THE B.N.A. ACT AND THE NEAR BANKS: A CASE STUDY IN FEDERALISM

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The achievement of national economic goals through the management of our monetary system is a complex task. The regulation of banking is fundamental to that task and appropriately banking and the incorporation of banks have been placed within the exclusive legislative authority of the Parliament of Canada. However, the question of regulation does not end there as there exist numerous provincially incorporated entities whose functions correspond in varying degrees to those of chartered banks, but are neither called banks nor subject to federal legislative control. Professor McDonald attributes the escape of these institutions from federal influence, not to any confusion as to which level of government has authority to enact banking legislation but rather to the lack of a "clear concept of the banking function". The author goes on to distinguish and examine the basic concepts of banking and assess the assistance which they may offer in clarifying the "banking function" for constitutional purposes. Through this analysis certain similarities or "common denominators" between the chartered banks and "near" banks are discovered. However, it is the lack of concrete distinctions between the two which leads Professor McDonald to call for the integration of "specialist" banks into a national banking system. The present hybrid system of regulation of financial "intermediaries" is confusing, and in many cases inadequate. Further, the uncontrolled competition which it allows between chartered banks and the "near" banks may seriously hamper Canadian monetary policy.

I. INTRODUCTION

The banking system is affected with the public interest to a much greater extent than most industries.[1] The community takes a special interest in the business of financial institutions and imposes upon them an exceptional degree of regulation and supervision, matched only by that accorded the public utilities. Indeed, financial institutions are regarded as much like public utilities because of the importance to the stability and growth of the economy of, first, the flexibility of the supply of money, which has increasingly come under the control of these institutions, and second, the solvency of thrift institutions and insurance organizations as the depositories of a substantial proportion of the financial assets of the community.[2]

In Canada, the incorporation and regulation of financial institutions is divided between the federal Parliament on the one hand and the ten provincial legislatures on the other. The specific division is not based on considerations of economic effects or administrative efficiency, but is the result of the distribution of legislative power accomplished by the British North America Act[3] of 1867 and of the subsequent judicial interpretations of that statute. Of equal significance in the present dual, and partly duplicative, system of constitution and regulation is the tendency of the federal Parliament to acquiesce in provincial assertions of legisla-

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[1] For 14th Amendment purposes, banking is "stamped with the public interest". *Noble State Bank* v. *Haskel* (1910) 219 U.S. 104.

[2] *See* Goldsmith, *Financial Institutions* 52-53 (1968).

[3] 30 Vict., c. 3.

tive competence, and to refuse to exhaust its legislative competence and fulfill its constitutional responsibilities. Historical accident has had as well not a little to do with the evolution of the present structure of control.

Among the classes of legislative competence in the British North America Act which are relevant to the business of financial institutions, section 91, paragraph 15 is of primary importance and constitutes the central concern of this paper. The paragraph assigns to the exclusive legislative authority of the Parliament of Canada, notwithstanding anything in the Act, all matters coming within the class of subjects "Banking, Incorporation of Banks, and the Issue of Paper Money." That grant of power is surrounded by others of a similar and complimentary nature: "Currency and Coinage" [section 91(14)]; "Savings Banks" [section 91(16)]; "Bills of Exchange and Promissory Notes" [section 91(18)]; "Interest" [section 91(19)]; and "Legal Tender" [section 91(20)]. The observation of Hudson J. of the Supreme Court of Canada is well founded: "Read together these have a cumulative effect, I think, much greater than if individual headings were taken separately."[4] As Laskin observes: "The B.N.A. Act contains overwhelming internal evidence of the conviction that money, banking and credit (in its public aspect) should be exclusively of federal concern."[5]

The Nature of the Problem

In *Canadian Pacific Railway Co.* v. *Ottawa Fire Insurance Co.* Davies J. said:[6]

> . . . [T]he obvious reason why the incorporation of banks was assigned to the Dominion and not left with the provinces was that the whole subject of banking and its adjuncts was being assigned to the Dominion, and if the provinces were allowed to incorporate provincial banks with the right properly and necessarily belonging to a bank the whole subject of banking would have been left in inextricable confusion. And so far from having a national banking system today [1907] of which we are justly proud, we would have a series of systems. . . .

As it happens, these remarks were profoundly ominous. Competing for the deposits of the banking public and for opportunities to lend or invest those deposits profitably are a host of institutions that are subject to the laws, regulations and supervision of the ten provinces and of the central government. The traditional contrast between American and Canadian banking, designed to illustrate the homogeneity of the latter and the haphazard nature of the former, is no longer valid. Notwithstanding the manifest objects of the confederating statute and the need for a systematic and uniform legislative policy in relation to banking, it cannot be doubted that Canada now has a series of banking systems.

It is surprising to find the Canadian federalism accommodating what are in essence provincial banks when the structure of that federalism was to such a large extent a reaction to developments in the United States. The years preceding the Canadian Confederation were characterized in the United States by "a chaotic era of wild-cat state banking" and strenuous efforts "to achieve sounder banking through an increase in federal control over commercial banks."[7] If reaction in the founding

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4 *Re Alberta Legislation* [1938] 2 D.L.R. 81 at 135.

5 Laskin, *Canadian Constitutional Law* 603 (3rd ed. rev. 1969).

6 (1908) 39 S.C.R. 405 at 425.

7 Note, *Constitutionality of Exclusive Federal Control over Commercial Banking,* (1934) 43 Yale L.J. 454.

provinces to the aftermath of decentralized banking control in the United States found its way into the language of the Canadian constitutional document, it did not find expression in the emerging pattern of legislative action.

Banking: A Conceptual Spectrum

There is no doubt about which level of government has control over banks and banking in Canada. The source of confusion is to be found rather in the lack of a clear concept of the banking function. What exactly is it over which the federal Parliament has power? The Privy Council has said: "The question is not what was the extent and kind of business actually carried on by banks in Canada in 1867, but what is the meaning of the term itself in the Act."[8] By parity of reasoning, it is not meaningful to adopt a definition of banking which is merely descriptive of the functions of those institutions which we at present happen to call banks.[9] If resort is had to jurisprudence and to the analysis of economists, no single, universally-accepted definition emerges. Banking can be either a broad term or a very narrow one.

The analysis which follows isolates a number of conceptions of banking and attempts to evaluate the merits of each for constitutional purposes. Attention is focused on a number of variables; function, legal relationship with customers, economic effects of operation, and technique. It is assumed throughout that jurisdiction over banking was assigned to the Dominion because there is some unique quality attached to that activity and to the institutions which carry it on, a quality which makes banking a matter of national rather than local or provincial concern.[10] Borne in mind is Professor Lederman's injunction: ". . . '[Banking] is used as the Statute [The B.N.A. Act] says as describing a subject for legislation, not a definite object'. We do not look just for banking as a matter of economic fact, we must look for regulation of banking as a matter of law."[11] The constitutional implications of the analysis are clear: there is no realistic conception of banking which includes *only* federally chartered institutions and excludes *all* institutions provincially incorporated and regulated. Many provincially incorporated organizations carry on what appear to be banking functions, but are not called banks nor are they subject to federal control. It is one thing to say that there are difficulties in attributing a precise meaning to the terms of the B.N.A. Act; it is totally another to say that those terms have no meaning.

It is well to note that I am here advocating, to the question of legislative competence in relation to banking, an approach which has been rejected in Australian constitutional jurisprudence. In *Bank of New South Wales* v. *Commonwealth*,[12] Dixon J. said that whatever might be the indispensable characteristics of banking, for constitutional purposes "they should be sought rather in the relations between banks and those who use them than in a more abstract consideration of the true economic nature of the contribution made by banking to the monetary

[8] *A.-G. Alberta* v. *A.-G. Canada* [1947] A.C. 503 at 516.

