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AND THE
CONSTITUTION OF EARLY CANADIAN BANKING

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This is a work in progress. Aspects of the topic may be incompletely developed and interpretations debatable. All comments, suggestions, criticisms, objections, reinterpretations, denunciations, etc. would be much appreciated, including references to sources that may have been overlooked.

IMPERIAL REGULATION AND THE CONSTITUTION OF EARLY CANADIAN BANKING

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Although there were transitory changes in the number and operations of banks, the nature of the Canadian banking system showed remarkable persistence from the middle of the nineteenth century through most of the twentieth century. Where did the unique style of Canadian banking come from?

Although there may have been deeper roots in the charters of the original Scottish chartered banks, it is well documented that the initial Articles of Association and subsequent charter of the Bank of Montreal (1822) and the charters of the other early Lower Canadian banks (the Bank of Canada (1822) and the Quebec Bank (1822)) were adaptations of the charter of Alexander Hamilton's Bank of the United States (Jamieson 1953, p. 4; Denison 1966, pp. 54-88; Shortt 1986, pp. 26-28).[1] This institutional transfer not only provided the starting point, it set the pattern for Lower Canadian banking through the 1830s. The influence of Hamilton's charter on Upper Canadian banking is not as obvious. Although there were elements of Hamilton's concept in the early Upper Canadian banks but there were also important differences. The Bank of the United States was built on conservative commercial banking principles and operated to impose a type of monetary and banking discipline on the other banks in the American system (Hammond 1957, pp. 197-226). Early Upper Canadian bankers envisaged a less cautious approach. Particularly in the 1830s, there was an indigenous drive for radical banking reform that could have produced a polyglot banking system in the contemporary American pattern. This did not happen in part because of the opposition, at times apparently vacillating and uncertain, of the Treasury. However, in the early 1840s the two banking systems were merged and, with some important exceptions, set in the pattern envisaged by the Treasury. The purpose of this essay is to review this little explored aspect of Canadian banking history.[2]

I. The Colonial Constitution

In the period that we are considering, the Canadian constitution was a British law, initially the Constitutional Act of 1791 (for Lower and Upper Canada) and subsequently the Union Act of 1840 (for the united Province of Canada) (UK 1791; UK 1840). The constitutions established bicameral legislatures with an elected Legislative Assembly and an appointed Legislative Council, empowered to legislate for "peace, welfare and good government". As effective administration required, an Executive Council (Cabinet) was also

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[2] Shortt reviews the reform movements and has some discussion of the role of the British government (Shortt 1986). Somewhat more attention is devoted to Imperial regulation by Breckenridge but the exposition is incomplete (Breckenridge 1910). See also (Neufeld 1967, pp. 87-90)

appointed by the Governor (a British appointee) and the locus of responsibility of the cabinet, to the Governor or the Assembly became a matter of serious contention. In any case, the Canadas were colonies and this status constrained Canadian governments in the formulation and implementation of economic policy, including banking policy.

Several provisions of both constitutions were important. Conditioning the controversy that ensued was an explicit limitation on the scope of possible Canadian legislative action on the major instrument of economic policy, the regulation of Canada's international trade whether by customs duties or prohibitions. The Canadian government was permitted to levy customs duties for revenue purposes but the power to impose them or other provisions "for the regulation of navigation, or for the regulation of commerce" was explicitly reserved to the British Parliament "… for the general benefit of the British Empire." Although there was no such explicit provision, the implication was that policies that related only to "internal and local affairs" were the province of the local government -- and this was the interpretation asserted by Canadian legislators and implicitly acknowledged by the Imperial authorities. At issue was whether banking was "internal and local" business.

Three other constitutional provisions were also of critical importance. First was the requirement that for any act, passed by both houses of the colonial legislature, to become law required Royal Assent signified by the signature of the Governor -- and Royal Assent was not a mere formality. The Governor could, and on occasion did, withhold his signature, reserving the bill "for the signification of her majesty." Such reserved bills were sent to London where they were reviewed by the Colonial Office and possibly other relevant departments (in the banking cases the Board of Trade and the Treasury). A recommendation through the Privy Council to Her Majesty could result in approval or disapproval, but for Royal Assent to be effective it had to be granted within two years. Inaction or delayed action could nullify the legislation. More pernicious in its potential consequences was a second provision that any act signed by the Governor and in good faith implemented in Canada could nonetheless be nullified by the British government within two years of the date on which it was received in London. Without a negative response from London within the two years, bills that bore the governor's signature became law. The third provision was that the Governor's actions in assenting to or reserving bills were to be governed not only by his assessment of the provisions of a bill but also by ",,, such instructions as may from time to time be given in that behalf by his Majesty …." The Colonial Office instructions to the Governor, both those issued at the time of his appointment and those issued at irregular intervals later, were extensions of the Canadian constitution, specifying laws or provisions of laws that could not be enacted without explicit reference to London. Unfortunately, they could not always be known in advance, were changeable and in some degree subject to interpretation -- not interpretation by an independent court but by the same body that issued them. Potential Imperial control over Canadian legislation was comprehensive (Swinfen 1970).

The stipulations regarding the reservation of colonial acts involved negative intervention. They constrained the actions of the provincial government. Apart from the provisions regarding customs duties, the constitutional acts did not provide for positive intervention by the Imperial government to establish economic policies applicable to Canada except in matters that were regarded as part of the Royal Prerogative including the chartering of corporations to engage in economic activities in the colonies. This provided a method by which positive intervention could occur. It was employed in 1837 to provide charters to the banks of Lower Canada when the Legislative Assembly was dissolved without renewing their charters and in 1840 to incorporate the Bank of British North America an institution of considerable importance in the early history of Canadian banking.

Thus, in the 1830s and 1840s the governments of the Canadas did not have all of the sovereign powers normally associated with a nation state. However, as time passed there was a gradual accretion of the powers over economic institutions and policies. The struggle over Imperial regulation of banking was an important part of that process -- part of a process that led to local control over important instruments of economic policy.

II. Pre-Union Commercial Banking

Prior to the union of Upper and Lower Canada each colony had its own system of commercial banking. Three banks had been chartered by the government of Upper Canada: the Bank of Upper Canada in Toronto, the Commercial Bank of the Midland District in Kingston and the small and relatively new Gore Bank in Hamilton. Similarly, there were three banks with indigenous charters in Lower Canada: the Bank of Montreal and the City Bank in Montreal and the much smaller Quebec Bank in Quebec City. Until the mid-1830s all of the important commercial banks were incorporated by charters issued by the colonial governments. By the mid-1830s, however, other firms engaged in commercial banking. A number of unincorporated banks -- commonly called private banks -- were operating in each colony and one large bank, the Bank of British North America, with a charter from the British government was operating branches in both colonies.

For the purposes of chartering and regulating banks, the two colonies -- and hence their banking systems -- were legally separate and distinct. Geography, however, dictated a different reality. Quebec and Montreal were the seaports for all of Canada and customs duties were collected there. Money follows trade. Banknotes, drafts, bills of exchange and specie regularly flowed in both directions, up and down the river, as merchants paid for goods and settled with customs authorities and banks collected on maturing bills of exchange and settled their financial obligations. A market existed in Montreal for the notes of the banks of the other province in which "internal rates of exchange" were determined. There were also a well established foreign exchange market and a nascent securities market. Montreal had become the financial centre not just for Lower Canada but for all of Canada and the Bank of Montreal had emerged as the dominant institution in the city and, indeed, although not without challenge, in all of Canada.

III. Imperial Regulation of Bank Charters in the 1830s

In England in the 1820s, 1830s and 1840s the formation of a corporation with limited liability was a special privilege obtainable only by Royal charter or special act of Parliament. Both methods were "…

expensive, cumbersome in procedure and uncertain of success" (Shannon 1931, p. 358). Apart from the Bank of England, which had a special charter but was as much a commercial bank as a central bank, commercial banks operating in England (as opposed to Scotland, the colonies or foreign countries) could not have limited liability (Crick and Wadsworth 1958). Initially, all English commercial banks apart from the Bank of England were "private banks" (single proprietorships or partnerships) and until 1826 they could have no more than six partners. In 1826 joint stock banks with transferable shares and an unlimited number of shareholders were permitted but only outside a 65 mile radius around London and all shareholders had unlimited liability (Crick and Wadsworth 1958). Although the prospects for unincorporated banks were thus improved, the Bank of England's unique position in the banking system was carefully protected and in a sense expanded in that the 1826 legislation affirmed its right to open branches, which it did in competition with the private and joint stock banks. Nonetheless, joint stock banks appeared in great numbers in large and small towns throughout England. By 1844 there were 100 joint stock banks and 273 of the old style private banks outside London (Crick and Wadsworth 1958, pp. 17-22).[3] In that year the 65 mile constraint was lifted but joint stock banks operating within the 65 mile circle could not issue banknotes and those outside the circle had their note issues frozen (Crick and Wadsworth 1958, pp. 24-25).

In this context, the willingness of the British authorities to ratify the establishment of incorporated commercial banks in the Canadas is interesting. In the material that I have reviewed, the Board of Trade and Treasury officials did not reveal their reason for accepting the principle of colonial bank charters (however, had their insistence on double liability for shareholders been enforced it would have more or less vitiated the "limited" in limited liability). Perhaps chartered commercial banks in Canada were tolerable in part because the Canadas were areas in which the Bank of England did not operate, in which it did not aspire to operate and in which its notes did not have wide circulation.[4] There was no Bank of England quasi-monopoly to protect. Probably more important was a recognition that in a capital-scarce frontier economy incorporation was helpful in encouraging investment in banking and hence the adequate capitalization of banks. In this the authorities may have been persuaded by the apparent undercapitalization of many of the private and joint stock country banks in England and their consequent vulnerability to macroeconomic fluctuations (Crick and Wadsworth 1958, pp. 15-24; Collins 1988, pp. 82-83). The officials may well have contrasted the experience of the English unincorporated banks with that of the large, well capitalized chartered banks in Scotland where the stability of the chartered banks was in sharp contrast with the instability of Scottish (as well as English) unincorporated joint stock and private banks (Crick and Wadsworth 1958, pp. 366-394). They may have been concerned about the danger of the proliferation of undercapitalized private banks in Canada if incorporated

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[3] The number of old style private banks had actually fallen considerably from 554 in 1825 s a result of amalgamations and failures (Crick and Wadsworth 1958, p. 20). Collins gives an even larger number (650) of private banks in 1825 (Collins 1988, pp. 52-53).

[4] Although they must have had some circulation, I find no references to the circulation of Bank of England notes in the contemporary literature. They probably would have had greater circulation if the pound sterling had been adopted as the monetary standard as the Treasury at times urged.

banks were denied   In any case, the *principle* of Canadian legislatures issuing corporate bank charters was not challenged by the colonial authorities. The *content* of such charters was another matter.

Although Colonial legislatures could initiate bank charters, like all legislation bank charters required Royal Assent. Moreover, among colonial laws bank charters were particularly sensitive because of the banks' money creating powers. A certified copy of the colonial act was forwarded by the Governor to the Colonial Office in London which then sent it to the Board of Trade and the Treasury. At the Treasury, the matter was brought before the Lord Commissioners of the Treasury for consideration, a process that often took months. Both agencies reported back to the Colonial Office who then had to make a recommendation through the Privy Council to the Queen (which was always adopted) to grant or withhold Royal Assent and report back to the Canadian government through the Governor. With respect to colonial bank charters whether the Treasury or the Board of Trade had priority was a matter of contention. The Board of Trade regarded colonial bank charters as its province with both the Colonial Office and the Treasury in advisory capacities and this formality was usually maintained in presenting regulations to the colonies (PRO(3), Dec. 23, 1843, pp. 350-353). Nonetheless, from the mid-1830s it was clearly the Imperial Treasury that was the critical agency. They were very aggressive in reviewing colonial banking legislation and, with one exception, in the material that I have examined its recommendation was always adopted.[5] In effect the Treasury had a veto over granting Royal Assent for colonial bank charters although at times its primacy was questioned by officials in the Colonial Office who also protested against its dilatoriness (see below, p. 23).

