

BANK INSPECTION: THE NECESSITY FOR EXTERNAL EXAMINATION

Published @ 2017 Trieste Publishing Pty Ltd

ISBN 9780649739400

Bank Inspection: The Necessity for External Examination by H. C. McLeod

Except for use in any review, the reproduction or utilisation of this work in whole or in part in any form by any electronic, mechanical or other means, now known or hereafter invented, including xerography, photocopying and recording, or in any information storage or retrieval system, is forbidden without the permission of the publisher, Trieste Publishing Pty Ltd, PO Box 1576 Collingwood, Victoria 3066 Australia.

All rights reserved.

Edited by Trieste Publishing Pty Ltd.
Cover @ 2017

This book is sold subject to the condition that it shall not, by way of trade or otherwise, be lent, re-sold, hired out, or otherwise circulated without the publisher's prior consent in any form or binding or cover other than that in which it is published and without a similar condition including this condition being imposed on the subsequent purchaser.

www.triestepublishing.com

H. C. MCLEOD

**BANK INSPECTION: THE
NECESSITY FOR
EXTERNAL EXAMINATION**

BANK INSPECTION

The Necessity for External Examination.

SECOND EDITION.

copy of individual
H. C. McLEOD, *1871*

1909.

RECEIVED
LIBRARY

The first edition of this pamphlet was printed on 15th November, 1909, and copies were sent to the general managers of Canadian banks. A conference of bankers followed, from which a faint hope was indulged that the bankers would go on record in favor of some effective system of inspection. This hope led to withholding the pamphlet from general distribution pending action by the Canadian Bankers' Association at its meeting on November 25th, 1909. A motion that the substance of the suggested amendment to the Bank Act (see page 37) should be adopted as a recommendation to the Finance Minister, did not receive other support than to be referred to a committee quite out of sympathy with inspection from without. The pamphlet is therefore presented to legislators, to bank shareholders, and to the public generally. Facts are the best arguments, and even bankers opposed to the scheme of external inspection herein suggested admit that the arguments presented are unanswerable. I ask careful perusal, unbiased judgment, and independent action.

H. C. McLEOD.

TORONTO,
November 26th, 1909.

327780
5. 6. 36.

1000

1000

1000



BANK INSPECTION.

ANNOUNCEMENT has been made that the Bank Act will be revised during the present session of Parliament. This, therefore, seems an opportune time to give some extended consideration to the desirability of adopting in Canada government inspection of banks, or the independent audit of banks by other means. I have long been convinced of the needfulness of independent examination, and advocated its adoption at the last decennial revision of the Bank Act. The weakest point in the Canadian banking system is the lack of any check on the direction and general management, and to this defect failures are mainly due. The government examination of the United States, and the independent audit of Great Britain and other countries, in effect investigate the conditions under which each bank is governed. The supervision of banks which is advocated is not experimental: in one form or another it is in vogue in countries transacting more than three-fourths of the business of the world.

On the 22nd of November, 1906, the *Globe* published an article over my signature urging external examination of banks.¹ That article called attention to bank failures in Canada, which were twenty-five per cent. in number within the preceding twenty-five years, while in the United States even an imperfect system of examination had reduced failures to five per cent. The article, although generally commended by the public, called forth criticism by some bankers opposed to external examination. Sir Edward Clouston in his annual

1. The letter appears in the appendix, page 27.

address, of 3rd December, 1906, to the shareholders of the Bank of Montreal said :

“ During the last quarter of a century, by failures of banks
 “ which could be organized under our present banking laws,
 “ the loss to depositors has been under \$750,000. The
 “ noteholders, of course, have lost nothing. I speak only
 “ of banks that could be organized under our present Acts.
 “ Other banks during that period failed, involving loss to
 “ both depositors and noteholders, but they were acting
 “ under old charters, and under conditions which do not
 “ now exist—in one case there was no double liability.
 “ Out of the twelve banks that have suspended since 1880
 “ five only could obtain charters under our present system.”

Of the banks in existence at the commencement of the period mentioned by Sir Edward Clouston, some were organized under Provincial charters with smaller capitalization than the Canadian Bank Act requires ; some were eligible to be organized under the present Act ; all were permitted to do business under the Act. A number of each kind failed, not for the reason of size, but on account of the quality of the management, which in all cases was reckless, in most cases fraudulent. If it be argued that small banks are more prone to disaster than large ones, the low percentage of failures in the United States, where the banks average very small in comparison with Canadian banks, gives increased weight to my contention. With capable management a bank of \$200,000 capital is not more liable to disaster than a bank of \$2,000,000 capital: the one must be content with a small circle of operation; the other must avoid the temptation to reach out with the dash and daring that in too many instances, for want of restraint, has resulted in menace and wreck. Splendid examples of banks that started with

exceedingly small beginnings may be cited from the list of active Canadian banks. Without prudent management capital is short lived: lack of prudence, which often progresses to fraud, is what external examination should disclose.

Sir Edward Clouston seemingly intimates that statistics of failures in Canada that take in the eighties are too remote. Investigating the period, 1893-1909, it is found that at the beginning there were thirty-nine banks, not under suspension, reporting to the Government; nine new banks have since commenced business, making forty-eight in all; ten have disappeared through mergers, and nine, or about nineteen per cent. of the whole, have joined the "majority," leaving at present twenty-nine banks in active operation. I say "majority" advisedly, for investigation shows that in the history of incorporated banks in British North America the list of failures exceeds in length the list of institutions active in 1909.¹ To claim that our present system has an effective restraining influence on bank management is to argue against the statistics, and to urge a virtue in the Bank Act that experience shows is wanting.

In respect to the claim that less than \$750,000 was lost to depositors by banks entitled to organize under the present Act, it is worthy of note that, although joint stock banking in Australia was commenced in 1816, up to the bank crisis of 1893 depositors in Australian banks had been wholly free from loss.² In that year the Australasian banking crisis culminated, with liabilities of suspended banks exceeding in

¹ Mr. Coulson's remarks at the annual meeting of the Bank of Toronto, January 9th, 1907, are interesting. (See appendix, page 35.)

² Mr. Cork's paper of 1894 on the crisis of 1893: "It had been the proud boast of Australians up to this crisis that no creditor of an Australian bank had ever lost by the banks."

volume the aggregate liabilities of all suspended companies and firms during any financial crisis that has ever occurred within the British Empire. I shall again refer to this crisis.

As early as 1875 the audit of banks was a subject of discussion in Canada. I quote from an article of that time : " Now, the only way in which an examination of a bank with " branches could be carried out would be by a simultaneous " audit at all points on the same day." Strangely enough, the same argument is the most prominent to-day; despite the audit of all the banks in Great Britain, in Australia, in Switzerland, in Austria and in Russia. In Germany the subject of bank audit is now under discussion. The branch banking system prevails in all those countries, some banks having more than twice as many branches as any bank in Canada. If there be any Canadian bank of which a fairly clear insight cannot be obtained by intelligent auditors within a week, by examination at the head office alone, that bank's system is out-of-date, and a chartered accountant's assistance might not be amiss for the purpose of improving it. In our investigation of the causes of failure of banks operating branches, we have not found one instance in which failure was due to bad management at the branches. The general management is always at fault, and the directors are frequently involved. There is almost no other history of the cause of bank disasters in Canada, and the same appears to be true of other countries having similar systems of banking. We have no record of fraudulent failure in which the vicious conditions existing could not have been readily detected by an expert at the head office of the bank. The assumption that a simultaneous inspection of every office is necessary to an efficient examination of a bank's condition