[9] The federal Bank Act prohibits the use of the word "bank" by institutions not authorized under the Act but nowhere prohibits others from engaging in banking activities, S.C. 1966-67, c. 87, s. 157(1).

[10] This basic contrast is what Clement rightly calls "The Cardinal Principle of Allotment" in the Canadian constitution. Clement, *The Law of the Canadian Constitution* c. 32 (3rd ed. 1916).

[11] Lederman, *Classification of Laws and the British North America Act* (Part 3, c. 1 *The Courts and the Canadian Constitution*, Lederman (ed.), 1964) 183, quoting from *Re Alberta Bill of Rights Act* [1946]3 W.W.R. 772 at 778.

[12] (1948) 76 C.L.R. 1.

system and public finance of a country by banks [sic]."[13] If banking is descriptive of an activity which poses special problems requiring intervention and supervision by the state, it is surely wrong to make the *a priori* assumption that those special problems arise only because banks stand in some peculiar relationship to their customers. To admit that banking is inextricably bound up with broad monetary and economic considerations while denying the relevance of those considerations in constitutional adjudication, is to guarantee the fabrication of rules both irrational and arbitrary.

II. BANKING AS FINANCIAL INTERMEDIATION

In their transactions, individuals and institutions deal in various types of items which may be classified into two large categories: non-financial and financial. Whatever else is characteristic of a bank, it is and always has been an institution whose assets consist almost exclusively of financial instruments, primarily of claims against non-financial borrowers and secondarily of corporate stock. Such an institution is clearly distinguished from the other sectors of the economy whose assets are made up chiefly of tangible items such as buildings, machinery, vehicles, inventories and land. Units in these sectors hold financial assets as liquid reserves or as subsidiary sources of income in the form of interest and dividends. Broadly conceived, banks are sources of purchasing power for business enterprises, individuals and governments.[14]

Equally distinctive of banks, as opposed to other lending and investment institutions, is the predominance among their sources of funds of liabilities compared to net worth, the latter the result of the sale of stock or the accumulation of retained earnings. The banking institution raises its funds by borrowing from the public, and uses them for lending. David Ricardo, England's leading nineteenth century economist, distinguished a bank in these simple terms:[15]

> There is this material difference between a Bank and all other trades: A Bank would never be established, if it obtained no other profits but those from the employment of its own capital: *its real advantage commences only when it employs the capital of others.*

Walter Bagehot uses his contemporary's description to contrast the capitalist and the banker: ". . . the distinctive function of the banker, says Ricardo, 'begins as soon as he uses the money of *others*;' as long as he uses his own money he is only a capitalist."[16]

Thus, banking may be described as a process of financial intermediation. Financial intermediaries effectively mediate between people who save (and therefore have money to lend or invest) and people who want to secure the use of the money for the purpose of spending. The function of intermediaries is to transfer the savings of surplus units in the economy to deficit units. Financial intermediaries obtain loanable funds by selling their claims to the public and invest the funds so obtained in primary securities issued by various classes of spending units.

The intermediary view of banks—the view that they act as channels

[13] *Id.* at 335.

[14] "Although a banking firm does many things, its main activity is to supply funds to the community". Galbraith, *The Economics of Banking Operation* 61 (1963).

[15] 4 Sraffa, *The Works and Correspondence of David Ricardo* 108 (1951), cited in Galbraith, *supra*, n. 14 at 14.

[16] Bagehot, *Lombard Street: A Description of the Money Market* 21 (1902), cited in Galbraith, *supra*, n. 14 at 14.

for transferring savings—was widely held in the nineteenth century.[17] It is certainly arguable that it was this conception of banking which was in the minds of those who assigned the banking power to the Dominion.[18] That this may be the case is not without consequence. In *Bank of Toronto* v. *Lambe*[19] the Privy Council adopted John Stuart Mill's definition of direct and indirect taxation for the purpose of interpreting section 92(2) of the B.N.A. Act; Mill's definition was accepted because it seemed to their Lordships to embody the common understanding of men that the Fathers of Confederation must have had in mind in using the categories of direct and indirect taxation.[20] The opinions of Walter Bagehot must have been particularly persuasive in 1867. Bagehot's *The English Constitution,* first written as a series of essays and published in book form in 1867, became the classic account of the subject. It was through his *Lombard Street* that the principles of central banking became generally understood and taken for granted.[21] His political and economic thoughts found expression in popular journals of the mid-19th Century.[22] Sir John A. Macdonald, writing as Prime Minister to provincial Lieutenant-Governors, cited Bagehot as a constitutional authority of no small repute.[23] It is no exaggeration to say that Bagehot was to banking and constitutional matters what Mill was to taxation.

In *United Dominions Trust, Ltd.* v. *Kirkwood*[24] Lord Denning said that financial intermediation was considered the essential characteristic of banking in the 18th Century and that this view continued for some time to dominate thought on the subject.[25] In 1914, Isaacs J. in the High Court of Australia said:[26]

> . . . [T]he essential characteristics of the business of banking may be described as the collection of money by receiving deposits on loan, repayable as and when expressly or impliedly agreed upon, and the utilization of the money so collected by lending it again in such sums as are required. . . .

Members of the chartered banking industry continue to urge a broad definition of the banking function keyed to the intermediary conception.[27]

An orthodox list of Canadian financial intermediaries would include the following:

Chartered banks
Quebec savings banks
Trust companies
Mortgage companies

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[17] *See* Galbraith, *supra,* n. 14 at 39.

[18] In the debates concerning Canada's first Bank Act, S.C. 1870, c. 11, banks were described as "the great middle men between the saving, thrifty class, and energetic, speculative, business men". (1870) H.C. Deb. 244.

[19] (1887) 12 App. Cas. 575.

[20] *Id.* at 583.

[21] *See* Binhammer, *Money, Banking and the Canadian Financial System* 54 (1968).

[22] *See* Bagehot, *The English Constitution,* Introduction by R. H. S. Crossman (1963).

[23] *See* Saywell, *The Office of Lieutenant Governor* 34, 36, 94 (1957).

[24] [1966] 1 All E.R. 968.

[25] *Id.* at 974.

[26] *State Savings Bank of Victoria Comrs.* v. *Permewan Wright & Co., Ltd.* [1915] 19 C.L.R. 457 at 471.

[27] Mr. R. M. MacIntosh, Joint General Manager, Bank of Nova Scotia, testified as follows before a Parliamentary Committee:

> We are a financial intermediary type of institution. Like all financial intermediaries we, in fact, do interpose between borrower and lender, and we are definitely lending other people's money. We are borrowing and we are lending. We are borrowing people's money and then lending it to borrowers. We lie between borrowers and lenders as do all financial institutions in one form or another.

Standing Committee on Finance, Trade and Economic Affairs, Minutes of Proceedings and Evidence, H.C. First Sess., 27th Parl. (1966) No. 23, 1324.

Credit unions and caisses populaires
Life insurance companies
Finance companies
Consumer loan companies
Provincial government savings institutions
Investment companies

Only the chartered banks and Quebec savings banks owe their corporate existence exclusively to federal authorities, and their activities alone are regulated exclusively by the Dominion.