Several banks were incorporated by Canadian legislatures before the Treasury became engaged in the issue. The first one successfully chartered by a Canadian government was the Bank of Kingston in Upper Canada in 1819.[6] It was given Royal Assent without prior reference to London and the Colonial Office did not object, but the bank was unable to raise the necessary capital and so could not launch its banking business. Nonetheless, from our perspective the chartering of the Bank of Kingston was significant. If it did not set a precedent, at least it established the expectation that the chartering of banks would be considered a "local and internal" policy, free of substantial intervention by Imperial authorities. This expectation must have been reinforced as the charter of the Bank of Kingston was soon followed by four others that did result in operating banks: in Upper Canada, the Bank of Upper Canada (1821) and in Lower Canada, the Bank of Montreal, the Quebec Bank, and the Bank of Canada (1822).

The charters of the first Upper Canadian banks were relatively simple and their provisions fell far short of what were to become the basic elements of Imperial banking policy. The terms of the charters were long

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[5] The one exception concerned provisions of the charter of British North America. See below, p. 30

[6] In a sense it was the second bank. A charter for the Bank of Upper Canada had been passed in 1817, reserved and sent to London where, after a long delay, it was approved. However, notification of the approval did not reach Upper Canada until after the two year time period had expired and so the Governor was unable to give it Royal Assent (KC 1819a). A new bill was enacted in 1819 but, because of a provision permitting the provincial government to become a shareholder, it was again reserved. Thus, the Bank of Kingston had priority.

and not uniform (27 years for the Bank of Upper Canada, 24 years for the Commercial, and when it came along in 1835, 25 years for the Gore); time limits for subscribing and paying up capital were vague; shareholder liability was single; small bills were not prohibited; the penalty for a 60-day suspension of specie payments was suspension of banking operations for the duration, not forfeiture of the charter; a prohibition on paying dividends out of capital was implied but not explicit; reporting requirements were minimal and the content of reports was not specified. The lack of a reaction from London about what were to become contentious provisions suggests that a coherent Imperial policy on colonial banking had not yet been formulated.

A. The Mauritius Regulations (1830)

The story of active involvement by the colonial authorities in the chartering of Canadian banks began in far off Mauritius. In 1830, faced with a proposal for a chartered bank in Mauritius, the Board of Trade drew up regulations that "… would tend to promote the commerce and general prosperity of the Mauritius or of any other of H.M.'s Colonies in which individual Capitalists might be willing to undertake such establishments" (Patriot 1833b). The 1830 regulations involved only three principles:

- *A real bills definition of banking* : "…the funds of the bank should not be employed in Loans or advances upon Land or other property not readily convertible into money … but be confined to … Advances upon Commercial paper or Government Securities, and general dealings in Money and Bills of Exchange." The provision ruled out not only lending on real estate but also trading in goods (other than gold and silver).
- *Double liability* for shareholders to provide protection for the creditors of the bank, including the innocent banknote-accepting public.
- *Financial reporting* to shareholders and government: "… the bank should make up and publish for the information of the proprietors general half yearly accounts …" and "… should be at all times liable to furnish to the Governor … on his requisition, similar accounts."

The Mauritius regulations were sent to Canada and in July 1833 the Governor sent them to the legislature and to the presidents of the Bank of Upper Canada and the Commercial Bank (Patriot 1833b). They were said to be motivated by a concern to prevent those charters from impairing "…. the security of the public and to prevent fluctuations in the amount and value of paper money" (Patriot 1833b). Although, the Mauritius regulations were too late to affect the bills that had been passed in 1832 to incorporate the Commercial Bank and augment the capital of the Bank of Upper Canada, the Treasury soon intervened with even more demanding regulations.

B. The First Treasury Intervention (1834)[7]

With one major exception -- it did not include permission for the provincial government to invest in the bank's shares, the section that had induced the Governor to reserve the Bank of Upper Canada Act in 1821 -- the Commercial Bank's charter was a scaled down version ($400,000 of capital vs. $800,000, 10 Directors vs. 15) of the 1821 charter of the Bank of Upper Canada to which Royal Assent had been given.[8] Following precedent, in February, 1832, the Governor gave Royal Assent to the charter of the Commercial Bank and to the bill to increase the capital of the Bank of Upper Canada but the Imperial authorities had two years from the date the acts were received in London to disallow them. The charter of the Commercial Bank, like the charter of the Bank of Upper Canada on which it was modeled, violated all three of the Mauritius regulations. Although the charter prohibited "… buying or selling any Goods, Wares or Merchandise or commodities whatsoever…" (except gold and silver), the real bills principle was not stated as the guiding principle for banking operations. Indeed, the charter seemed to open the door to loans on "Lands, Tenements and Hereditaments," giving the bank power to hold properties "…bona fide mortgaged to it by way of security …," a clear infringement of the real bills principle (KC 1832a). The charter did not impose double liability on shareholders and on the reporting side it required only a once annual report "if required" by the legislature. There was no provision for inspections of the books on demand of the governor at his initiative.

In January, 1834, almost two years after he gave Royal Assent to the bills, the Governor received a dispatch from London with revisions that the Treasury wanted to be made in the charters of *both* the Commercial Bank and the Bank of Upper Canada even though this would have implied reopening the 1821 charter of the Bank of Upper Canada that still had 14 years to run.[9] Quite explicitly, the dispatch was an

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7 In 1831 the Lower Canada act to incorporate the City Bank was disallowed. The issue in this case, however, was not the banking provisions of the act but the inclusion of what had been a standard clause in bank charters prescribing the death penalty for embezzlement or for the possession of plates for the counterfeiting of the bank's notes. The Imperial authorities objected to the severity of the penalties, which were contrary to the recently reformed British criminal code, and to the inclusion of such penalties in commercial legislation for the protection of a particular firm. They asserted that such penalties, if they were to be enacted at all, properly belonged in the criminal code, not in a bank charter (Patriot 1833d).

8 All values were originally expressed in pounds, either sterling or currency, the official unit of account in the Canadas. I have converted all values to dollars, the common medium of exchange, at the official exchange rates: £1 sterling = $4.867 and £1 currency = $4.

9 Lurking in the background was the relentless crusader against banking monopolies (among other colonial evils), William Lyon Mackenzie. He went to England in 1832 on behalf of Upper Canadian reformers and devoted over a year to remonstrating with the Imperial authorities about the reform movement's grievances concerning the governance of Upper Canada (Kilbourn 1956, pp. 85-97). In one of his letters published in his newspaper, the Colonial Advocate, Mackenzie proudly announced that because of his efforts the Imperial government had decided to disallow both acts.

> *That His Majesty's Council has disallowed these acts is a fact on which you may place the most implicit dependence; and the people of Upper Canada ought to be for ever grateful to the Crown for this especial mark of its wisdom and goodness. I may be told that it is an act of interference with our domestic legislation. So it is: and such acts of interference must and will and ought to continue so*

elaboration and expansion of the Mauritius regulations and was the first serious Imperial intervention in Canadian banking policy. (Patriot 1834c). Some provisions should apply to both banks:

- *The real bills principle* should govern banking operations. Neither charter contained this provision
- *Weekly balance sheets* should be prepared and be available for inspection by the governor and a half yearly statement presented to the Legislature and published in a local newspaper. The charters called for an annual statement.
- *Forfeiture of the bank's charter if specie payments were suspended* for more than 60 days. The charters required only that business be suspended for the duration of the suspension of convertibility.
- *Banknotes to be convertible to specie* at the head office and at the branch from which they were issued. The charters were silent on this.
- *Restrictions on loans to directors* and prohibitions on the bank owning its own shares or lending on the security of its own shares. The restriction on loans to directors was not in the charters but the prohibition of lending on the banks own shares was.

Some provisions should apply to the Commercial Bank but only to the new shares of the Bank of Upper Canada:

- *Double liability* on shares. The charters prescribed single liability.
- *Half the subscribed capital to be paid up* and if not paid up "to be called for forthwith." The Bank of Upper Canada's original capital was fully paid up so the regulation only applied to the new shares. The Commercial's charter required only $160,000 subscribed and $40,000 paid up, 10% of a potential capital of $400,000, for the bank to open. By 1834 both banks had easily satisfied the Treasury's regulation.

The dispatch indicated that the acts were being reviewed in light of the new regulations but that decisions had not yet been reached on whether they would be disallowed. In response, the Bank of Upper Canada did nothing but, although the time for disallowance had almost expired, the directors of the Commercial Bank panicked. Fearing that their charter would be disallowed, they petitioned the legislature for a new act that would almost conform to the Imperial regulations (Patriot 1834d).[10]

The Treasury's threat of disallowance is puzzling. The long delay in reacting to the acts inevitably meant that disallowance would be retroactive. Both banks had implemented their acts. The Bank of Upper Canada had opened subscription books for its new capital in August 1832 and by December, 1833, had raised $330,000 of the allowed $400,000 (Ridout 1832a; Baskerville 1987). For this bank, double liability was to apply to the holders of the new stock only, creating two classes of shares and shareholders: holders of the original shares who would have single liability and holders of the new shares who would have double liability

long as our Legislature is liable to be unduly influenced to do these things which might bring ruin on thousands of the population (Advocate 1833a)

The British Treasury would have heartily endorsed the defense of Imperial intervention but Mackenzie's assertion proved to be incorrect. That he could make the assertion in May, 1833, following what he described as his "ample opportunity to state my objections" to the charters, suggests that a long and possible rancorous debate went on in the British bureaucracy because the Treasury's concerns were not committed to paper until October 30, 1833 (and, as noted in the text, did not reach Canada until January 1834). Kilbourn, in his biography of Mackenzie, erroneously states that the charters were disallowed (Kilbourn 1956, pp. 92-93).

[10] The directors were willing to meet all of the provisions except that calling for the preparation (although not the publication) of a weekly balance sheet to be available for the Governor's inspection (Patriot 1834d).

(even though they had subscribed to the shares without such a provision). The editor of the Patriot shrieked such a change " … is too contemptible for criticism" and went on: "The Lords of Trade must not be permitted to meddle with our money concerns. They will be more likely to make ten fractures than mend one" (Patriot 1834e). The Commercial Bank had begun raising capital in mid-March, 1832 (Harper 1932a). By mid-1832 it had sufficient capital to commence business and by December 1833 it had over $360,000 paid up all on shares that carried single liability (KC 1832c; MG 1834e). It is interesting to contemplate what the courts, let alone the new shareholders, would have thought about the retroactive application of double liability had the Treasury proposal been adopted.[11] The threat of disallowance was clearly unsupportable, politically if not legally. However, the implied threat aggravated an already tender political situation in the colony and gave rise to a rancorous debate in the Legislative Assembly, not about the substance of the Treasury regulations but about "… the interference of his Majesty's Government" with their "internal and local affairs" -- what one editor called "… the puerile meddling of the Lords of Trade" (CG 1834a; Patriot 1834e; Patriot 1834f). The strong reform sentiment in the chamber was echoed in harsh words directed at the Imperial authorities. It is reported that one member, with echoes of the prelude to the American revolution, asserted that the Imperial action

> *… was inconsistent with those sacred principles which are essential to a free Government, that persons who are governed should have a voice in the making of those laws in respect to which their obedience is required. …. (T)hey cannot be considered as a free people if laws are imposed upon them to which they do not freely give their consent through the constitutional medium of representatives chosen by and accountable to themselves (CG 1834a; Patriot 1834f).*

Another added "The Home government had no right to interfere in their local affairs and it was their duty to set their faces against dictation" (CG 1834a; Patriot 1834f).

