremely doubtful that the Canadian Government will make any endeavor to recompense the sufferers of the Farmer's Bank.

10. It seems superfluous to fix the responsibility for a calamity that is a thing of history and one which has been thoroughly investigated by the proper authorities. There are many who deserve censure for the Farmer's Bank Failure but we must bear in mind the fact that the dishonest manager was directly responsible for the failure and although some must share with him, they are blameworthy in the most part for allowing Travers to continue his fraudulent proceedings. Manager Travers is to blame for his unique method of selling stock,

for the expensive organization, for hypothecation of bank notes, for heavy, illegal loans to the Keeley Mine, for stealing from the bank's funds and for falsifying the monthly returns to the Government. The provisional directors and the Department of Finance should receive some blame for the procedure by which the certificate was secured. The directors and president of the Farmer's Bank are to be severely censured for not keeping themselves in touch with the transactions of the institution over which they had control. The heavy loans should have been stopped. The false returns and other illegal deeds should have been checked up with firm hands. The employees of the bank ~~xxdxx~~ would have done well to have reported the irregularities to the Bankers' Association or the Minister of Finance. Lastly, the Department of Finance are culpable for not keeping a careful watch on the monthly returns.

The remedies for the difficulties peculiar to the Farmer's Bank disaster will best be treated in the following chapter on the Bank Act Revision of 1913.

References.

1. According to the Report of the Chartered Banks for June 30th, 1909, there were only five banks with less paid-up capital than the Farmer's Bank, but that institution operated largely over Ontario and the effects were more serious than if it had been a local bank.

2. Monetary Times, Vol. 46, p. 1019.

2½. Monetary Times, Vol. 46, p. 1019.

3. Lennox, H.? House of Commons, May 2nd, 1911.

4. Fielding, W. S., House of Commons, ~~Mayxxxxxxx1911x~~ March 15th, 1911.

6. Laurier, Sir W., House of Commons, Jan. 19th, 1911.

7. Monetary Times, Vol. 45, p. 2616.

8. Foster, G. E. House of Commons, March 15th, 1911.

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10. Sir W. Osler and D. Henderson. Foster, G. E., House of Commons, March 15th, 1911.

11. Fielding, W. S., House of Commons, March 15th, 1911.

12. Monetary Times, Vol. 46, p. 615, and Lennox, H., House of Commons, May 2nd, 1911.

13. Fielding, W. S., House of Commons, March 15th, 1911.

14. Monetary Times, Vol. 46, p. 615.

15. Monetary Times, Vol. 46, p. 615.

16. Foster, G. E. House of Commons, Jan. 23rd, 1911.

17. Chapter V111, Part 11, Sec. 5.

18. Monetary Times, Vol. 46, p. 615.

19. Chapter V111, Part 11, Sec. 5.

20. Article 10.

21. Foster, G. E., House of Commons, Jan. 23rd, 1911.

23. V. 53, C. 31, S. 15.

24. Monetary Times, Vol. 46, p. 929.

25. Toronto, Mail and Empire, January, 1911.

26. Toronto Globe, Aug. 26th, 1911.

27. Monetary Times, Vol. 46, p. 316

28. Monetary Times, Vol. 46, p. 316

29. Monetary Times, Vol. 46, p. 421.

30. Monetary Times, Vol. 45, p. 2614.

31. Financial Post, January, 1911.

32. Editor, Financial Post, December 10th, 1910.

33. Monetary Times, Vol. 45, p. 2514.

34. Report of the Chartered Banks of the Dominion of Canada, June 30th, 1909.

35. Curator's Report, January, 1911. Quoted Monetary Times, Vol. 46, p. 318.

36. Monetary Times, Vol. 46, p. 214.

37. Loans to the mine had grown excessive in June, 1909.

38. Monetary Times, Vol. 46, p. 720.

39. Monetary Times, Vol. 46, p. 721.

40. Monetary Times, Vol. 46, p. 720.

41. ~~Monetary~~ We do not wish to make the statement that organization expenses are generally less than $100,000 for it is very doubtful if any but the organizers know the real cost. However, more than $100,000 is hardly ever taken from subscriptions to capital for the early expenses.