Each financial intermediary issues its own specific brand of obligation. The chartered banks, Quebec savings banks, and provincial savings offices assume liabilities for deposits; trust companies assume liabilities for trust accounts and for deposits; credit unions and caisses populaires issue two types of liabilities, called shares and deposits; life insurance companies issue life contingency contracts; loan and finance companies issue notes and debentures; investment companies issue shares, debentures and investment certificates. But there is nothing in principle to differentiate the borrowing activities of a federally chartered bank from those of any other borrowing financial institution. "The borrowing instruments used may differ, but the instruments employed, whether they be deposits or not, all serve the same general purpose: to provide the holders with a convenient financial asset."[28] The federally chartered institutions compete for public savings with other financial intermediaries.[29] Competition is aggressive in lending markets as well.[30]

For constitutional purposes it is sensible to interpret "banking" in the sense of financial intermediation only if that activity raises distinct problems of public policy which seem to require particular kinds of legislative intervention. Or, as Professor Lederman would put it, one must find in banking as a matter of fact conditions and problems requiring banking legislation as a matter of law. Without attempting any exhaustive analysis at this point,[31] it is fair to say that the business of financial intermediaries raises two such distinct problems of public policy. First, while solvency is important for all types of institutions, it is exceptionally important for institutions which borrow funds from the public for the purpose of lending to the public. In articulating a legislative purpose behind the Ontario Loan and Trust Corporations Act,[32] Kelly J.A. made the point admirably:[33]

> . . . [T]he purpose . . . [is] to exercise a form of control over the incorporation and operation of corporations which lend to the public funds drawn from a wide clientele of depositors, debenture holders and other persons in a creditor relationship to the corporation to the end that some measure of protection may be offered to those who entrust, or are exposed to solicitation to entrust their funds to the corporation.

In seeking a legislative purpose for bringing the diverse operations of financial intermediaries under one umbrella, Kelly J.A. found a "recog-

[28] Galbraith, *supra*, n. 14 at 8.

[29] *See* Standing Committee on Finance, Trade and Economic Affairs, *supra* n. 27, No. 24, 1453. *See also* Royal Commission on Banking and Finance, Report 101, 360-361 (1964) [hereinafter cited as Porter Commission Report].

[30] *See* Porter Commission Report, *supra*, n. 29 at 101, 360-361, 377-378.

[31] A problem not considered here is the influence of intermediaries on the demand for goods and services. *Infra*, at 194.

[32] R.S.O. 1960, c. 222.

[33] *Sidmay Ltd. et al.* v. *Wehttam Investments Ltd.* [1967] 1 O.R. 508 at 523.

nizable common denominator" in the need to protect the money of the public loaned to companies for the purpose of enabling them to lend it to others.[34] "Because, more than any other enterprise, it handles other people's savings, a financial institution must be given supervision and protection by the state."[35]

A second feature of the intermediary system that is of major importance to the public interest is its role in the allocation of financial resources. The allocation of intermediary funds to borrowers constitutes support for the spending programmes of the borrowers; since not all would-be borrowers can be wholly satisfied at once, "it falls to the capital market or to the lenders in the capital market, in substantial measure, to select the spending programmes to be supported."[36] Any major revision of the rules governing the lending operations of a class of intermediary, or any change in the relative rates of growth of intermediaries with distinctive investment preferences, will influence directly and profoundly the pattern of resource allocation in the economy.[37] If indication is wanted of the importance of intermediaries in financing expenditures which economic units cannot finance out of their own savings, it is to be found in statistics showing that intermediaries held over 50 per cent of primary debt[38] outstanding in Canada in 1961.[39] In the private sector intermediaries held 70 per cent of business debt, 56 per cent of mortgage debt, and 80 per cent of other personal debt.[40] And the relative importance of intermediaries in financing economic activity is increasing.[41] To a large extent then, intermediaries determine the purposes for which public savings will ultimately be spent.

Federal Laissez-Faire

The history of banking regulation in Canada is notable for the absence of any attempt by the federal Parliament to provide comprehensive regulation of financial intermediation in the interests of those who entrust their savings to lending institutions. Rather, the efforts of Parliament in the field of banking "have been directed toward the creation and maintenance of an economically powerful [chartered] banking system capable of maintaining a strong competitive position vis-a-vis other financial institutions. . . ."[42]

The regulatory system which emerged from early federal banking legislation was selective. The first permanent banking statute[43] made it unlawful for anyone, other than a federally chartered bank, to issue any note or other instrument intended to circulate as money or to be used as a substitute for money.[44] An amendment in 1880 made it an offence for any person, firm or company to assume or use the title of "bank" unless authorized so to do by a federal statute.[45] By further amendment

[34] *Id.*

[35] Government of Quebec, *Report of the Study Committee on Financial Institutions* 56 (1969).

[36] Hood, *Financing of Economic Activity in Canada* 16 (1958).

[37] *See* McIvor, *Canada* (c. 11 *Commonwealth Banking Systems*, Crick (ed.) 1965) 426-433.

[38] Primary debt means "the debt contracted by non-financial borrowers with a view to engaging in transactions on the goods market". Raynauld, *The Canadian Economic System* 271-272 (1967).

[39] *Id.* at 274.

[40] *Id.*

[41] *Id.* at 276-277.

[42] Baum, *Banking in Canada*, (1971) 59 Geo. L.J. 1127 at 1130.

[43] An Act relating to Banks and Banking, S.C. 1871, c. 5.

[44] *Id.* s. 68.

[45] S.C. 1880, c. 22, s. 10.

in 1883 it was made an offence for any person, firm or company to use the title "bank" or similar designation without adding the words "not incorporated" unless authorized so to do by federal statute.[46] The effect of these prohibitions has been summarized as follows:[47]

> If a financial institution called itself a bank and wished to be incorporated it had to be chartered federally, and it had to act in accordance with federal banking law. If it did not call itself a bank, or if it avoided incorporation and note issue, it could escape federal control entirely.

Long before Confederation, the banks operated in competition with other institutions taking deposits and selling to the public other financial instruments such as debentures.[48] Reserved as its solicitude was for note-holders,[49] the Dominion did nothing to bring all such institutions under federal control.[50] Like the "private banks,"[51] trust companies, mortgage companies and credit unions were outside the federal banking law, even though from their 19th century beginnings they had operated as financial intermediaries in the same way as the chartered banks.[52] In the years after Confederation, various other types of financial institutions were organized to compete for public savings.[53] The circumstance that some were governed only by the general provisions of company law was the subject of critical comment by the Governor of the Bank of Canada.[54]

The recent and spectacular failures of a number of financial institutions, notably Atlantic Acceptance Corporation and Prudential Finance, called to Parliament's attention the need for supervision and control of those intermediaries, particularly sales finance companies, which had theretofore escaped anything in the nature of banking regulation. It was recognized that sales finance companies, for example, act in much the same way as other financial intermediaries such as banks, insurance companies, trust companies and mortgage loan companies which were subject to an elaborate structure of governmental supervision.[55] The gap was illogical, and Parliament enacted the Investment Companies Act.[56] The object of the Act is to ensure the solvency of financial institutions which solicit funds from the public by offering debt instruments.[57] The Act imposes stiff regulations on companies whose major business is to borrow money on the security of bonds, debentures, notes or other-

[46] S.C. 1883, c. 20, s. 8.

[47] Drummond, *Financial Institutions in Historical Perspective*, (1967) 74 The Canadian Banker 150 at 151.

[48] Neufeld, *Canadian Financial Intermediaries: A Century of Development*, (1967) 74 The Canadian Banker 143 at 144.

[49] *See* Drummond, *supra*, n. 47 at 152; Falconbridge, *Banking and Bills of Exchange* 24-26 (2nd ed. 1913).

[50] Savings banks incorporated under pre-Confederation provincial legislation were required to obtain federal charters by Dominion legislation of 1871. S.C. 1871, c. 7.