The Legislative Assembly was defiant. The revised charter for the Commercial Bank was rejected by vote of 23-11 and a strongly worded memorial to the King, protesting the Imperial interference, was adopted, including many of the same strong phrases quoted above. (CG 1834b).[12] In the event, the charters were not disallowed. The Imperial authorities could not accept the risk of financial and economic disruption and the

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[11] It was probably because of potential legal complications that the Treasury proposed to apply double liability only to the new shares of the Bank of Upper Canada. In the case of the Commercial Bank, disallowance of the initial charter and the implementation of a new one would probably have eliminated technical legal problems but the bank would presumably have had to permit those who had already subscribed to shares to void their contracts.

[12] The legislature proposed the theory that the only legitimate use of the disallowance power was to prevent the colonial legislature from enacting laws "… which are incompatible with treaties between Your Majesty's Government and foreign states or with the just rights of any other of Your Majesty's Colonies" (CG 1834b). In reporting that the acts would not be disallowed, the Colonial Office at the same time reaffirmed the right of the King to disallow such legislation (""… a prerogative, which he always exercises with reluctance") "founded on experience in other Colonies." The Colonial Secretary went on "… and I trust that the language employed by the legislators on this occasion can only be attributed to temporary excitement on a deeply interesting question" (C&A 1835a).

associated political consequences that would follow from the disallowance of the charters of sizable operating banks (Correspondent 1835).

C. Early Bank Charters in Lower Canada[13]

Compared to those of the Upper Canada banks, the 1822 charters of the Lower Canadian banks, like that of their American progenitor, were conservative. Nonetheless, had the later Treasury regulations been in effect, their charters would have been deemed defective. On one central issue, the nature of banking operations, they almost conformed to the Imperial standards. They adopted the real bills principle -- but with an equivocation. The banks were not to

> *… directly or indirectly, deal in anything except Bills of Exchange, Discounting on Notes of hand or promissory Notes …; gold or silver bullion, or in the sale of stock (i.e. merchandise) so pledged an not redeemed ….(and) … on no account shall money be lent on Mortgage, hypothêque, or upon Land, or other fixed Property."*

This was the Imperial rule, but in the bank charters there was the equivocation. A bank

> *… may take and hold Mortgages, hypothêques on real property … by way of additional security for Debts contracted to the said Corporation (LC 1821a)*

As the Treasury later observed, this opened a back door to a portfolio of illiquid mortgages contrary to real bills banking.

The other defects were less subtle. It was boldly announced that " … the Notes of the Corporation shall be payable in gold or silver coin, current by the laws of this Province" but no penalty was prescribed for a suspension of convertibility. To avoid certain conflicts of interest on the part of directors they were prohibited from acting as private bankers while serving as directors but there was no restriction on loans to directors. Similarly, there was no prohibition against the bank holding its own shares or lending on the security of its shares. There was provision for reporting "from time to time" at the request of the government but clearly the banks had in mind reporting once per legislative session. The onerous preparation of weekly balance sheets for inspections on demand was not contemplated. Finally, the bank charters did not impose double liability on shareholders.

The Lower Canadian bank charters were for 10 years (vs. 27 years for the Bank of Upper Canada and 24 years for the Commercial Bank), The charters of the Bank of Montreal and Quebec Bank expired in 1831 (the Bank of Canada had fallen by the wayside) but by then the 1930 Imperial regulations had not yet been sent to Canada and so were not an issue in the charter renewals (MG 1830a; QM 1830a; QM 1830b; MG 1831a). The new acts simply extended the original charters with amendments. Most of the amendments were technical details such as voting rights, election of directors the form of the report to the government etc., but the acts also provided for an increase in the banks' capital. There were two amendments that had future regulatory implications. First, as a result of widespread hostility to banks in the Assembly the renewals were

[13] In reviewing the charters of the early banks in Lower Canada I explicitly examine only that of the Bank of Montreal. In the essential provisions, the other bank charters were substantially the same. (LC 1821a; LC 1821b; LC 1821c). The Bank of Montreal charter is reprinted in (Neufeld 1967, pp. 53-67)

for a short period only (Denison 1967, pp. 246-274).[14] Second, the right to issue notes in denominations less than $5 had become a central issue in the debate over the Bank of Montreal's new charter (MG 1830a; QM 1830a; QM 1830b). The issues raised were the same as those of concern in England (see below, p.24) but do not appear to have been presented by the Governor on behalf of the Treasury. Rather, the controversy seems to have had local roots but with reference to debates then ongoing in England.[15] In any case, the upshot was a restriction on the right to issue small notes in both charters. Notes of denominations less than $5 were limited to 20% of the bank's total circulation and notes of denomination less than $1 were prohibited.

The short terms of the 1830-31 charters had interesting consequences. Anticipating a hostile (and perhaps paralyzed) legislature in which renewed bank charters would probably not have been approved, the banks applied to the Imperial government on an emergency basis for interim Royal Charters. When the charters expired the banks briefly operated as private, unincorporated associations. After a perfunctory review by the Treasury (and no objections) the requests for Royal charters were approved. This was a demonstration of another instrument of Imperial intervention in Canadian banking (see below, p. 30). However, it was used not to reform the system but to preserve the status quo. Faced with a minor crisis, the Treasury approved Royal charters that did not meet the Imperial regulations. Following the dissolution of the government of Lower Canada and the appointment of a Special Council to manage the province's affairs, the Bank of Montreal applied for a new Canadian charter that was but a minor revision of the earlier version. The Quebec Bank applied to the Council to extend the Royal Charter, effectively turning it into a Canadian charter. Both were regarded as interim measures, awaiting resolution of the constitutional issues facing the Canadian provinces and their probable unification. Unfortunately, the discussions in the Special Council were not reported so we do not know what issues were raised. However, the outcome was an extension of the status quo.

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[14] The charter of the Bank of Montreal was renewed in 1830 while that of the Quebec Bank in 1831. The new charters of both banks (and that of the new City Bank) expired in 1837.

[15] In 1826 the Montreal Herald printed an editorial on the question of small note circulation, replete with mixed metaphors. The central message was:

> *The danger to which the circulation of small notes exposed the Currency of the Country (England) has long been a topic of discussion and reprobation among political economists. The shoals of these notes issued yearly came over the Currency like a blighting mildew, and might be compared to Goths and Vandals destined to over-run the gold and silver Currency of the country. The present misfortunes are a great political lesson which it is impossible to overlook …. (Herald 1826a)*

Despite these strong words, however, the editor was "… not prepared to state whether the same rule applies to this country" and concluded that

> *Our bankers know best whether some modification of the measures pursued at present in England with respect to the currency would be attended with many advantages in Canada.*

The bankers must have bought a lot of newspapers but were not without a conflict of interest. They were unlikely to willingly sacrifice a major part of their circulation and source of profits.

D. The Glenelg Circular (1836)

Following an 1835 act to incorporate the Gore Bank, Upper Canadian legislators must have thought that they had won a constitutional victory. The charter seriously violated the new Imperial banking policies. It allowed very a small capital for the bank to open, did not require closure of the bank in the event of suspension of convertibility, had minimal restrictions on loans to directors and did not require periodic reports on the bank's financial condition (Glenelg 1836b; UC 1836d). In his dispatch to the governor, the Colonial Secretary spelled out the act's many defects, defects that impaired the "security of the public" sufficiently to deny confirmation if the decision was based on "… none but considerations of commercial policy…." However, the Imperial authorities did not recommend disallowance. Rather, the Colonial Secretary stated that he did not want to act against the judgment of the Provincial Legislature given "the importance which, in the Province, is attached to … confirmation (UC)."[16] Was banking now to be regarded as a "purely local" matter, the exclusive province of the government of Upper Canada?

The apparent constitutional victory was short lived. Seeking to avoid being again placed in the awkward position in which Imperial policies called for the disallowance of an act relating to currency or banking that was already in force, with probable serious ensuing financial consequences, in August, 1836, Lord Glenelg, the Colonial Secretary circulated an important new instruction to Governors:

> *… you will not permit any Act … to come into operation … relating to the local currency, and circulating medium, or to the rates at which coins should pass current, or be a legal tender, or to the circulation of promissory notes, or other papers, either by the local Government, or by any corporate bodies, or individuals, without having first received His Majesty's sanction…. (Glenelg 1836a)*

The instruction was presented as a measure to protect the Commissariat, the British government agency responsible for managing the financial affairs of the British Army in Canada, from the vicissitudes of changes in official exchange rates. However, it cast a wide net. The provision relating to the circulation of promissory notes by "corporate bodies" clearly put at risk the legislature's unfettered ability to charter new banks and some legislators also feared that inclusion of "other paper issues" extended similar controls to provincial debenture issues

When the Glenelg dispatch was presented to the Legislative Assembly in mid-December, 1836, it provoked another rancorous debate on the role of the Colonial office in the governance of Canada (Patriot 1837a). A resolution critical of Imperial policy was adopted (although it was much less abrasive than the

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[16] There were similar problems with a companion act to increase the capital of the Commercial Bank which was also confirmed. However, the Imperial government's willingness to allow the Upper Canadian government to set its own course on internal financial affairs was clearly limited. Just prior to confirming the two offending bank acts, the Imperial Government disallowed another act for the incorporation of the Upper Canada Life Assurance and Trust Company (Glenelg 1836c). Primary among several concerns were the inherent conflict among its several financial functions and the incapacity of the Upper Canadian legal system to deal with abuses that might arise. This is a different set of issues than those raised in the bank cases but again represents the Imperial government attempting to safeguard the interest of the general public of Canada rather then the broader interests of the Empire.

earlier one) requesting repeal of the edict.[17] In the mean time the Governor was asked if he interpreted the regulation as requiring him to reserve all bank acts (UC 1836/37a). His affirmative reply put Upper Canada's banking reform program in jeopardy (UC 1836/37a, p. 286).

IV. Upper Canada's Abortive Struggle for Alternatives to the Status Quo

The preeminent historian of early Canadian banking, Adam Shortt, characterized the 1830s as "one of the most exciting and abnormal periods in Canadian political and financial history." (Shortt 1986, p. 830). What was 'abnormal" and "exciting" was in part the monetary turmoil that surrounded the international financial crisis of 1836-37 including the suspension of convertibility in both provinces, in part the political turmoil that followed the rebellions of 1837 and in part the spirit of reform that dominated discussions of both political and financial affairs. The political reform movements and the rebellions had powerful effects on political institutions. The financial reform movements had a much less pronounced effect on the banking system.

In the early 1830s each of the chartered banks had a virtual monopoly in its district. Although some banks had an agency in another centre, there were many communities without resident banking institutions. In Lower Canada, as noted above (p. 10), hostility to banks among legislators briefly endangered the survival of chartered banking. In the rapidly growing Upper Canadian economy, despite rapid monetary expansion, there were incessant complaints about "tight money" and the unavailability of bank credit. That monopoly power and shortages of bank capital and banking offices were retarding economic development, both province-wide and locally, was a matter of gospel to reform politicians. Both banking monopolies and banking lacunae were contentious issues providing fuel for both banking and political reform. Complaints and demands for easier credit and more diverse collateral were particularly strong from the dominant agricultural sector.