42. Foster, G. E., House of Commons, March 15th, 1911.

43. Foster, G. E., House of Commons, March 15th, 1911.

44. Foster, G. E. House of Commons, Jan. 23rd, 1911.

45. Foster G. E., House of Commons, Jan. 23rd, 1911.

~~46. Bank Act, 53 V., C. 31, S. 15.~~

46. Foster, G. E., House of Commons, Jan. 23rd, 1911.

47. Bank Act, 53 V., C. 31, S. 15.

48. Monetary Times, Vol. 46, p. 729.

49. Monetary Times, Vol. 46, p. 729.

50. Bank Act, 53 V., C. 31, S. 139 and 140.

51. Monetary Times, Vol. 46, p. 1019.

52. Monetary Times, Vol. 46, p. 1019

53. Foster, G. E., House of Commons, Jan. 23rd, 1911.

54. Foster, G. E., House of Commons, Jan. 23rd, 1911.

55. Monetary Times, Vol. 46, p. 828.

56. Monetary Times, Vol. 46, p. 831.

57. Monetary Times, Vol. 45, p. 2618.

58. Monetary Times, Vol. 45, p. 2615.

59. Monetary Times, Vol. 45, p. 2614.

60 Monetary Times, Vol. 45, p. 2615.

61. Reports of the Farmer's Bank to the Government from October 1909 to Nov. 1910.

85. Report of the Chartered Banks of the Dominion of Canada, November 30th, 1910.

86. Foster, G. E., House of Commons, Jan. 23rd, 1911.

87. Toronto "Star" February 27th, 1913.

88. Toronto "Star" February 27th, 1913.

89. Monetary Times, Vol. 45, p. 2618.

90. Monetary Times, Vol. 46, p. 248.

91. Monetary Times, Vol. 45, p. 2730.

92. Monetary Times, Vol. 46, p. 315.

93. Monetary Times, Vol. 46, p. 430.

94. Monetary Times, Vol. 46, p. 529.

95. Monetary Times, June 5th, 1911.

96. Monetary Times, Vol. 46, p. 2257.

97. Monetary Times, Vol. 46, p. 315.

98. Monetary Times, Vol. 46, p. 1115.

99. Monetary Times, Vol. 46, p. 1115.

100. Monetary Times, Vol. 46, p. 729.

101. Monetary Times, Vol. 46, p. 1144.

102. Monetary Times, Vol. 46, p. 829.

103. Monetary Times, Vol. 46, p. 2017.

104. Monetary Times, Vol. 47, p. 1934.

105. Monetary Times, November 20th, 1911.

106. Monetary Times, Vol. 47, p. 1423.

107. Monetary Times, Vol. 47, p. 2057.

108. Henderson, D., House of Commons, March 15th, 1911.

109. Sharpe, S., House of Commons, March 16th, 1911.

110. Aylesworth, Sir A. B., House of Commons, March 8th, 1911.

111. Monetary Times, Vol. 46, 1015.

possible only where there is no competent supervision. ~~Hxxxxxxxx~~ Herein lies the key to the situation. Negligence is attributable to the directors of each of the Ontario, Sovereign and Farmer's Banks. Presidents and directors must no longer be of the "dummy type" but must be held responsible for conditions over which they may have control. The failure of directors to exercise their powers as regards inspection of head office and managerial activities should be a criminal offense.

In connection with the three failures now under discussion, the evidence showed that in each case the monthly returns to the Department of Finance were falsified. This permitted the banks to continue their disastrous career. It is generally conceded that a check upon a fraudulently inclined manager can be secured by inspection either by Government, Bankers' Association, stock holders audit, or some other outside accountants, Which of these four is the best is a problem for another study. The by-laws of the Canadian Bankers' Association might be altered so as to secure a more elaborate and comprehensive monthly report. Regarding the suggested reform of outside inspection, we quote from a well-known banker. (1) "Most if not all of the failures since 1896, were fraudulent and it is now plainly evident that a few hours' examination by a skilled banker would have disclosed an insolvent condition in any one of these banks, years before it collapsed."

The enormous loans made by the Sovereign and Farmer's Banks could not have taken place if there had been competent inspection, either by directors, with a sense of responsibility, or by careful auditors. Nor would a manager of the McGill type be permitted to gamble on the stock market.

Moreover, the case of the Farmer's Bank makes necessary a tightening up of the regulations governing the establishment of new banks. Institutions must not be born so easily as was the Farmer's Bank. A point worthy of notice is that none of the three large failures in late years have been due to lack of business. We live in a rapidly growing country and any bank working along sound banking principles has a splendid opportunity to succeed. The Sovereign Bank suffered because of lack of public confidence but only after it's precarious position had become known. The purchase of a bank's own stock, a practice indulged in by the directorate of the Ontario and Sovereign Banks, could be made impossible by the external audit, This last habit is a particularly pernicious one in that it hurts the efficiency of the double liability provision.