[51] 190 of such institutions existed in 1890. They accepted savings deposits and made loans, but were not regulated by anyone because they were not incorporated and did not issue notes. Drummond, *supra*, n. 47 at 151.

[52] *Id.*

[53] *See* Neufeld, *supra*, n. 48 at 146-149.

[54] Bank of Canada, Annual Report of the Governor to the Minister of Finance (1956) at 26:

> Finance companies carry on an operation which is in all essentials banking. . . . [They] are not required to maintain reserves nor are they subject to regulation in the way that banks, life insurance companies and some other investment institutions are.

[55] *See* Standing Committee on Finance, Trade, and Economic Affairs, Minutes of Proceedings and Evidence, H.C. Third Sess., 28th Parl. (1970) No. 1, 16.

[56] S.C. 1970-71, c. 33.

[57] "Companies that raise money only on equity instruments are not covered. For them, the investors are shareholders and they thus undertake to follow the fortunes of the enterprise, good or bad." Standing Committee on Finance, Trade and Economic Affairs, Minutes of Proceedings and Evidence, Third Sess., 28th Parl. (1970) No. 1, 8. (Mr. R. Humphrys, Superintendent of Insurance.)

wise, and to use the proceeds to make loans, to purchase corporate securities, or to buy obligations representing part or all of the sale price of merchandise or services.[58] The Act requires investment companies to obtain certificates of registry, to file annual financial statements (and such other information as may be required) with the Department of Insurance, to refrain from making loans and investments where there may be a conflict of interests, and to permit examiners to examine their books and records as required. Extensive remedial powers, including the power to take control of assets or to direct that the business of investment be discontinued, are vested in the Minister and Superintendent of Insurance.

Notwithstanding that the Act's definition of the business of investment companies is in truth an acceptable definition of banking as the term was widely understood at Confederation, and that the Act imposes controls appropriate for banking institutions, only companies incorporated by or pursuant to an Act of Parliament are subject to the specified controls.[59] Provincially incorporated "investment companies" continue unregulated by the federal authorities. The extravagant irony in the statute's selectivity was disclosed when the Superintendent of Insurance admitted before the Standing Committee on Finance, Trade and Economic Affairs that had the Act been passed 5 years earlier, it would not have prevented the bankruptcies which prompted its enactment; Prudential and Atlantic were provincially-incorporated.[60] Said the Superintendent: "I am not aware of any federally-incorporated companies that have gone bankrupt in recent years."[61]

In enacting the Investment Companies Act, Parliament acted on the assumption that its banking power was not broad enough to encompass all intermediaries. In 1966 the Inspector General of Banks said that Atlantic Acceptance Corporation did not carry on a business that could have been described as banking: "They were not normally in short term borrowing. They did not carry on a chequing business."[62] This narrow conception of banking is in sharp contrast to the ideas of federal officials not so far removed in time from Confederation. In 1910 the federal Minister of Justice was called upon to express his opinion as to the constitutional validity of a Quebec statute authorizing a trust company to receive money on deposit and make such money bear interest. The Minister said:[63]

> The receiving by a company of the money of others on general deposit or at interest to form a joint fund which may be used by the company for its own benefit, or for the purpose of making temporary loans and discounts, or of dealing in notes or bills of exchange, is in the view of the undersigned a transaction especially connected with banking, and therefore *ultra vires* of a provincial legislature to authorize.

The Minister was not persuaded by the argument of the Quebec Attorney General that the business of banking was confined to the receipt of

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[58] Investment Companies Act, S.C. 1970-71, c. 33, ss. 3(1); 2(1)(b),(g).

[59] *Id.* s. 2(1)(d). Chartered banks, Quebec savings banks, Canadian and British insurance companies, co-operative credit associations, and federal trust and loan companies are excluded. *Id.* s. 2(1)(9).

[60] Standing Committee on Finance, Trade and Economic Affairs, Minutes of Proceedings and Evidence, Third Sess., 28th Parl. (1970) No. 1, 33.

[61] *Id.*

[62] Standing Committee on Finance, Trade and Economic Affairs, Minutes of Proceedings and Evidence, First Sess., 27th Parl. (1966) No. 18, 906.

[63] Gisborne and Fraser, *Provincial Legislation 1896-1920* 256 (1921).

money to be repaid on demand, or when drawn by cheque.[64] The fact that before the enactment of the B.N.A. Act, as well as since, private bankers had engaged in the business of receiving customers' money upon deposit, did not, he felt, make that sort of business any the less banking, or remove it from the legislative authority of Parliament.[65]

The failure of Parliament to make its legislation applicable to all investment companies may well produce a "competition in laxity" between the federal and provincial governments, just as did the failure of Congress to require membership of all state banks in its Reserve System.[66] If provincial regulations are absent or less stringent, investment companies will be induced to organize as provincial institutions. This point was raised in the committee hearings on the Investment Companies Bill. Asked whether institutions covered by the Bill might forego their federal charters and pick up provincial charters, the Superintendent of Insurance replied:[67]

> This is always possible and I think in a structure such as we have in Canada, with two levels of jurisdiction incorporating companies and supervising them . . . there is always the question of will there be a tendency to move to the jurisdiction that is the easiest as far as their regulation and supervision is concerned.

The Superintendent felt however that sound regulation and supervision would be welcomed by companies that appeal to the public for funds.[68] This, unfortunately, has not been the American experience.[69]

Legal Relationship with Customers

All financial intermediaries obtain funds from surplus units in the economy. But the relationships between intermediaries and those from whom they obtain funds are not uniform. Because one of the essential characteristics of banking is said to derive from the nature of the relationship between the bank and its depositors, it is important to examine those intermediary relationships which do not follow the traditional banking model. In the typical intermediary business (including that of banks), "funds gathered from many sources become a single pool available for investment in the company's portfolio of assets and the company retains any difference between revenues and administrative and borrowing expenses."[70] This description is not apt in respect of the business of some financial institutions described here as intermediaries.

Trust companies perform two distinct functions: the first is of course their primary function of trustee, and second their activities as financial intermediaries. The estate, trust and agency activities are quite different from an intermediary business. Estate and trust business—and much of the agency work—consists of managing individual asset holdings to maximize the objectives of the beneficiaries in return for a percentage or fixed fee. Trust funds are administered as individual accounts subject to the duties outlined in the deed of trust, and the companies possess

[64] *Id.* at 257.

[65] *Id.* at 260.

[66] *See* Note, *supra*, n. 7 at 457-459.

[67] Standing Committee on Finance, Trade and Economic Affairs, Minutes of Proceedings and Evidence, Third Sess., 28th Parl. (1970) No. 1, 24.

[68] *Id.*

[69] *See* Note, *supra*, n. 7 at 458. ". . . [T]he counter inducements of the liberal state laws have enticed banks away from the Federal Reserve System." *See also* Robertson, *Federal Regulation of Banking: A Plea for Unification*, (1966) 31 Law and Contemporary Problems 673.