A. District Banks

The banking reform movement in Upper Canada was very aggressive. The conservative reaction was to propose increases in the capital of the existing banks to permit them to increase their loans and note

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[17] In his instruction to the new Governor Arthur (December 1837), Glenelg defended the circular, reiterating that disallowance was a prerogative of the Queen "always most reluctantly employed." In this case the motives for disallowance "were of no light or ordinary kind." Given the state of "Commercial speculations … on the North American continent" the government anticipated

> *… the rapid approach of a period at which the multiplication of various Conventional Substitutes for Gold and Silver Money, would involve the British North American Provinces in Financial difficulties of the most serious character. The effect of such a state of things upon the operation of the Commissariat, and upon the Commercial relations of Great Britain, not only with the British Provinces, but with many Foreign State, became the subject of serious concern. ….*
>
> *The disallowance of Acts on the credit of which large Capitals had already been embarked, and many Commercial transactions undertaken, would have been a measure of the most extreme difficulty. The reservation of these Laws for the sanction of the Crown before they actually came into operation, appeared, therefore, to be the only practical resource. (NAC 1837a)*

circulations and perhaps to establish branches in outlying areas. If this had been the only measure it would have aggravated popular anger about monopoly power. A more radical plan involved establishing a new bank, more or less of the conventional type, in each of the outlying districts. In 1836/37, in a clear challenge to the Imperial authorities, the Upper Canadian legislature increased the capital of the three chartered banks, incorporated 9 new banks, 8 of which were to be distributed throughout the province and incorporated a trust and loan company and an insurance and loan company each with some banking powers. In aggregate the banking capital of the province would have increased from $2 million to $18 million.

The bills had been introduced before the Glenelg dispatch was reported to the Assembly but the legislature persisted in its enactment in the face of the dispatch and despite the threat of reservation and probable disallowance. All of these bills were reserved. When they were received in London, the Treasury was deeply upset by this extravagant proposed expansion of banking capacity. The trust and loan and insurance company bills were disallowed but in what was clearly a political gesture, the Imperial government did not explicitly disallow the acts to incorporate the new regional banks. Rather, they were returned for reconsideration by the legislature and the Governor was instructed to use his powers of persuasion to bring the legislators to their senses (Glenelg 1837a). In the political and economic turmoil that followed the rebellion and international financial crisis of 1837, the new banks apparently were forgotten. The two year time limit for Royal Assent expired and the status quo was preserved.

Thus, without the use of the blunt instrument of disallowance but with the fortuitous intervention of political and economic crises, the Treasury had effectively blocked a potential dramatic expansion and change in the structure of the banking system of Upper Canada -- although, like the many railway proposals of the time, it is doubtful that many (if any) of the proposed banks would have been successful in raising capital and opening for business given the difficult financial situation in 1837 and the subsequent depression. However, there was another potential path for banking reform involving proposals for banking along non-traditional lines.

B. The Freeholders' Bank

Replication of traditional banks could not satisfy the complaints of the agricultural sector. Farmers sought a new type of bank, one that would convert real estate, their major, but generally unbankable asset, into collateral for loans and as the basis for banknote issues. The ninth bank in the Upper Canadian panoply of 1837, the Freeholders' Bank of Upper Canada, was intended to satisfy this desire. It was radically unorthodox in concept; a concept that must have sent shivers down the Treasury spines (Patriot 1837b; UC 1837e).[18] Its

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[18] One newspaper supporter of the Freeholders' Bank asserted that it modeled on a "…most successful precedent in New Orleans where it … proved eminently practical" (Patriot 1837b). What were there called "property banks" had a brief popularity in some southern states (Louisiana, Arkansas, Mississippi, Florida) in the 1820s and 1830s (Redlich 1968, pp. 205-208; Schweikart 1987, p. 48). Three were chartered in Louisiana but their records were not sterling. In the words of one Louisiana banking historian, "The financial crisis of 1837-1842 buried the property bank idea." (Green 1972) All three Louisiana banks failed. Changing gears, in the same editorial the editor of the Patriot also argued that "… very few private Banks were ever established in

proponents anticipated that the bank would be controlled by the owners of freehold property in the Upper Canada who would purchase its shares either by paying money or, more likely, by drawing mortgages in favour of the bank on their freehold property (land and buildings).[19] The shares subscribed could be no more than half the value of the property pledged. The mortgages were to be held by five Commissioners who were to be independent of the directors and management of the bank as security for the debts of the bank.[20] If the bank defaulted on these debts, properties were to be sold by the Commissioners to satisfy the debts and the interest thereon.[21] The bank would be allowed to issue banknotes (minimum denomination $1) and also borrow by issuing bonds with its total debt limited to three times its subscribed capital. There were no constraints on the collateral that banks could accept on loans which opened the door to lending on real estate. The bank was to operate on "Scottish" principles (discussed below) and each shareholder, whether he subscribed in cash or by mortgage, was entitled to a cash loan in the amount of half the value of his shares, secured by those shares. Advances beyond this would require …"the same security as would be extracted from any other individual" (Patriot 1837d).

The Freeholders' Bank was conceived as a very large institution. Its authorized capital was to be $4 million, with at least half of this subscribed before the bank opened for business. By comparison, the authorized capital of the Bank of Upper Canada, the Commercial Bank and the Gore Bank combined was only $2 million (with slightly less actually paid up). The bank was to be a province wide institution, with a head office was at "the seat of Government." But any district in which was subscribed $400,000 of stock was entitled to have a branch office but with capital limited to $400,000. One of the benefits to the province was to be the "abundant and safe circulating medium as the Freeholders' Bank would not fail to supply." (Patriot 1837d). The sale of shares was unlikely to produce a large volume of operating funds. In part these were to be provided by the issuance of banknotes. However, the main portion of the funds were to be obtained by issuing debentures secured by the shares which were secured by the mortgaged freehold property. Although not stated in the act, the plan appears to have been that the bank would borrow a large sum ($4 million was

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England without mortgaging real property of individuals." However, the mortgaging of real property to raise funds to capitalize a bank is not the same thing as the device proposed in this charter.

[19] In a peculiar twist, shareholders who paid in money would receive interest on their subscriptions in addition to their dividends the interest rate being the same as that at which the bank borrowed (presumably not including banknote issues). According to Redlich, in the original property banks only landowners were permitted to be shareholders. This does not appear to have been the case in the Freeholders' Bank.

[20] As additional security, part of the profits of the bank were to be used to create a sinking fund against the bank's indebtedness. Two of the Louisiana property banks attempted to use the mortgage-backed shares as collateral to borrow money in England but found that they required a state guarantee to sell their bonds (Green 1972, pp. 24-25). There was a suggestion that the promoters of the Freeholders' Bank had the same plan: "The Bank requires the interposition of the Provincial Government in the London Money Market to borrow a Million of Money" (Patriot 1837d).

[21] The act was silent on the question of which mortgaged properties were to be selected by the Commissioners to be sold.

mentioned in one story) in London on the security of the mortgages held by the Commissioners and the additional security of a government guarantee.

The bank was approved by the Legislature in early 1837 but, as with the district banks, Royal Assent was withheld and no action was taken in London. Could the Freeholders' Bank have been a success? Had it been granted Royal Assent the timing of its launch was not auspicious. The entire North American economy was in a serious depression from 1837-1843. If it had nonetheless succeeded in opening its future would have depended on the bank's ability to maintain a strong liquidity position which, in the context of a frontier economy in the 1840s, implied holding large reserves of gold and silver. This would have been very a very contentious policy for an institution with an ethos for overcoming monetary stringency by lending freely to the agricultural sector. The Louisiana property banks failed in the depression and at least one analyst blamed their problems on the illiquidity of their asset portfolios (Green 1972, pp. 66-67).

C. A Provincial Bank

Other plans for a large provincial bank would also have been marked departures from the status quo and from English practice. The details of the proposals varied but the common element was a bank partly or wholly owned by the government (UC 1835e; Shortt 1986, pp. 309-11). The bank would issue banknotes -- and, indeed, might have a monopoly of the note issue -- providing a government-controlled paper currency. In its lending operations it would follow the "Scottish principles" discussed below and perhaps lend on the security of land . Strongly supported by reformers but opposed by the established banking interests, such a proposal was passed in the reform controlled Legislative Assembly in 1836 but blocked in the Tory controlled Legislative Council. Paradoxically, in 1837 a Tory-controlled Assembly incorporated the core of the previous provincial bank bill into a bill to increase the capital of the Bank of Upper Canada leading one newspaper editor to observe that "… the Bank of Upper Canada has merged into the Provincial Bank," while the bank's Kingston agent and board member expostulated that the Tories had "… completely bowed to the force of public desire …for more banks" (MG 1837c; Baskerville 1987, p. 111).[22]

Minority government participation had been a feature in the Bank of Upper Canada from the outset (Baskerville 1987, pp. xxvii-xxxvi). The 1837 proposal, however, was different in scale and concept. There was to be a dramatic expansion in the size of the bank. Explicitly authorized capital was to increase from $800,000 to $2,800,000 with all of the additional $2 million subscribed by the provincial government. Thus, the government would have majority ownership and, by appointing a majority of the Board of Directors (8 of 15

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[22] It is not clear how widely the shareholders were consulted. However, the act contained an opting-out clause:

> *"… nothing in this Act contained, shall extend or be construed to extend to compel the President, Directors & Company of the Bank of Upper Canada to accept the provisions of this Act if they shall express their dissent therefrom to the Governor … within one month after the passing of the same." (UC 1837f)*

directors), effective control. There was also a provision that any district (other than the Home district) whose inhabitants bought shares worth $100,000 would be entitled to a branch office and the capital subscribed in the districts was to be an addition to the capital explicitly authorized. In the almost inconceivable event that all of the districts met the minimum subscriptions required for a branch, total authorized capital could have reached $4,000,000.[23] The bank, of course, was to be the exclusive banker for the government and in return the bank was to pay 3% interest on government deposits. Critical to the proposal was a provision to borrow $4 million in London. The provincial government was to issue its debentures for this purpose, the debt to be serviced and repaid by the bank (but, of course, with the government ultimately responsible). This was another application of the Louisiana solution to the capital shortage.

The Bank of Upper Canada proposal violated every major tenet of the Imperial banking regulations. The provision of the original charter limiting the total liabilities of the bank (banknotes plus debentures but excluding deposits) to three times the authorized capital "… actually paid into the bank " was not repealed. However, assuming the government subscribed to all of the shares allotted to it, and that the maximum sum was borrowed in London, this meant a potential banknote issue much larger than the Imperial government contemplated. The real bills principle was not invoked and double liability was not imposed. Suspension of convertibility of banknotes called for a suspension of operations and a twelve percent interest payment to banknote holders for the duration of the suspension, not revocation of the charter. The availability of weekly financial statements was not required and there were no constraints on loans to directors. Despite these failings, and although the bill was reserved, it was sent to London with the Governor's enthusiastic endorsement (Baskerville 1987, pp. 113-114). The Colonial Secretary, echoing the Treasury, referred to it ironically as a "remarkable … innovation" (Glenelg 1837a).