2. In the light of a study of remedies for bank failures, of the last period, the 1913 Revision of the Bank Act, is most interesting. On July 1st, 1911, the charters of all the Canadian banks expired but as this was during the period when the investigations into the failure of the Farmer's Bank were in progress, the Government decided to extend the charters for one year and at the expiration of that time to revise the act. Accordingly, the decennial revision did not take place until the session of 1912 - 13. The Finance Minister, the Hon. W. T. White and his committee had the findings of the then past investigations at their command. We note in the present bill the influence of the failure's of not only the Ontario and Sovereign Banks but also of the Farmer's Bank. According to the new bill, the Finance Minister will be able to have the bank returns verified by a special auditor appointed by the shareholders and paid by the Government. More minute and more elaborate returns to the shareholders and to the Government will be required. Some claim that this external audit is a step towards government (2) inspection, but a well-known banker claims that this last is impracticable. (3) The auditor will be independant of the board of directors and will be held accountable by the Government. Under the new Bank Act, the chance of false statements and illegal transactions passing unchallenged will be small. The new bill positively states that directors and officers of a bank which has been mismanaged, can be punished ~~xx~~ not only for intent but for proven negligence.

Regarding the question of organization, a daily paper (4) states: "The attention of the Government has been fixed upon the necessity of providing further securities against incompetence, recklessness or fraud on the part of promotors and conductors of banks. In the new bill Mr. White adds to the Government responsibility in the matter of protecting the public in the premises. Provisional directors will be kept within close limits as to expenditure and new banks will not get their certificates until they have satisfied the new, more stringent requirements." Those who framed the revision put in this portion of the clause because of the Farmer's Bank experience.

In conclusion, it seems that the new Bank Act, as outlined in the Bill now before the House, (5) will make it improbable that any Canadian bank will suffer loss because of a fraudulent general-manager. The monthly reports to the Department of Finance, can be no longer falsified without those guilty running a serious risk of being detected. These returns will be more elaborate so as to better disclose a bank's financial condition. In future a new bank will have to pass a severe examination before a certificate, authorizing it to commence business, will be issued. Lastly, we will have a very important improvement. A bank's directors who do not take their office seriously, and who are guilty of negligence will be prosecuted in the criminal courts. If the Canadian Bank Act of 1901 had assumed the shape of the present Bill one would have no hesitancy in declaring that the Ontario, Sovereign and Farmer's Banks would be doing a flourishing business today. In short, the 1913 Revision, in the light of recent failures, is an important step towards making the Canadian banking system as near perfect as possible.

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CHAPTER X.

Conclusion.

To conclude the study of bank failures in Canada, we will note the tendency to concentration, as shown in the failure of many small banks and in the amalgamations of the last few years, the general causes for failures in Canada, the amounts lost to noteholders and depositors, the success of the double liability, and the circumstances peculiar to the liquidation of Canadian banks.

1. There were twenty-seven chartered banks doing business in Canada during the year following Confederation. For two decades there was a tendency to increase banking facilities by creation, for we find in the year 1889 that there were forty-one banking institutions.[1] For the next twenty-two years there was a complete reversal of policy. Canadian banking business was being more and more operated by a few large houses with numerous branches. Due to failures and amalgamations, chartered banks in Canada numbered in 1911 but twenty-seven. After the year 1886, the first charter to be granted was in 1890, but the institution that received it never commenced operations. From then until 1901, not a single bill for the incorporation of a new bank passed the House.[2] Regulations governing the organization of new banks are more severe than in the early history of the Dominion. On account of these regulations it is extremely unprofitable for an institution to be opened if it intends to do merely a small, local trade. The banking facilities desired in Canada can be offered most successfully by the large bank with its many agencies. Since 1908 there have passed the House several bills authorizing new banks to prepare for business and for this reason we have in Canada today smaller institutions than we would find in the normal situation. Notwithstanding this fact, there are only

(3)

five banks with a paid-up capital of less than $1,000,000. There have been a comparatively large number of bank amalgamations of late and the fact that the practical bankers of the country, realize that their interests will be served by the conjunction of capital and other forces, strengthens our theory.