[70] Porter Commission Report, *supra*, n. 29 at 186.

no proprietary interest in the assets.[71] As trustees, trust companies do not act as borrowers or lenders in their own names and for their own accounts, as other intermediaries do; there is in this respect no debtor substitution. If the trust business is set apart from intermediation on this basis, however, the exclusion can be questioned with respect to "pooled accounts", which are estate, trust and agency funds belonging to several clients and commingled in a single portfolio for management.[72] "The trust companies have a measure of control over these monies; they are more than *pro forma* administrators."[73] About the "pooled accounts" more will be said later.[74]

Trust company legislation contains explicit authorization for the firms to engage in the intermediary business: to receive deposits repayable upon demand or after notice, to pay interest thereon, and to retain the profit resulting from the investment or loaning of such deposit money in excess of the amount of interest payable to depositors.[75] Also authorized is the receipt of money on term investment.[76] But the funds obtained in this manner are legally held in trust rather than borrowed. The Alberta Trust Companies Act provides: "All deposits and investment monies received by a provincial company . . . are held by the company as trustee for the person entitled thereto, notwithstanding any agreement to the contrary."[77] A company has no power to receive monies on deposit under an arrangement whereby the company is the debtor of the depositor.[78] The debtor-creditor relationship is absent in trust company business. And it has been held consistently that this relationship is essential to banking. In *Everley* v. *Dunkley* Riddell J. said:[79]

> . . . [S]ince the case of *Foley* v. *Hill*, 2 H.L.C. 36, the relationship of banker and customer has uniformly been held to be not that of trustee and *cestui que trust* but that of debtor and creditor. There is nothing sacred in the position of banker, he sells the use of money—nor is there anything abstruse or recondite in his relation to his depositor—he is an ordinary debtor.

The property in money deposited with a bank is in the bank.[80] The trust company depositor or investment certificate holder has an equitable interest in a particular fund which is by statute "ear-marked and definitely set aside;"[81] this is the "guaranteed fund."

Is federal jurisdiction over the intermediary business of trust companies to be denied because of the presence of this fiduciary relationship? Is the statutory label of trust sufficient to exempt an institution from banking regulation or to warrant provincial incorporation? Surely the important question, as Professor Baum suggests,[82] is whether banking functions are performed by trust companies. On this point, the Quebec Study Committee on Financial Institutions is unequivocal:[83]

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[71] *See* Baum, *The Near-Banks: Trust Companies of Canada*, (1971) 45 Tulane Law Review 546 at 554-555.

[72] *See* Goldsmith, *supra*, n. 2 at 22.

[73] Baum, *supra*, n. 71 at 556.

[74] *Infra*, at 198.

[75] *See e.g.*, The Trust Companies Act, R.S.A. 1970, c. 372, s. 99. The receipt of deposits by trust companies ante-dates Confederation. Baum, *supra*, n. 71 at 558.

[76] *See e.g.*, The Trust Companies Act, R.S.A. 1970, c. 372, s. 100.

[77] *Id.* s. 101.

[78] *Id.* s. 99(4).

[79] (1912) 8 D.L.R. 839 at 843.

[80] *Beacom* v. *Bank of Montreal* (1930) 39 O.W.N. 334.

[81] The Trust Companies Act, R.S.A. 1970, c. 372, s. 104.

[82] Baum, *supra*, n. 71 at 568.

[83] Government of Quebec, *Report of the Study Committee on Financial Institutions* 23 (1969).

> Even if 'guaranteed investment certificates' issued by trust companies appear to create a fiduciary relationship between lender and borrower, they nevertheless amount to a financial transaction similar to that carried out by other institutions. In this respect, a trust company deposit is no more 'guaranteed' than a bank deposit.

The guaranteed fund is not a cash reserve; it may include any investments and loans authorized by the legislation except those that can be made only with the use of the company's own funds (the shareholder's equity).[84] Looking to the economic effects of operation, the Porter Commission was equally blunt in its characterization of these "trust" funds:[85]

> . . . [T]he fact that the funds are legally held in trust rather than borrowed does not make any practical difference to the trust companies or the financial system: the economic effects of their intermediary operations are the same as those of loan companies, banks and other institutions and the business is carried on in a similar way.

It is noteworthy that in the two cases[86] which have dealt with the constitutional validity of provincially incorporated trust companies, the results did not turn on the nature of the legal relationship between the company and its lenders. And as the Minister of Justice quite correctly pointed out in 1911, there was no intention in *Foley* v. *Hill*[87] "to state or define comprehensively the essential qualities of banking business."[88] The only point decided was that an action in respect of a customer's bank account should be at law and not in equity.

If banking is synonymous with financial intermediation, then trust companies (except in respect of their estate, trust and agency business) are banks notwithstanding the statutory declaration of trust in respect of their liabilities to customers.[89]

Insurance companies are intermediaries—reservoirs in the flow of funds from surplus to deficit units—but there are important differences between the character of their operations and that of banking institutions. Insurance companies do accumulate pools of funds from premium and investment income out of which to meet claims under policies written; they do manage portfolios of assets like other financial institutions.[90] But the holding and management of financial assets is ancillary to their principal activity, provision of protection against specified risks. The essence of insurance is service "which gives rise to long term obligations and then investments made with a view of meeting these commitments when they fall due."[91] The premium paid is not a loan, and the policy is not a security.[92] The insurance policy is not generally considered a security because it includes no savings feature. The Porter Commission reasoned:[93]

> The purchaser of general insurance does not accumulate financial assets in this way, he simply buys a service; these companies [general insurance companies, including those life companies which sell insurance against sickness and accident] are thus not financial intermediaries in the full sense.

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[84] *See* The Trust Companies Act, R.S.A. 1970, c. 372, s. 104(1).

[85] Porter Commission Report, *supra*, n. 29 at 176.

[86] *Re Dominion Trust Company* [1918] 3 W.W.R. 1023; *Re Bergethaler Waisenamt No. 2* [1948] 1 W.W.R. 305.

[87] (1848) 2 H.L. Cas. 28.

[88] Gisborne and Fraser, *supra*, n. 63 at 260.

[89] Professor Neufeld is of the same opinion. *See* Neufeld, *supra*, n. 48 at 147-148.

[90] Porter Commission Report, *supra*, n. 29 at 250.

[91] Government of Quebec, *Report of the Study Committee on Financial Institutions* 100 (1969).

[92] *Id.*

[93] Porter Commission Report, *supra*, n. 29 at 250.

Life companies constitute a distinct category of insurance company; they provide a means of accumulating savings as well as offering protection. Payments made in respect of annuity contracts and life insurance policies other than term insurance[94] "provide for the accumulation of substantial savings as well as covering the cost of protection itself."[95] Because these contracts have a high savings content, the life business involves a far greater accumulation of assets than does any other type of insurance. What is more, premiums paid in respect of life policies derive a measure of liquidity through two features of the usual contract: cash surrender values and policy loan options. The bulk of savings in life insurance is available, if the need arises, for a temporary or permanent recovery of the sums accumulated in earlier years. The Porter Commission was able to say: "Despite the unique characteristics of life insurance, the companies must compete actively for the public's savings."[96] Their growth, like that of any other financial intermediary, is dependent upon the attraction of savings. In their importance as intermediaries, the life insurance companies rank second only to the chartered banks.[97]

Reacting to suggested similarities between the life insurance business and the business of other financial institutions, the Life Insurance Association of America emphasized in a 1962 study that life insurance savings are fundamentally different from savings through banking institutions.[98] First, the inflow of savings through premiums to life insurance companies is long term and contractual in nature and is therefore more stable. Second, the accumulation of savings through life insurance is secondary or incidental to the main purpose of providing financial protection for beneficiaries in the event of the death of the insured. Third, life insurance saving is ordinarily expected to be left intact until the death of the insured rather than withdrawn for consumer expenditure. To this catalogue of dissimilarities the Association might have added the fiduciary character of the relationship between insurer and insured. The Royal Commission on Life Insurance described life insurance funds in these terms:[99]

> Your Commissioners have no doubt that accumulated insurance funds are, in every essential particular, trust funds. They belong to the policyholders and not to the shareholders. The directors are not in possession of them as trading capital in any sense or to any degree. They are not subject to trading risk. They are held in trust for investment and to be eventually paid to those whose money they are.