That the British authorities were not opposed to the concept of a large, provincial-government-controlled, note-issuing bank, with appropriate safeguards is suggested by the 1840 proposal for a provincial bank by the relatively liberal implementer of the union of the provinces, the British Governor General, Lord Sydenham (Shortt 1986, pp. 401-14). Unlike the Bank of Upper Canada proposal, Sydenham's plan was for a provincial bank that would have a monopoly of the issuance of paper money. However, again unlike the Bank of Upper Canada proposal, this one had a mechanism for the control of the note issue. (Shortt 1986, pp. 401-14). A basic fiduciary issue of banknotes was to have a 25% reserve of legal tender gold and silver coins with the balance issued against government debentures. The maximum fiduciary issue was set at $4 million (for the united Province of Canada, not just Upper Canada) (QG 1841b). Beyond this limit any notes issued by the bank were to have a 100% specie reserve. Sydenham's proposal thus foreshadowed essential features that would govern the Bank of England under the British Bank Act of 1844, features that were also incorporated

[23] The number of districts in Upper Canada varied over time. The 1836 and 1837 censuses showed 11 districts in addition to the Home District; the 1838 census, 12; the 1839 census, 13 and the 1840 census, 14 (Canada 1876, pp. 120-131).

into the Canadian monetary system after Confederation. [24] If implemented, the Sydenham proposal would have had a profound effect on the structure of Canadian banking, although it was presented as a device to help resolve the desperate governmental fiscal situation and to finance essential public works rather than as a deliberate attempt at banking reform. Whether the Treasury would have approved we do not know. The Sydenham bank was blocked in the legislature but its fiscal purpose was partially achieved by a tax on banks based on the value of banknotes in circulation.

D. "Scottish Banking"

Central to the reform agenda was the adoption of "Scottish banking," a vaguely defined concept that had a panacea-like attraction for Canadian banking reformers of the period. It was supposed to provide a system of safe, stable banks and a sound currency while vigorously promoting economic progress and prosperity.[25] Scottish style banks were to be free to open branches and agencies throughout the province. This was a power already possessed by the chartered banks but the style of operations of the Scottish banks was to be very different. In particular, they were to lend on *cash accounts* instead of only discounting bills for fixed periods and they were to *pay interest on deposits*.

A cash account was a line of credit that could be drawn upon at any time without the formal discounting of a note that had a fixed term to maturity. While such accounts may have been invented in Scotland, by the early 1830s they had been widely adopted in England, but not in Canada (Watt 1836). The size and timing of loans could be tailored to the needs of the borrower and outstanding loans could be repaid, in whole or in part, at any time and not just on scheduled repayment dates or on maturity of the bill.[26] This was particularly attractive to farmers. Funds could be made available at the beginning of the agricultural season before there was any saleable output to secure a discountable bill and the advances repaid as the crop was sold. The farmer would no longer be dependent upon a merchant for credit. However, security for the line of credit was a crucial issue. The "Scottish principle" required either the surety of other people of known wealth or the collateral of other assets, perhaps financial assets, perhaps real property (Chambers 1834; Crick and

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[24] In his biography of Lord Sydenham, Adam Shortt suggests that in his previous involvement in the banking committee of the British parliament and the Board of Trade Sydenham was one of the originators of Peel's Bank Act of 1844 that transformed the role of the Bank of England in the English banking system and the structure of the monetary system (Shortt 1908, pp. 327-30). The structure of the specie reserve requirement in Sydenham's Canadian plan was the same as that in the 1844 Bank of England Act.

[25] A succinct contemporary account of the Scottish system from Chambers' Edinburgh Journal, received some circulation in Canada, reprinted in the Quebec Mercury and the Kingston Chronicle (Chambers 1834). It contains a clear statement of the nature and benefits of the Scottish system, arguing that the banking system was almost solely responsible for superior performance by the Scottish economy. The same notions are echoed in other contemporary Canadian commentaries. See for example, (UC 1835a; Anon 1837a; Young 1838). While more cautious in his claims, Adam Smith provided strong authority for the proposition that "... the banks have contributed a good deal to ... the very considerable increase of ... the trade and industry of Scotland." (Smith 1776; 1910). For a modern argument to the same effect see (White 1984).

[26] However, Smith emphasized the importance of regular payments on cash account loans as a method by which banks could monitor the loans and hence the performance of the debtors (Smith 1776; 1910).

Wadsworth 1958, pp. p. 370). For a frontier farmer to find two wealthy persons to stand surety was said to be both difficult and demeaning.[27] For most farmers, the only available security would be their land. In bad times, however, that implied the loss of the land to the bank. This, of course, was anathema to banking reformers and it is not clear how this concern was to be reconciled with "Scottish banking."

The payment of interest on deposits by the old, established chartered banks was almost unknown in the 1830s.[28] The attraction for bank reformers is obvious. Surplus funds, perhaps to be used over the winter, could be lodged in the presumed safety of an interest bearing account, reducing the risk of holding banknotes and providing a source of income not then available from normal bank deposits. Reformers argued that because paying interest on deposits would mean that excess funds would be deposited in a bank, not hoarded as banknotes, excess borrowing would be discouraged and the danger of excess note issues reduced. The note issue would adapt to the actual needs of the economy (Hallowell 1834).

All of these elements of "Scottish banking" could have been implemented within the chartered banking system -- and eventually were. Much more radical was another aspect the "Scottish system," freedom of entry and minimal regulation in order to promote competitive banking.[29] Freedom of entry implied banks operating without legislative charters and hence, given the lack of a general incorporation law, with unlimited

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[27] Young offered a pointed criticism of personal sureties:

> *In its very inception ... (King) ... was thus made a matter of delicacy and embarrassment. It compelled ... (the borrower) ... to disclose his plans to others. It involved him in contracts and engagements other than his own. He was forced to assume heavy obligations. He had to return, at the same or some short period after, similar favours to those he had received. It led to a complex and universal system of accommodation. It involved the fortune of every man too deeply in the general circumstances of the community. It stood in many cases as an insuperable barrier to enterprise .... (Young 1838, p. 25).*

Similarly, the editor of the Patriot expostulated against :

> *… the misery of hunting up and soliciting endorsers, the anxiety and loss of valuable time in attending on renewals …; the mortification of having a note refused under some pressing exigency because one of your endorsers is a defaulter from having endorsed a note for another, who has again endorsed for another, who is a defaulter per se …. The most disgusting perplexities that ever attended Banking business (Patriot 1837d).*

[28] Interest was paid on small deposits by a few savings banks operated as charities for the "deserving poor." Chartered banks in turn paid interest to savings banks on their deposits with the chartered bank. However, interest on other deposits with the old-line chartered banks was almost unheard of. I will note the payment of interest by the Bank of British North America below (p. 31).

[29] An editorial writer stated:

> *... we wish to see Banking free to all, under proper regulations and restrictions. ... (L)et any five individuals who may wish, commence Banking, and issue their notes, provided that such notes never extend more than a certain fixed amount beyond that capital which they have invested (Hallowell 1834).*

Apart from the (unspecified) linkage of the note issue to capital, the editor did not specify the "proper regulations and restrictions." It is not clear if "five individuals" was to be a maximum or a minimum. If the former it was not a Scottish principle. Indeed, the opposite is true. What distinguished early Scottish banking organization was the dominance of unchartered joint stock banks with many shareholders.

liability of partners or shareholders. This was thought to ensure responsibility in management and, because the entire wealth of shareholders was at risk, enhanced security for note holders and depositors.[30] The prospect of strong competition for the entrenched chartered banks was one of the powerful attractions of Scottish banking to Canadian reformers. Paradoxically, however, a part of the package of banking reforms of the mid-1830s was the suppression of private banks, the agents of Scottish banking.

E. The Suppression of Private Banks

Scottish banking practices were introduced into Canada by private (i.e., unincorporated), note-issuing banks. Private banks were opportunistic ventures, made possible by a gap in banking regulation. They were not organized under any Canadian law and, indeed, may have been illegal.[31] At least one developed business that straddled the international border and some had a social or political agenda that included links to the political reform movement in Upper Canada. Apart from the Bank of British North America, which is a special case discussed below (p. 30), and the brief period of private banking by the three chartered banks of Lower Canada (see above, p. 10), there were perhaps fourteen indigenous private banks that were legitimate enterprises attempting to conduct a normal banking business in Canada in the mid-1830s, six in Upper Canada and seven in Lower Canada (Paterson and Shearer 1992). From 1833 they grew rapidly until by 1837 those for which Don Paterson and I have data accounted for over 8% of the supply of Canadian money (Figure 1). Some disappeared in the crisis of 1837 but subsequently there was resurgence so that by 1841 they accounted for 14% of the supply of Canadian bank money. As the 1840s began it would appear that private banks were poised to play a significant role in the banking system. However, that was not to be.

Although the failure of private banks was yet to occur, in 1837 the legislature enacted a law prohibiting new private banks (UC 1837). Four operating banks were grandfathered. The reaction of the Lower Canadian government was slower and, at least on the surface, different from that in Upper Canada. An 1839 ordinance restricted the banking business to "… any bank chartered, recognized or authorized by the legislature of this Province…." and those private banks that applied for and were granted a license to carry on the business of banking (LC 1839b). Licensing is an interesting conceptual innovation, representing the first suggestion in Canada that a government was willing to sanction banks through an administrative rather than a legislative procedure. There are records of applications by Molson's, Hart's and the Union banks for licenses, none of which were approved (NAC 1839; QA 1839a) . Indeed, we have found no records of any licenses being

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[30] Thus, one editor:

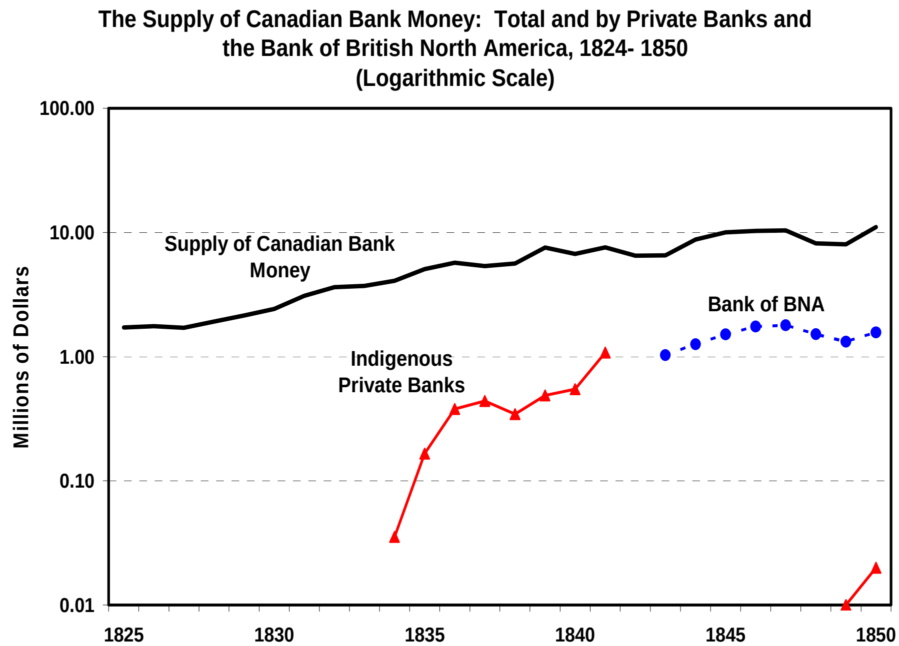
> *... Private Bankers are answerable to the Public to the whole extent of their fortunes, and are therefore more trustworthy than the United States institutions, which are legalized not to pay their debts in case of failure .... (Hallowell 1834).*

Some legislators had the legitimate concern that owners of private banks could skip across the border and vanish with their assets.

[31] The 1765 British act that repealed the relevant parts of the Bubble Act made no mention of a 1741 act that had extended the Bubble Act's prohibition of unchartered joint stock companies to the North American Plantations and Colonies (UK 1765; UK 1825a). This seems to have been the reference in at least one contemporary suggestion that Canadian private banks were illegal (Observer 1835a; Observer 1835b).

granted. However, enforcement must have been slack. The Union bank continued to operate. It published a balance sheet in January 1840 although it showed notes and deposits of only $18,000 (Bean 1840). In November 1841 the bank was voluntarily dissolved (Gray 1841). The Montreal firm of Viger, DeWitt et Cie. also continued to operate until it was granted a charter as La Banque du Peuple.