not what is argued

2. So much has been said about dishonest managements and fraud that one would think that dishonesty was the prime cause of the bank failures in Canada. This might be true in the United States where defalcations by officers are common, but after a hurried ~~xxx~~ study of the Canadian failures the conclusion ~~xxxxxxxxxxxxxxxx~~ ~~xxxxxxxxxxxxxxxx~~ we arrive at is that incompetence concerning the matter of the use of lending resources has been the first cause of trouble. Generally speaking, fraud is present merely for a concealment of the insolvent condition. In the period 1867 to 1881 there were seven failures. Five of these banks were poorly managed and during the season of financial stringency they were forced to close their doors. Over ambition was the prime cause of another while fraud was responsible in only one case. If we glance back at our conclusion for the period from 1881 to 1888 we note that five out of six disasters were directly attributable to recklessness in the matter of the business undertaken. Poor business connections were the causes of the other bank failures of this period. Between 1893 and 1905 four banks, all with a large number of bad loans, closed their doors. Dishonesty was present, to an appreciable degree, in only one case. In connection with the later failures, we note that La Banque de St. Jean had an incompetent management. In this instance fraud was a second cause. The Bank of St. Hyacinthe lost in the ~~fxxxx~~ fight because of excessive loans while the Bank of St. Stephens failed because of the size and character of its business. Speaking of the failure of the Ontario Bank we note that, although there were no unwise loans, the cause of the disaster was primarily the improper use of the banks resources. Bad loans were the real causes of the Sovereign and Farmer's Banks' disasters. True, there were other causes. Ambition, in a most reckless form, was responsible for the unwise loans of the Sovereign Bank. Fraud

to a large extent was present in connection with the Farmer's Bank, but it was the unwise loans to the Keeley Mine that first placed the bank in an unstable position. If a few large mercenary borrowers fail, the loss to a bank is a direct one, as in the case of the Bank of Yarmouth, in 1905. Dishonesty can be concealed for a time but if a bank has its resources tied up in poor loans, it has difficulty in meeting circulation and depositors' demands. Bank failures in Canada, in the first place, have been due to injudicious banking, particularly in the matter of excessive loans. Minor causes were fraudulent management and depreciation of securities in a time of general stringency.

3. Bank note circulation in Canada is conceded by all to be safe. The bank circulation redemption fund has worked so successfully that notes of a bank pass at par even months after the bank itself has suspended and closed its doors. Before legislation made it impossible for a holder of a Canadian bank note to suffer, two banks were unable to redeem their circulation in full. The noteholders of the Banks of Acadia and Liverpool lost a total of $165,552. (4) The depositors of Canadian banks have not fared so well. During the period 1867 - 1881, $125,000 was lost to those who had their savings in banks that were forced to suspend. (5) The Banks of Acadia and Liverpool paid nothing to the creditors and the Mechanic's Bank was able to refund only 57½ percent. From 1881 to 1888 depositors lost $1,559,000. (6) The Exchange, Maritime and Central Banks paid 66⅔, 10 3/5, and 99 2/3 percent respectively to the creditors. La Banque du Peuple and La Banque Ville Marie, the two French institutions that failed in the 1893 - 1905 period were unable to pay their creditors in full. The former paid 75¼ percent but La Banque Ville Marie were able to pay their depositors only 17 cents on the dollar. Deposits amounting to $2,484,000 were unpaid in this period. (7) The results of the failures after 1906 are not altogether certain but it is believed that of the three less important banks only the depositors of La Banque de St. Jean will suffer. The creditors of the Ontario Bank were paid in full. The debts of the Sovereign Bank

will be paid if the liquidator's call on the shareholders is successful. The depositors of the Farmer's Bank will receive nothing unless both the Keeley Mine and the call on the double liability are in some degree successful. Altogether the depositors of Canadian banks have lost something over five million dollars.(8) Ten of the twenty-three banks, whose failures we have studied, were unable to pay their depositors in full.