It is possible, however, to make far too much of these distinctions. Certainly the stability of life insurance savings leaves the companies "peculiarly free from problems of short-run liquidity,"[100] but the difference is one of degree and not of kind. And security is as much the all-encompassing consideration for banks[101] as it is for life insurance companies. For both analytical and practical purposes, the essential point is that institutions as different as banks and insurance companies have the

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[94] 67 per cent of life insurance sold in 1960 was term insurance. Raynauld, *supra*, n. 38 at 227.

[95] Porter Commission Report, *supra*, n. 29 at 240.

[96] *Id.* at 241.

[97] McIvor, *supra*, n. 37 at 428.

[98] Life Insurance Association of America, *Life Insurance Companies as Financial Institutions*, A Monograph Prepared for the Commission on Money and Credit, 16-19 (1962).

[99] Royal Commission on Life Insurance, Report 167 (1907).

[100] McIvor, *supra*, n. 37 at 431.

[101] Baum, *supra*, n. 42 at 1128.

common characteristic of borrowing directly or indirectly from primary lenders by persuading people to hold claims on the intermediary and of transferring the funds so obtained to spending units.

The pattern of governmental regulation of the insurance business reflects this basic similarity. Traditionally, this regulation has been of three types.[102] First, governments have always imposed special conditions upon the grants of corporate privileges to persons entering the insurance business, as they have in respect of banking institutions. Second, there has been regulation of the terms and incidents of the insurance contract, this in recognition of the need "to secure to parties insuring a just and reasonable contract, to prevent the exaction of unjust and unreasonable conditions, and to protect parties from being imposed upon. . . ."[103] This type of regulation may not be so appropriate where the obligation on the institution is relatively standard; that is, to repay a certain sum of money on demand of the lender. Third, and in particular, public supervision is imposed upon the insurance business in an effort to guarantee the solvency of insurers. Arguments which led to the regulation of banking sufficed to bring insurers under similar supervision, entrusted as they are with the care and investment of the funds of others.[104] Not so traditional is the regulation of both banks and insurance companies which seeks to control their function in the allocation of financial resources. Recognizing that this function can lead to unwarranted control of other sectors of the economy[105] public policy seeks to limit the ability of intermediaries to assume control of business corporations. This is the object of section 76 of the Bank Act,[106] which limits the banks' ownership of the voting shares of a corporation to 50 per cent,[107] and of insurance legislation limiting the companies' ownership of the shares of any corporation to a certain percentage.[108] Institutional investors are elephants in the market place; the state seeks to prevent extensive intermediary control of other businesses.[109]

As judicially defined, constitutional jurisdiction over insurance does not take cognizance of this variety of objects and purposes which motivates regulation of the insurance business. "Provincial legislatures have attained an unhampered and unqualified jurisdiction to regulate the business of insurance *in all aspects* within the provinces."[110]

It has been found not remarkable that no specific mention of the subject of insurance appears in the British North America Act.[111] The

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[102] Corry, *The Growth of Government Activities Since Confederation* 113-115 (1939).

[103] *Citizen's Insurance Co.* v. *Parsons* (1881) 4 S.C.R. 215 at 245. This is Chief Justice Ritchie's description of the object of an early Ontario insurance statute.

[104] Corry, *supra*, n. 102 at 115.

[105] *See* Baum and Stiles, *The Silent Partners: Institutional Investors and Corporate Control* (1965).

[106] S.C. 1966-67, c. 87.

[107] Baum, *supra*, n. 42 *passim*.

[108] *See e.g.*, Canadian and British Insurance Companies Act, R.S.C. 1970, c. I-15, s. 63(1)(m)(iii). In *Re Rogers* [1941] O.W.N. 92, at 94, Lelly J. said the object of this provision is to "prevent the taking over of the business of the company itself with the attendant problems and duties of management and control."

[109] Federal insurance regulation of this type and all types extends only to insurance companies incorporated under the laws of Canada or of the former Province of Canada.

[110] Gray, *More on the Regulation of Insurance*, (1946) 24 Can. Bar Rev. 481 (emphasis added).

[111] Royal Commission on Dominion-Provincial Relations, Report, Book II 59 (1940). The Minutes of Proceedings of the Quebec Conference, 1864, contain a resolution by the Honourable Mr. Mowat that the competence of the General Legislature should include power to pass laws, "For the regulation and incorporation of fire and life insurance companies." Pope, *Confederation Documants* 30 (1895). The Conference agreed, however, to strike out the resolution. *Id.* at 88. This historical evidence is not unequivocal in its implications. It could mean that the framers of the Constitution regarded the business of insurance as included under some other, more general head of federal jurisdiction; or that their intention was to reserve that business for provincial control; or, finally, that they had no intention whatever regarding the insurance business.

business of insurance in Canada in 1867 was on a comparatively minute scale;[112] there was no regulation of life insurance prior to that date, and such regulation as was attempted of other forms of insurance was of a very simple nature.[113] The absence of a specific provision in the B.N.A. Act referring to insurance has obliged the courts to find in section 91 or section 92 some general head of jurisdiction under which the regulation of insurance (in some or all of its aspects) could be said to fall. The story of the judicial decision-making which resulted in provincial ascendancy in the field of insurance regulation has been told elsewhere[114] and need not be repeated here. Two points, however, require particular emphasis.

While the Dominion has unsuccessfully invoked almost every conceivably relevant provision in the B.N.A. Act in support of its insurance regulation,[115] there is no evidence that the Dominion has ever relied upon its banking power to support federal regulation of the insurance business or to challenge the validity of provincial legislation in the field. The banking power would of course be relevant only in respect of regulation governing the intermediary aspect of the insurance business. One of the major purposes of two federal insurance statutes found *ultra vires* by the Supreme Court in 1942[116] was to ensure against British and foreign companies becoming insolvent as regards policyholders in Canada and to declare when they should be liable to be wound up. One of the requirements of the statutes was the deposit with the Dominion of securities to the amount of $100,000. Here was legislation concerning the solvency of an intermediary, but it did not follow the pattern of traditional banking regulation which attempts to structure the composition of institutional assets (loans and investments) in a manner compatible with the obligations of the institution so that insolvency does not occur. The provisions here were designed to protect the policyholder in the event of insolvency (actual or imminent) and would find support more appropriately, if at all, in the bankruptcy and insolvency power[117] than in the banking power. The

[112] *See* Neufeld, *supra*, n. 48 at 145. In 1867 there was one Canadian life insurance company, 22 foreign life companies and "a number" of small fire insurance companies. The assets of the life insurance companies were "probably not larger" than two per cent of total intermediary assets.

[113] Corry, *supra*, n. 102 at 113.

[114] *See* MacDonald, *The Regulation of Insurance in Canada*, (1946) 24 Can. Bar Rev. 257; Gray, *supra*, n. 110; Laskin, *supra*, n. 5 at 417-431: Smith, *The Commerce Power in Canada and the United States* 35-41, 80-90 (1963).

[115] MacDonald, *supra*, n. 114 at 272. The relevant provisions are Criminal Law, Aliens, Bankruptcy and Insolvency, Immigration, and Taxation. In each case, says MacDonald, the legislation was "carefully framed as 'aspects' of those subjects". *Id.*

[116] *Re Section 16 of the Special War Revenue Act* [1942] 4 D.L.R. 145.