Figure 1



Had the suppression of new private banks not occurred would they have radically altered the structure of the banking system in the early 1840s? The continued growth of the note and deposit liabilities of the private banks after the financial crises of 1836-37 might suggest this.[32] However, on closer examination the evidence is far from convincing. Most private banks were financially fragile and disappeared in troubled economic times. All of the 1838-1841 increase occurred in three banks. The Niagara Suspension Bridge Bank more than trebled its monetary liabilities from 1838-1841 -- then failed (Colonist 1841a; Colonist 1841b). The Bank of the People of Toronto showed an even more dramatic increase in its notes and deposits. Unlike other banks it survived the financial crisis of 1837 without suspending convertibility -- an amazing performance, suggesting strong management, that must have added substantially to its reputation.[33] It increased its monetary liabilities over twelve fold from 1838 to 1841, but almost 70% of this occurred in the final year, after control had been purchased by the Bank of Montreal. In that year it should probably not be counted as a private bank. Although its initial growth was relatively modest, Viger, DeWitt et Cie was by far

32 Unfortunately, data are not available from 1842 through 1848.

33 The bank was managed by Francis Hincks who later became an outstanding Finance Minister.

the most successful of the indigenous private banks.[34] Established in 1835, it prospered by catering to the Francophone population of Montreal and environs. Unfortunately I do not have balance sheets for 1842-1843 so I cannot trace its growth in its final years as an unicorporated bank. However, it sought the legal protection of a charter in 1843 (issued in 1844). This was not the last indigenous note-issuing private bank. The Farmers' Bank struggled on but closed its doors some time in 1844. The company with its grandfathered operating rights was purchased by another group in late 1848 and operated until early 1855 when it also failed. The Agricultural Bank had failed in November 1837.

Thus, the available evidence does not provide strong support for the proposition that the indigenous note-issuing private banks were on the brink of transforming the Canadian banking system. Private banking was a passing phenomenon. Nonetheless, the restrictive legislation of 1837 and 1839 stifled the development of an innovative sector of the banking system that had some effect on banking practices, at least in Upper Canada. To the extent that they were agents for banking reform, it was because of their introduction of "Scottish banking". Two of the Upper Canadian banks emphasized their links to agriculture in their names (the Agricultural Bank and the Farmers Bank) and they are generally credited with the introduction of interest bearing deposits and cash accounts in that province. The payment of interest on deposits and lending on cash accounts would have occurred eventually; private banks accelerated their introduction. In Lower Canada it is not clear whether the "Scottish banking" concept had similarly wide currency among the private banks. However, they had another important impact on banking practice. Some of the private banks, like all of the chartered banks, were Anglophone. The one successful private bank, La Banque du Peuple, pioneered in providing banking facilities for Francophone businesses.

I have found no evidence that the Treasury promoted the suppression of private banks. However, that the bill received Royal Assent without comment suggests that the Treasury was not opposed to it.

F. The Upper Canada Reform Program: Reprise.

Contemplating the Upper Canada reform proposals is like attending a production of the theatre of the absurd. An atmosphere of surrealism is pervasive. The Upper Canada program involved the creation of two very large banks, with similar schemes for the opening of district branches in competition with separately chartered district banks in lightly populated districts. Taken as a whole, the program contemplated the possibility of an astronomical increase in bank financial resources, including subscribed capital, borrowing and banknote circulation. The two large banks each had a plan to raise major sums of money on debentures

[34] Viger, DeWitt et Cie. had special status such that it may not be appropriate to classify it as a private bank. It was organized as a société en comandite, a limited partnership in which the directors who managed the firm had unlimited liability while the ordinary shareholders had limited liability. This was a very old French form of company organization (Howard 1932). The Quebec Act of 1774 provided that while the criminal law of the colony would be that of England, with respect to property and civil rights the "laws and customs of Canada" would prevail (Houston 1891). It has been argued that sociétés en comandite existed in New France at the time of the conquest and that therefore they were part of the "customs of Canada" and were legitimate. (Smith 1974).(Smith 1974, p. 8). Certainly, the government did not challenge the legitimacy of the bank during or after the crisis.

issued in London, one with a provincial government guarantee explicit in the law and the other apparently with an implicit commitment to such a guarantee. Given the financial situation of the province it is unlikely that either issue would have been successful, let alone both. Did the Tory legislators enact the charters thinking they would gain popularity and hence votes while anticipating that the Treasury would veto them and take the blame? If so they were trumped. To add to the absurdity, the Imperial authorities did not explicitly disallow the proposals even though these proposals violated every tenet of Imperial regulations. Rather the acts were sent back to be reconsidered by the impetuous legislature. The timing of their return (the dispatch was dated November 27, 1837) almost guaranteed that the bank bills would be lost in the much more pressing immediate concerns following the financial and banking crises and the suspension of convertibility. The immediate Treasury objective was achieved but without explicit Imperial action.

Why were the banking acts not disallowed? The reason may lie in discord among Imperial authorities. Knaplund asserts that James Stephen, the Undersecretary in the Colonial Department until 1846, waged a running verbal battle with the Treasury (Knaplund 1953, pp. 201-227). Whereas Stephen was of the view that banking was a local issue, best left to the colonial authorities -- a matter on which "… the Canadians should be given the opportunity of learning wisdom through experience" -- he accused the Treasury of assuming "… the role of governess for the colonies in all banking matters" (p. 207). Citing Stephen's correspondence, Knaplund makes clear that although he did not challenge the technical soundness of the Treasury's objections, he was very sensitive to the political dimensions of the review process. Thus, Stephen is quoted as arguing that:

> *In fact the Regulations promulgated by Lord Glenelg at the instance of the Treasury relieves all the local authorities, Legislative and Administrative, from the due sense of responsibility about Banking Enactments, and transfers that responsibility entirely to the Government at home, or rather to the Head of this Office, leaving them or him to incur the reproaches to which neither they nor he ought to be exposed, and exhibiting to the people of Canada their Colonial relation to this Country in its most distasteful aspect (p. 216).*
>
> *My own judgment is that it is unwise to enter into any such struggle (over banking laws). I believe it to be altogether hopeless and I think that the benefit whatever it may be, of insisting on sound banking principles in Canada, is dearly purchased at the expense of the ill will which such a controversy must excite, and of the improvident measures which that ill-will must provoke (p. 217)*

Whatever the reason, Imperial threats of disallowance must have lost credibility in Canada. Although their bills were not approved and died an administrative death, the fact that they were not disallowed must have made the local authorities wonder if they had won control over banking policy as a "local and internal" matter.

V. The 1837 and 1840 Regulations

In April 1837, before the Upper Canada bills reached London, the Treasury sent to the Colonial Office a new set of banking regulations. They were given to the new Governor at year end as an attachment to the official explanation of the rejection of the request to repeal the Glenelg circular of 1836 (NAC 1837a). The new regulations were a reiteration of the 1834 regulations (see above p. 8) with two important additions, one of which became a focus of controversy:

- Double liability was to be reinforced by maintaining shareholder liability for one year after shares were sold
- No "small" banknotes could be issued (i.e., of a denomination less than £1 currency =$4)[35]

By the end of the 1830s the Treasury had not succeeded in shaping Upper Canadian banking in its ideal model perhaps in part because of the lack of wholehearted support from the more politically sensitive Colonial Office (Knaplund 1950; Knaplund 1953). Despite the earlier failures in 1840 new regulations were drafted by the Treasury and circulated to colonial governors with minor changes to various clauses (particularly time limits), the addition of four technical provisions but no major changes of principle (NAC 1840a). [36] The 1840 regulations are reproduced in the Appendix. Another revision in 1846 introduced more technical adjustments and one important new provision: (NAC 1846a)[37]

- Total issue of banknotes not to exceed the paid-up capital.

The proposed limitation on banknotes was of obvious importance but it was the prohibition of small banknotes that became the centre of London-Canada controversy. Why did the Treasury place so much emphasis on this policy?

VI. Small Banknotes.

The Treasury's rationale for the small notes prohibition was to "…secure to the People of Canada the benefit of a metallic circulation which is incompatible with the circulation of paper of this description" and by doing so to avoid "… evils which an unsound currency may entail on the Community", evils " … which it is needless specifically to point out" (PRO(3), Feb 17 1847 P 146-7, Feb 11, 1843 pp 25-34, Nov 21 1846, pp 157–165). Perhaps the arguments were well known and hence obvious to contemporaries because a prohibition on small note circulation had been a prominent feature of the British monetary system for many years. Scotland had a long history of circulation of very small notes until 1765 when the minimum was set at £1 (UK 1765a).[38] In England, by contrast, although the minimum was initially set at £1 (1775) it was quickly

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35 The regulations were laid before the Legislature in 1839 but, in a curious note dated February 6 the Governor observed that "… as no action appears to have been taken on it by them -- the restriction (i.e., the 1836 Glenelg circular) may be considered as still existing" (NAC 1837a)

36 The new provisions are:

- No. 12 Dividends to be made out of profits not out of capital
- No. 14 Bye-laws not to violate the charter
- No. 15 Can add to capital with the sanction of the Treasury
- No. 17 Charter to be a simple as possible

37 The technical adjustments include:

- Definition of the bank as a body corporate, able to sue and be sued in its own capacity, etc.
- Term of the charter not to exceed 21 years

38 The circulation in Scotland of small denomination banknotes was a concern to some English bankers and politicians, partly because of the apparent unfairness to English bankers and partly because of the

raised to £5 (1777) (UK 1775a; UK 1777a; Coppieters 1955, pp. 53-59). The prohibition of small notes in England was suspended during the Napoleonic wars and their aftermath when the country was on an inconvertible paper standard and there was a shortage of coin. In 1826, following a severe financial crisis that some blamed in part on instability of the small note circulation, the reinstatement of the prohibition, which had earlier been scheduled for 1833, was accelerated to 1829 (UK 1822c; UK 1826b; UK 1826c, pp. 165-170; Welsby and Beavan 1854, Vol 1., pp. 317-319). The prohibition in England was not finally removed until 1863 (UK 1863a).

In contemporary discussions there were four interrelated concerns about the circulation of small notes (Coppieters 1955, pp. 59-67).[39] First was Adam Smith's argument that permitting small denomination banknotes opened the door to the circulation of worthless paper by "mean people" -- "beggarly bankers" -- who preyed on the poor and uninformed (Smith 1776; 1910). In the Canadian case, with private banks prohibited the fraudulent notes would presumably be counterfeits of chartered bank notes, notes of questionable US banks and notes of phantom (non-existent) banks. Second was the assumption that holders of small banknotes would be skittish, susceptible to rumours of banks in difficulty and prone to panic no matter how outrageous the rumours. (Hawtrey 1919, p. 19). At the first hint of difficulty they would make runs even on sound banks and perhaps even dispose of their good banknotes to speculators at a discount.[40] The merchants who used large notes in commerce were sufficiently sophisticated to identify frauds and so take care of themselves. Third, it was argued that small notes were particularly susceptible to forgery perhaps because they were of small denomination and hence less likely to be carefully scrutinized and perhaps because they would circulate primarily among uneducated and unsophisticated people who could not easily detect forgeries (Clapham 1945, v.2, p. 76).[41] Fourth, it was argued that issues of small notes were particularly vulnerable to wild fluctuations, expanding overly rapidly in good times and contracting precipitously

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possibility of a sizable circulation of Scottish notes in northern England (UK 1826a). In 1826 the circulation in England of small notes issued in Scotland or Ireland was prohibited (UK 1828b). A parallel concern was raised in an 1830 debate on the right of the Bank of Montreal to issue small banknotes. It was argued that if the bank were prohibited from issuing such notes American notes, many of dubious worth, would circulate in their place (MG 1830a).