4. The result of the calls upon the double liability of shareholders will be noted briefly. Three of the seven banks of the 1867 - 1881 period could meet all liabilities with the assets in hand. The call on the double liability was partially successful in the case of the Metropolitan Bank but the shareholders of the Banks of Acadia and Liverpool were unable to aid in the payment of creditors. Between 1881 and 1888 three calls were made on the double liability of shareholders. One was well responded to while the other two were partially successful. La Banque du Peuple, of the 1893 - 1905 period, operated under a Royal charter and the shareholders had only a single liability. In one instance the unaided assets paid all creditors, while in the two cases where the call was made partial success was the result. Two of the small banks that failed after 1906 were creditably wound up without the aid of the shareholders, but only a fair amount was received as a result of the call to the holders of the stock of La Banque de St. Jean. The shareholders of the Ontario Bank, all paid their double liability, and although little has been done yet regarding the Sovereign and Farmer's Banks it is likely that in the former as well as the latter that the shareholders will have to make up a deficit before the creditors can be paid. Summing up the results of the twenty - three failures after Confederation, we find that in thirteen cases the shareholders were asked to pay the double liability. After three failures, this call was well responded to, and it was only partially successful in connection with six banks. Twice, nothing was received from the shareholders and in two more cases the result is still doubtful. On the whole, calls upon the double liability have been met with only a fair degree of success.

5. Whatever else may be said of the manner in which the majority of bank failures in Canada have been handled, it must be admitted that the freedom from panic marking such events has been remarkable.(9) Canadian banks, when they have ~~xxxxxxxxxxxxxx~~ been forced to suspend, have gone about liquidating their debts in such a business-like manner that the public today has every faith in the banking system of our country. If a bank is in an insolvent condition, aid is nearly always forthcoming from the other banks. The Exchange Bank, the Federal Bank, the Commercial Bank of Manitoba, La Banque du Peuple, the Ontario Bank and the Sovereign Bank all received aid either to clear their paper and pay deposits until some arrangement was made as to their disposal or received help in the matter of liquidation. The assets of the Bank of Liverpool, the Consolidated Bank, the Bank of London, the Bank of St. Stephens, the Ontario Bank and the Sovereign Bank were all purchased by financial institutions, so that liquidation could be proceeded with immediately and to the advantage of the owners. The facts of the suspensions of the Ontario and Sovereign Banks show clearly that the Canadian banks would like to see all failed institutions liquidate quietly with open doors.(9½) These circumstances strengthen the view concerning the solidarity and unity of the Canadian system. When a time of financial depression and a crisis comes they act in self-defence both quickly and effectively. In times of stress our banking system bears up well under the strain. The failure of the Sovereign Bank may be cited as an excellent example. "Aside from street chatter; aside from the question of scientific elimination, the fact remains that, having to fail, it closed it's doors in a quiet, business-like way."(10)

Canadian banks are always ready to aid each other in times of need. As this essay is being completed, the daily press give us an excellent example of this fact.(11) On March 5th there was a run on the Montreal City and District Savings Bank. It was not known how it originated but two millions of dollars were paid out in one day. No securities were sold. The simple fact was that the deposits more than equalled the withdrawals. Other banks and the Provincial Government had come to the aid of the institution in distress and had placed in its vaults sufficient gold to overcome the difficulty. Confidence was restored and business soon assumed a normal aspect.

There have been many bank failures in Canada but we don not think that this is a criterion by which to judge the value of the Canadian system. The banks that have closed their doors have been more or less the smaller institutions. The Canadian banks are today large, strong houses with activities spreading over the whole Dominion. One or two unhappy investments will not jeopardize their financial stability. Supervision and inspection will soon be so thorough that fraudulent methods, on the part of an officer, will be unable to escape detection. Competition has exposed weak, careless and untrustworthy management; failures have meant a tightening up of the regulations under which our banks must operate and it has been shown that Canadian banks are ready to stand by one another in a period of stringency. We repeat that in spite of the failures that have taken place, the Canadian banking system is in an extremely healthy condition. It is doubtful if a bank failure will ever again threaten the peace of the financial community, for the closing of a large Canadian bank's doors is now a thing of the past.

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3. Report of the Chartered Banks of the Dominion of Canada. Feb. 28th, 1911.
4. See Reference 25, Chapter 111.
5. Monetary Times, February 22nd, 1908.
6. Monetary Times, February 22nd, 1908.
7. Monetary Times, February 22nd, 1908.
8. In this total $1,000,000 and $100,000 are the probable losses to the depositors of the Farmer's Bank and La Banque de St. Jean.
9. Editor, Monetary Times, May 2nd, 1908.
8½. "To liquidate with open doors." The ordinary business of the bank is not carried on for no new business is undertaken. Circulation is redeemed and the assets are realized upon under the old name and often under the old management.
10. Editor, Monetary Times, May 2nd, 1908.
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