[117] No reference was made in *Re Section 16 of the Special War Revenue Act, id.*, to the bankruptcy and insolvency power [section 91(21)] as a basis for the insurance legislation under consideration. In a recent case the Supreme Court of Canada held invalid as an invasion of the federal bankruptcy and insolvency jurisdiction provisions of the Ontario Insurance Act, R.S.O. 1960, c. 190, which required companies to deposit securities with the Minister for the purpose of enabling policy-holders to share in the proceeds thereof upon insolvency. *A.-G. Ontario* v. *Policy-Holders of Wentworth Insurance Co.* (1969) 6 D.L.R. (3d) 545.

It is worth asking here why the Dominion cannot successfully rely upon this power in support not only of legislation which envisages insolvency but as well of legislation designed to ensure that insolvency does not occur. There is authority for the proposition that federal powers will support preventive as well as curative legislation. *A.-G. Ontario* v. *Canada Temperance Federation* [1946] A.C. 193 at 207 (Viscount Simon); *Goodyear Tire and Rubber Co. of Canada Ltd.* v. *The Queen* [1956] S.C.R. 303 at 308 (Locke J.). In *A.-G. B.C.* v. *A.-G. Canada* [1937] A.C. 391, Lord Thankerton held that legislative provisions, the purpose of which is the avoidance of bankruptcy, are properly within the sphere of s. 91(21). But to this general proposition he added the qualification that such provisions are valid if insolvency is assumed. *Id.* at 403. This may well be a necessary requirement in seeking to support preventive legislation under s. 91(21). In *The Companies Creditors Arrangement Act Reference*, [1934] S.C.R. 659, upon which Lord Thankerton relied for his general principle, both Duff C.J. and Cannon J. regarded as material to the validity of the statute under consideration the fact that the powers created were exercisable only in case of insolvency. *Id.* at 661, 665. Were s. 91(21) interpreted otherwise, virtually any regulation of business would fall within its scope as a means of avoiding insolvency. *See* Gray, *supra*, n. 110 at 485.

$100,000 deposit was not analogous to cash reserve requirements in banking legislation; the latter are designed to ensure that banks are able to meet their day-to-day liquidity requirements. The question whether regulation of the life insurance business has a banking aspect has not been raised in the courts, much less decided. This is to be borne in mind when one reads that the regulation of the business of insurance in all aspects falls within the unqualified jurisdiction of the provinces.

The failure of the courts to recognize any federal regulatory jurisdiction in respect of the business of insurance appears attributable, in part at least, to accidents of litigation. In the beginning, Dominion insurance legislation was directed chiefly to the questions of solvency and financial responsibility of the companies to which it applied,[118] but the line of cases which has emasculated federal jurisdiction in the field had its origin in a decision to the effect only that the provinces may regulate the conditions and incidents of insurance contracts.[119] One need not question the validity of the early federal legislation in order to support the decision in the *Parsons* case.[120] But the Privy Council found it difficult to appreciate that the B.N.A. Act distributes not fields of law nor general jurisdiction over particular subject-matters but authority to enact particular kinds of statutes.[121] The Privy Council thought of subject-matters such as insurance as matters which, as such, must come under section 91 or as such must come under section 92. Hence, when Dominion insurance legislation did come before the Privy Council in 1916[122] and 1924[123] the die was cast. In finding the Dominion statute *ultra vires* in the earlier case, Viscount Haldane was not at all concerned with its object or purpose, and he described the aspect doctrine as one which "ought to be applied only with great caution."[124] Viscount Haldane emphasized his aversion to the aspect doctrine with this statement: "Where the British North America Act has taken . . . [particular] forms of business out of provincial jurisdiction, as in the case of banking, it has done so by express words. . . ."[125] The B.N.A. Act does not assign particular forms of business; it assigns authority to enact particular kinds of laws.[126] In the 1924 case Duff J. was able to say that the decision in *A.-G. Canada* v. *A.-G. Alberta* was conclusive that Parliament had no authority to regulate generally the business of insurance in such a way as to interfere with the exercise of civil rights in the provinces.[127] That the *Parsons* case should have had the effect of marking out for exclusive provincial control the regulation of the business of insurance is most surprising; in subsequent decisions of the Privy Council it was made clear that the *Parsons* case was to be

[118] An Act respecting Insurance Companies, S.C. 1868, c. 48, provided that all insurance companies, except provincially incorporated companies doing business in only one province, should secure a licence from the Minister of Finance, make deposits and file annual statements. The statute was typical in its coverage: a company could avoid the Dominion legislation by seeking a provincial charter and restricting its operation to that province.

[119] *Citizens Insurance Co.* v. *Parsons, supra,* n. 103.

[120] *Id.*

[121] *See* O'Connor, *Report to the Senate of Canada on the B.N.A. Act,* Annex I 25, 40, 90-91 (1939).

[122] *A.-G. Canada* v. *A.-G. Alberta* [1916] 1 A.C. 588.

[123] *A.-G. Ontario* v. *Reciprocal Insurers* [1924] A.C. 328.

[124] *Supra,* n. 122 at 596. This was said out of "a desire to limit legislative competence according to subject matter rather than purpose or effect". Laskin, *supra,* n. 5 at 89.

[125] *Supra,* n. 122 at 597.

[126] O'Connor, *supra,* n. 121 at 25, 40, 90-91, 131-132.

[127] *Supra,* n. 123 at 336.

taken as an example of the application of the double aspect doctrine.[128] Can it be said with any confidence that the provinces would, in any case, have secured unhampered jurisdiction over insurance had Sir Montague Smith been called upon in 1881 to determine the validity of the early Dominion insurance legislation?

The important point of similarity between banks and insurance companies, and the variety of aspects in insurance regulation are recognized by P.J.T. O'Hearn in his documented proposal for a new constitution.[129] In the proposed catalogue of exclusive federal powers is included the following: "Banking, including the Incorporation of Banks, and the Acquisition and Management of insurance or investment funds."[130] The financial affairs of all insurers would be subject to federal supervision, leaving insurance contracts and the licensing of agents to the provinces.[131] O'Hearn justifies this allocation of power as follows:[132]

> The subjects in this class are grouped together because they are variants on the common theme, the need to regulate people and institutions that handle large masses of money supplied by other people. So vast is the extent of banking, insurance and investment funds and so extensive are the effects of employing them, that only the federal government could have a hope of exercising adequate and necessary controls. Because of central control, the Canadian banking system is extremely stable and this stability should be imposed on the other subjects in the class.

There is a savings-investment and an insurance aspect to the live insurance business: the latter is prominent in the insurance contract and the former in insurance company investments:[133]

> Because of the magnitude of their operations, the Canadian life insurance companies, through their investment decisions, necessarily exert a particularly strong influence on the savings-investment process and on the broad pattern of allocation of resources within the Canadian economy.

Restrictions on the investments life companies are allowed to make warrant classification as banking legislation. This conclusion is invited, if not compelled, by the intermediary conception of banking.

There is a fundamental difference between intermediary claims which constitute a debt or fixed obligation of the institution (the characteristic feature of bank liabilities), and instruments under which losses or gains experienced by the institution's portfolio of assets are automatically passed through to those who entrust their money to the institution:[134]

> It is this difference which distinguishes the instruments (shares or units) issued by a mutual fund from those issued by other financial institutions. The mutual fund share or unit does not constitute a debt or fixed obligation; its value fluctuates directly with the value of the proportionate interest which it represents in the mutual fund portfolio.