[39] Not all informed contemporaries were opposed to small banknotes. The economist and legislator, David Ricardo, was a strong advocate of such notes as a cost saving measure. However, his strongest development of the case was with reference to a government owned but constitutionally independent national bank that would have a monopoly of the note issue and hence would avoid most of the "evils" (except that of forgery) (Ricardo 1851; 1816; Ricardo 1951; 1824). In a sense, this was the Sydenham solution.

[40] As an indicator of the strength of the argument, referring to the situation in England, one Canadian commentator noted "To prevent panics the small note currency has been prohibited." (SS 1833). According to Coppieters the financial panic of 1825 was commonly blamed on a reflux of the small note issue of English "country bankers." Coppetiers also suggests that there is little or no evidence to support this contention (Coppieters 1955, pp. 59-62).

[41] Coppieters notes that in England coins were more frequently forged than small bank notes and that forgeries of coins were more difficult to detect. He also emphasizes the success of small note circulations elsewhere in the world (Coppieters 1955, p. 66).

in bad, accentuating if not generating financial instability. For these reasons, it was argued that small notes would create a disorderly currency, expose financially unsophisticated poor people to unnecessary risks and the economy to accentuated fluctuations.

In his study of the English bank note, Coppetiers dismissed the various assertions about small banknotes as mere prejudices (Coppieters 1955, pp. 59-67). However, the Treasury was convinced of their evil nature and repeatedly harangued the Colonial Office and through that office the Governor of Canada that notes under £1 should be prohibited. Such a prohibition would have been contrary to long established (and benign) Canadian practice and was successfully ignored by successive Canadian governments.

When the issue arose in connection with the review of bank charters in 1842 and 1846 the Imperial Treasury badgered the Canadian government about the circulation of small denomination banknotes. In 1841 the Canadian legislature renewed the charters of the three banks of Lower Canada and incorporated the Bank of the Niagara District. After reviewing the legislation in 1842, the Treasury reiterated its strong objection to the banks' rights to issue small notes but did not recommend disallowance. Virtually acknowledging that banking was an internal matter, they concluded that:

> *… it would be far more satisfactory to my Lords that the evils likely to result from continuing such a paper circulation should be prevented by the interposition of the Colonial Legislature than by the abrupt rejection of Acts to which the sanction of the Legislature of Canada and of the Governor General has been, after full consideration, deliberately.*

and went on to

> *… express a hope that the Canadian Legislature will at an early period revise this part of the system of banking in the province and secure to the People of Canada the benefit of a metallic circulation which is incompatible with the circulation of paper of this description (PRO(3), Feb 11, 1843 pp 25-34) .*

In 1846, following an act to incorporate la Banque des Marchands, the Treasury noted that they it waived its objections in 1842 on the assumption that the Canadian government would revise its policy. The continued circulation of small notes was supposed to be temporary. They thought that four years was ample time for the Canadian government to have "reconsidered." However, the Treasury did not wish to force change on Canada "prematurely" given that the community had become habituated to the circulation of small notes (PRO(3), Nov 21 1846, pp 157-165). This appears to have been the final admission by the Treasury that the Canadian policy on small banknotes was beyond its influence let alone control.

Why did the Canadian government defy the Imperial Treasury on this matter? They undoubtedly knew that the Colonial Office did not wholeheartedly support of the Treasury and so probably concluded that the risk in ignoring the Treasury's objections was low. In Canada, a powerful force was the vested interest of politically influential banks. Not all banks published a breakdown of their bank note issues by denomination but some data from those that did are reported in Table 1. It is apparent that the small notes accounted for a substantial portion of the note issue, and given the overall importance of bank notes, the counterpart discounts must have accounted for a substantial portion of each bank's profits. However, it was also the correct decision. The government must have known of Ricardo's argument that small bank notes were a (socially) cost effective means of providing a circulating medium. Moreover, with private banks banned, Canada had no institutions that were the equivalent of the English country banks that were alleged to be the root of the small note problem in Britain . There is no evidence that Canada suffered from the "evils" that were recited in defense of the English prohibition (and, as noted above, Coppetiers concluded that there was little evidence of serious problems in England). Indeed, the Treasury's argument can be turned on its head. In the absence of Canadian small bills the Canadian authorities were undoubtedly correct that US notes, many of dubious quality, would have circulated more freely in Canada. Moreover, Canada had a long, unsatisfactory history in attempting to manage a monetary system based on silver and gold. Although there were technical solutions to most of the problems, in a small, open economy dominated by the New York money market, even a well-functioning metallic circulating medium would have been subject to exchange rate induced fluctuations of the type that the Treasury ascribed to small banknotes.

Table 1
Bank Note Issues by Denomination, Selected Banks, Early 1840s

Bank	Date	Value of Banknotes by Denomination		
		Less than $5	$5 and Greater	Total
		Thousands of Dollars		
Commercial	Sept. 1842	95.6	248.5	344.1
Upper Canada	July 1841	193.4	378.0	571.4
Gore	June 1841	177.2	131.2	308.5
		Percent of Note Issue		
Commercial	Sept. 1842	27.8	72.2	100.0
Upper Canada	July 1841	33.8	66.2	100.0
Gore	June 1841	57.4	42.6	100.0

VII. Bank Charters after the Union

Soon after the 1841 union of the provinces bank charters began to expire. In 1841 revised charters were enacted for the Bank of Montreal, the Quebec Bank, the City Bank and the Bank of Upper Canada, and the Bank of the Niagara District was incorporated. They were given Royal Assent in 1842. Although it would be many years before a single bank act provided uniform provisions for all banks, the new charters were almost identical and incorporated most, but not all, of the Treasury regulations. To illustrate the point, Table 2 compares the old and new charters of the Bank of Upper Canada with the 1840 regulations.

Table 2

Bank of Upper Canada
Comparison of Charter Provisions and 1840 Treasury-Board of Trade Regulations

Aspect	Regulation	1842 Charter	Old Charter
Bank lending	Real bills principle	Real bills principle with exceptions	Not limited to real bills
Suspension of convertibility	Forfeit charter after 60 days	Forfeit charter after 60 days	Suspend operations & pay interest
Shareholder liability	Double; Continues 6 months after sale	Double	Single
Debt Limit	3 times paid up capital	3 times paid up capital	3 times paid up capital
Banknote limit	Paid up capital	Paid up capital	No limit except debt limit
Inspection	On demand of governor	On demand of the governor	Silent
Financial reports	Half yearly or yearly	Half yearly	Call of legislature
Loans to directors	Limited to 1/3 of loans	Limited to 1/3 of loans	Silent
Dividends	Out of profits only	Out of profits only	Silent
Government participation	Silent	Silent	Yes
Small banknotes	None below $4	None below $1; No more than 20% below $4	None below $1

I am as yet unable to explain how or why this transformation of Canadian banking policy occurred. It is tempting to attribute it to Sydenham. Although they ultimately emanated from the Treasury, in the dispatches from the Colonial Office the banking regulations were attributed to the Board of Trade.[42] Before he accepted the post as governor General of the Canada's Sydenham (then Poulett Thompson) was President of the Board of Trade and a member of the House of Commons committee on banking. He must have been involved if not in the drafting of the regulations at least in approving them. Thus, he had much more acquaintance with the regulations and the issues underlying them than preceding governors (most of whom had military backgrounds). Moreover, he had the bribe of a £1.5 million Imperial guarantee of provincial debentures in his pocket. This may have given him more greater persuasive powers with banks and legislators as the laws were being drafted. However, this argument is not convincing if only because during his regime five non-conforming bank charters were passed by the legislature (they are discussed next) and vetoed by the Treasury. It is also notable that he was instrumental in relaxing the double liability provision for the Bank of British North America (see below, p. 32). Sydenham was taken seriously ill in September, 1841, submitted his resignation then died suddenly following an accident, well before the conforming acts gained Royal Assent. .

Of probably greater importance was the fact that in 1841 the Treasury finally found their backbone and recommended disallowance of five bank charters (NAC 1841a). Three were routine bills to increase the capital of the Bank of Upper Canada, the Commercial Bank and the Gore Bank. They were disallowed because they did not contain appropriate small note provisions. The other two were to incorporate new banks, the Prince Edward District Bank (one of the 1837 group) and the Farmer's Bank (a private bank attempting to become a chartered bank). They were disallowed because

> *The Bills for establishing new Companies have been framed without regard to the precautionary conditions for which it has appeared to Her Majesty's Government to be expedient to stipulate with a view to the protection of the Public and the proper regulation of Banks in all Charters or Acts of Incorporation for Banking companies in the Colonies. (NAC 1841a)*

Suddenly the Treasury's hollow threats became credible. The Canadian banking community may have concluded that the Treasury had lost patience and now meant business.

However, a refusal to renew that charter of an ongoing institution was much more serious than refusing to increase its capital or to disallow the charter of a new bank. This provided room for

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42 The Treasury described them as "regulations laid down by the (Treasury) Board in concert with the Lords of the Committee of Privy Council for Trade" (i.e., the Board of Trade) (PRO(3), Feb 11, 1843 p. 25). There was intense rivalry between the Treasury and the Board of Trade for primacy in the determination of the British government's reaction to colonial legislation on financial matters (PRO(3), 1842, pp. 13-14, 19-25). In principle, the Colonial Office referred matters dealing with economic and financial policy in the colonies to the Board of Trade for advice and the Board of Trade consulted with the Treasury "… on those items that are the proper purview of Treasury." As was evident in the Bank of British north America case, there was some ambiguity about the scope of the "proper purview of Treasury." See below, p. 30

compromise. It is significant that in approving the new charters for Bank of Upper Canada and others the Treasury permitted the weak form of the real bills principle and, despite its emphasis on the importance of prohibiting small notes, allowed note as small as $1. Perhaps the Treasury recognized that the long standing "additional security" exception to the real bills principle had not created difficulties and that its position on small notes was insupportable in the Canadian context.

VIII. An Alternative Imperial Intervention

Although in principle legislation by the British Parliament was possible, in practice the British authorities would not initiate changes in Canadian banking policy; they would only react to Canadian legislation, allowing or disallowing and advising. There was another potential type of intervention, however -- chartering a British bank to operate in the Canadian colonies. Of course, the Treasury was only reactive in this process as well. They did not initiate proposals for colonial banks but reacted to proposals brought forward. From the perspective of Canada, however, the process inserted a banking institution that the Canadian authorities had not invited.

In fact the Treasury played no role in the initial penetration of Canada by the Bank of British North America, When it arrived in 1837 the BBNA was a private bank with a very large subscribed capital, ($4,867,000) established to engage in banking in both the Atlantic provinces and Canada. Rather than generating instant hostility, it appears to have been welcomed by the established banks as a useful link to the British financial markets and particularly as a conduit for attracting specie to the colonies (Shortt 1986, p. 326). It easily obtained acts from the legislatures of Upper and Lower Canada giving it legal status in the courts, the right to sue and be sued in the name of the company but not limited liability (UC 1837b; LC 1838b).

The BBNA opened an office in Montreal on March 23, 1837, in Quebec on May 1 and in Toronto on June 13 -- just in time for the financial crisis (BBNA 1837a; BBNA 1837b; BBNA 1837c). When it opened in Montreal and Quebec the Lower Canada Legislative Assembly was in suspension. The bank operated for over a year like other private banks, without corporate status in the courts, and, lacking legal authority and legal protection, it refrained from issuing the banknotes that it had prepared for circulation. However, the May 1838 Lower Canada Ordinance that gave it legal status also made explicit its authority to issue bank notes. Another Ordinance enacted on the same day, a few days before the first resumption of specie payments by the banks in Lower Canada, gave legal sanction to the suspension of convertibility by the banks, with explicit mention of the Bank of British North America (LC 1838b; LC 1838c).[43] The

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[43] In principle, for an unincorporated company legal action to recover debts would have to be in the names of all of the shareholders. However, the first annual meeting was told that arrangements had been made "under competent legal advice" to operate in Lower Canada. Robert Carter, one of the London directors who was sent on a mission to visit each of the colonies in which the bank planned to operate, reported that it was possible for the bank to sue in the name of the manager or one of the directors "by the means we have taken," which were similar to those used "for years by several of the banks in the Colonies before they procured acts of incorporation and I feel confident that no inconvenience will be felt

Treasury approved these acts without comment. Soon thereafter the bank began to issue banknotes in Montreal (and presumably in Quebec). Note issues in Upper Canada may have been delayed until 1841.[44]

Even before it opened its offices in Canada, the BBNA announced that it would introduce both cash accounts and the payment of interest on deposits. Although private banks had already introduced Scottish banking practices in Upper Canada on a small scale it appears to have been the BBNA that spread them through both Canadas on a large scale (Patriot 1836a). Because the bank delayed issuing banknotes by over a year in Lower Canada and longer in Upper Canada it had to rely initially on deposits to augment its capital to provide funds for its lending operations (BBNA 1839a). This may explain the Bank's eagerness to pay interest on "special deposits. (BBNA 1837b; BBNA 1837d). [45]

From the outset, the founders of the bank agreed that it was "indispensable to obtain a Charter from the (British) government" but enquiries suggested that "Circumstances connected with the political state of the Colonies" created "insuperable obstacles" (BBNA 1836-1839, March 15, 19, 21, 1836; BBNA 1840a). The bank sought and obtained acts permitting the bank to sue and be sued in the courts of both colonies but were warned by the Governor that their practice of issuing notes of $1 denomination might Imperial their status in Lower Canada (BBNA 1836-1839, January 15, 1839). In early 1839 the bank applied for a British charter which was granted in early 1840 (BBNA 1840a).

In this case, the provisions of the charter were negotiated with the Treasury so it was in a position to insist that the regulations be incorporated into the charter. As approved by the Treasury the charter included:

- Lending on the basis of the real bills principle
- Prohibition of banknotes of smaller denomination than £1 currency = $4
- Double liability of shareholders

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by us on that ground" (BBNA, 1837). The nature of the legal arrangements was not explained. The bank may have been referring to a promise by government officials of appropriate legislation. Alternatively, they may have arranged for the appointment of trustees to hold the voting stock, a device used by some joint stock private banks in England to simplify legal processes.

[44] There seems to have been a problem with the design of the notes for Upper Canada. (BBNA 1841). A new series of notes was issued in 1841 (Charlton, 1980, 104). In Upper Canada the imperative to not issue notes was strong. The March 1837 act that gave the bank a legal corporate identity contained a clause requiring it to "wholly discontinue their Banking operations" during any period when the bank suspended convertibility (Upper Canada, 1837c). There appears to have been no local statutory basis for the bank's reluctance to issue notes during the suspension in Lower Canada but there was presumably the risk of private law suits demanding payment in lawful money, i.e., specie. There may also have been legal problems in Britain, although the bank was not yet chartered there.

[45] In 1839 the bank dismissed its Montreal manager in a dispute over bank policy, including constraints placed on the independence of the local board and manager, and allegations of his "want of temper and discretion" both in management and in correspondence with the Court of Directors in London. In the published correspondence relating to the affair the deposed manager made the telling observation that " Beyond the item of interest on deposit accounts I know of no advantage that (the bank) offers to the public above others …" (Scott 1839). Even with this inducement, he argued, the bank was faltering.

- Charter forfeit if convertibility suspended for more than 60 days
- Once annual publication of financial statements
- Inspection by the Governor on demand

The bank was unhappy with the terms of the charter which, the bank argued, were more onerous than those that governed its Canadian competitors. Its particular concerns were the prohibition of small banknotes, the rigid real bills principle of lending and double liability for shareholders. The bankers continued to lobby the relevant official and, much to the dismay of the Treasury, at a meeting with Poulett Thompson (later Lord Sydenham), president of the Board of Trade, the double liability clause was deleted (PRO(3), June 330, 1840, pp. 166-169). The bank continued to lobby to have the small banknotes prohibition removed from its charter. The Treasury, however, was adamant. When the Free Bank Act was passed in 1851 the BBNA registered under the act for the purpose of issuing small bank notes. For many years it was the most important "free bank" and for some time the only one.

IX. Conclusions

It is widely accepted that the unique character of the Canadian banking system owes its origin to the adoption of the charter of the Bank of the United States by the early banks of Lower Canada. Perhaps the strongest statement is from Adam Shortt, the preeminent historian of early Canadian banking:

> *… I may state categorically that the Canadian banking system was derived in a very direct and literal manner from the United States. …. The father of the Canadian banking system was Alexander Hamilton, the first Secretary of the Treasury…. (Shortt 1986, pp. 9-27).*

This was certainly an important factor, particularly for the adoption of nationwide branch banking. However, I have argued in this paper that the regulations drawn up by the British Treasury for colonial banks were equally if not more important in establishing the basic operating characteristics of Canadian banks in the second half of the nineteenth and much of the twentieth centuries.

The Treasury's involvement in Canadian banking was vacillating and enigmatic. Regulations were drafted and circulated but seldom enforced. This is perhaps in the spirit that the regulations were

> *… for general information and guidance of the Colonial Authorities rather than as directions to be in all cases absolutely conformed to (PRO(3), June 30, 1840, p162)*

Yet, in the 1830s the Treasury dithered but allowed the two year time limit to kill major reforms of Upper Canadian banking (which may in any case have been non-starters financially) and, clearly frustrated that the Canadian government had not accepted his advice, in 1841 vetoed five charters that did not conform to the regulations. Subsequently, the Canadian legislature enacted charter renewals that accepted most but rejected some Treasury requirements. Among the rejected rules was the prohibition of small banknotes, a regulation that the treasury regarded as crucial. Thus, although the Canadian government accepted some Treasury rules it also demonstrated a degree of independence that the Treasury did not effectively challenge. It became evident in the 1846 chartering of la Banque des Marchands (which broke the small bills rule) and in the 1851 enactment of the Free Bank Act (which horrified the Treasury and was sent back for reconsideration but approved) that home rule had been achieved in this field of economic policy, a contribution to the assumption of responsible government

Appendix
1840 Treasury Regulations for Colonial Banks

REGULATIONS AND CONDITIONS FOR THE OBSERVANCE OF WHICH PROVISION SHOULD BE MADE IN THE CHARTER *OR* LEGISLATIVE ENACTMENT RELATING TO THE *INCORPORATION OF BANKING* COMPANIES IN THE· COLONIES

lst.- The Amount of Capital of the Company to be fixed; and the whole of such fixed amount to be subscribed for within a limited period, not exceeding Eighteen Months from the date of the Charter or Act of Incorporation

2nd.- The Bank not to commence business until the whole of the capital is subscribed, and a moiety at least of the Subscription paid up.

3rd.- The whole amount of the Capital to be paid up within a given time from the date of the Charter or Act of Incorporation, such period, unless and particular circumstances, not to exceed Two Years.

4th.- The Debts and Engagements of the Company on Promissory Notes, or otherwise, not to exceed at any time thrice the amount of the paid-up Capital with the addition of the amount of such Deposits as may be made with Company's Establishment by individuals in Specie or Government Paper.

5th.- All Promissory Notes of the Company, *whether* issued from the Principal Establishment, or from Branch Banks, are to bear date at the place of issue, and to be payable on demand in Specie at the place of date.

6th.- No Promissory or other Notes to be issued for sums under £1. sterling (or in the North American Colonies £1. Halifax currency), or the equivalent thereof in any other local currency, and not for fractional parts of that amount

7th.- Suspension of specie payments on demand at any of the Company's establishments for a given number of days (not in any case exceeding 60) within *any* one year either consecutively or *at* intervals, forfeit the Charter.

8th.- In event of the assets of the Company being insufficient to meet its engagements, the Shareholders are to be responsible to the extent of twice the amount of their subscribed Shares (that is, for the amount subscribed and paid up, and for an additional amount equal thereto).

9th The Company shall not hold shares in its own stock nor make advances on the *security* of those Shares.

10th.- The Discounts or Advances by the Company on Securities bearing the name of any Director or Officer thereof, as drawer, acceptor, or endorser, shall not at *any* time exceed one-third of the total advances and discounts of- the Bank.

11th. The Company shall not advance Money on security of Lands or Houses, or Ships, or on pledge of Merchandise, nor hold Lands or Houses, except for the transaction of its business, nor own ships, or be engaged in trade except as dealers in Bullion or Bills of Exchange; but shall confine its transactions to discounting Commercial Paper and negotiable Securities and other legitimate Banking business.

12th.- The Dividends to Shareholders are to be made out of profits only, and not out of the Capital of the Company.

13th.-- The Company to make up and publish periodical statements of its assets and liabilities (half-yearly or yearly), shewing, under the heads specified in the annexed form, the average of the amount of its notes in circulation and other liabilities at *the termination of each week or mouth during the period to which the statement refers, and the average amount of specie or other assets that were available to meet the same. Copies of these statements are to he submitted to the Government of the Colony within which the Company may be established ; and the Company to he prepared, if called upon, to verify such statements by the production, as confidential documents, of the weekly or monthly balance-sheets from which the same are compiled. And also to be prepared, upon requisition from the Lords Commissioners *of* Her Majesty's Treasury, to furnish in. like manner such further information respecting the state or proceeding of its Banking establishments as their Lordships may see fit to call for.

14th.- No Bye-law of the Company shall be repugnant to the conditions of the Charter or Act of Incorporation, or to the law of any Colony in which the Company's establishment may be placed.

15th: The Charter or Act of Incorporation may provide for an addition to the Capital of the Company, within specified limits, with the sanction of the Lords Commissioners of the Treasury; such additional capital, and the shares and subscription that may constitute the same, being subject in *every* other respect, from and after the date of the above-mentioned sanction, to conditions and regulations similar to those applying to the original Capital

16th- In all cases in which Shares in the Company's Stock are transferred between the period of the Grant of the Charter or Act of Incorporation, and the actual commencing of business by the Bank the responsibility of the original holder of the transferred Shares shall continue for Six Months at least after the date of the transfer.

17th.-- As the insertion in Charters or Acts of Incorporation, of Provisions relating to the detailed Management *of* the Business *of* the Corporation, has in several instances been found to render the documents complicated and unintelligible, and has been productive of great inconvenience,, it is desirable that such insertion should be avoided, and that the Provisions *of* such Charters or Acts should be confined, as far as practicable, to the special powers and privileges to be conferred on the Company, and the Conditions to be observed by the Company, and to such general regulation relating to the nomination and powers of the Directors, the institution of Bye-laws, or other proceedings of the Company as may be necessary with a view to the public convenience and security**.**

FORM of RETURN referred to in REGULATION No. 13.
RETURN of the Average Amount of Liabilities and Assets of the Bank of ___ during the period from (QM) to (BAFL) 184_

Promissory Notes in circulation not bearing Interest	£	Coin and Bullion	£
Bills of Exchange in circulation not bearing Interest	£	Landed or other Property of the Corporation . . .	£.
Bills and Notes in circulation tearing Interest	£	Government Securities	£
Balances due to other Banks *	£	Promissory Notes or Bills of other Banks	£
Cash Deposits not bearing interest	£	Balances due from other Banks	£
Cash Deposits bearing Interest	£	Notes and Bills Discounted, or other debts due to the Corporation, not included under the foregoing heads	£
Total average Liabilities	£	Total average Assets	£

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