Similarly, the closed-end investment companies, modelled after the English investment trusts, are not primarily concerned with borrowing and lending. They do, it is true, borrow some of their funds by the issue of debentures, and they do lend in so far as they hold government bonds

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[128] *Hodge* v. *The Queen* (1883) 9 App. Cas. 117 at 130; *A.-G. Ontario* v. *A.-G. Canada* [1896] A.C. 348 at 363. This point is made by Smith, *supra*, n. 114 at 108.

[129] O'Hearn, *Peace, Order and Good Government: A New Constitution for Canada* (1964).

[130] *Id.* at 42.

[131] *Id.* at 153-154.

[132] *Id.* at 153.

[133] McIvor, *supra*, n. 37 at 431.

[134] Report of the Canadian Committee on Mutual Funds and Investment Contracts, Provincial and Federal Study 113 (1969) [hereinafter cited as Mutual Funds Report].

and industrial debentures. But more characteristically they *own* and *are owned*; that is to say, they are effectively a means for indirect diversified investment in common stock.

Mutual funds and closed-end investment companies, known collectively as investment companies, have developed entirely since Confederation.[135] They are unique among financial intermediaries in that they raise all or most of their funds through the sale of their own common stock to individuals; and in that they use these funds primarily to acquire already outstanding common stock of large corporations that they do not control or manage. Loans are made only "to limit the effect of savings in stock prices and dividends on their assets and earnings."[136] Funds are supplied by owners rather than creditors. This, and the absence of obligation to pay a fixed return, was enough to exempt the companies from the requirements of the Investment Companies Act.[137] For the mutual funds and closed-end companies, "the investors are shareholders and they thus undertake to follow the fortunes of the enterprise, good or bad."[138] The key concern of banking regulation, the protection of creditors' funds, is absent.

The difference between banks and investment companies, unlike that between banks and trust companies, is one of substance rather than form. Banks provide "indirect debt," investment companies "indirect equity." Both types of institution do, however, gather pools of money for investment purposes. And between banks and mutual funds (though not closed-end companies) there is a further important point of similarity which tends to obscure the basic difference between them. The nature and significance of this point of similarity is examined later.[139]

Also included within the generic description "investment companies" are those institutions which sell savings certificates to the public and invest the proceeds in financial assets, principally mortgages, to yield a specified sum in the future to each certificate holder. There were eight such investment contract companies operating in Canada in 1969.[140] The investment contract is a debt instrument which specifies the amount payable by the issuing company on the maturity date of the contract. Debt instruments which promise the holder a fixed return are, of course, the traditional vehicles offered by banks to attract savings dollars. Like banks, investment contract companies profit by earning more on the funds allotted to borrowers than is paid to savers holding their financial obligations.

The investment contract companies argue that the nature of the product offered to savers makes life insurance companies their most direct competitors.[141] Competition comes as well from the savings certificates offered to the public by the chartered banks. "The depositor can pay either by cash or by installments for his certificates, and they are redeemable at face value plus accumulated interest at any time, in any branch of the issuing bank."[142] Purchase by installment and cash

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135 Neufeld, *supra*, n. 48 at 148.

136 Porter Commission Report, *supra*, n. 29 at 253.

137 S.C. 1970-71, c. 33.

138 Standing Committee on Finance, Trade and Economic Affairs, Minutes of Proceedings and Evidence, Third Sess., 28th Parl. (1970) No. 1, 8 (Superintendent of Insurance).

139 *Infra*, at 197-198.

140 Mutual Funds Report, *supra*, n. 134 at 651.

141 *Id.* at 650.

142 Baum, *supra*, n. 42 at 1139.

surrender (or optional settlement, or loan) values prior to maturity are the distinguishing features of investment contracts.[143] The similarity to life insurance, other than term insurance, is partially reflected in the legislation which regulates the investment contract companies.

The one federally incorporated company, Investors Syndicate, Limited, surrendered its charter in 1958.[144] Apart from the Western Savings and Loan Association, which was originally incorporated in Oregon, the companies are organized under provincial legislation. Five provinces have legislation specifically applicable to investment contracts;[145] Alberta's Investment Contracts Act[146] is typical. The Act imposes two types of requirements: those traditionally applied to lending institutions issuing debt instruments to the public, and those traditionally included in securities legislation. Included in the former category are provisions respecting minimum capitalization,[147] the maintenance of reserves bearing a specified relationship to liabilities,[148] and audit, inspection and disclosure.[149] The Act imposes no restrictions upon interest rates on funds borrowed or loaned, and does not define with precision the nature of the relationship between institution and customer. This pattern of control and freedom invites comparison with the Bank Act.[150] The only provision thereof dealing with asset control is section 72 which requires banks to maintain cash reserves equal to twelve and four per cent of demand and notice deposits respectively. The assets-to-debt requirements of the Investment Contracts Act are more extensive. Companies governed by the Act must maintain a deposit of "qualified assets"[151] equal in amount at any time to the amount the company is liable *at that time* to pay to the holders of its contracts.[152] At the same time, the companies must maintain reserves that, together with future payments and interest, will attain the maturity value specified in the contracts when due.[153] These restrictions require the maintenance of assets sufficient to meet liabilities as they fall due and impose restrictions on dividend distribution; the Bank Act's prohibition of dividend payments which impair capital[154] is similar in effect. In the area of investment control, the investment contract companies may invest only in assets in which a company registered under the Canadian and British

143 Mutual Funds Report, *supra*, n. 134 at 648-649.

144 Information supplied by Corporations Branch, Department of Consumer and Corporate Affairs.

145 Alberta, R.S.A. 1970, c. 191; British Columbia, S.B.C. 1962, c. 30; Ontario, R.S.O. 1960, c. 194; Newfoundland, S.Nfld. 1961, c. 14; Saskatchewan, R.S.S. 1965, c. 144. According to the Mutual Funds Report, *supra*, n. 134 at 655-656:

> In the others, investment contract companies are regulated by the securities administrators under securities legislation. This is true of Manitoba, but in that province the Securities Commission is given addditional authority by the special Acts of the Manitoba legislature under which Investors Syndicate, Limited and the Western Savings and Loan Association were organized. In the provinces without specifically applicable legislation, the securities administrators use their discretionary authority to apply requirements which are substantially similar to those contained in the relevant statutes of the other provinces.

146 R.S.A. 1970, c. 191.

147 *Id.* s. 8(b)).

148 *Id.* ss. 8(c), 30.

149 *Id.* ss. 26-28, 32-33.

150 S.C. 1966-67, c. 87.

151 Defined to include cash, first mortgages, mortgages made under federal housing legislation, securities authorized under the Canadian and British Insurance Companies Act (R.S.C. 1970, c. I-15), and real property acquired by foreclosure. R.S.A. 1970, c. 191, s. 2(1)(f).

152 R.S.A. 1970, c. 191, s. 8(c).

153 *Id.* s. 30.

154 S.C. 1966-67, c. 87, s. 71(1)(b).

Insurance Companies Act[155] may invest its funds;[156] regulations found there are extensive. The comparative freedom of activity permitted by the Bank Act is manifest in section 75(1)(e) which authorizes "such business generally as appertains to the business of banking." While the "company law" of banks is contained in the Bank Act itself, that of the investment contract companies is typically found in general companies legislation.

Not only are the banks and investment contract companies alike in what they do but also in how they are regulated. The key object in each case is solvency, to ensure protection and security for savings. Such differences as pertain in activity and regulation are differences only of degree. The essential similarity is made clear by the fact that the definition of "investment contract," issuance of which is prohibited without registration with a provincial authority, is in terms wide enough to include the savings certificates of the chartered banks.[157] To the extent that the provincial statutes purport to regulate the activities and require the registration of the chartered banks, they are, on the authorities, *ultra vires.*[158]

III. INSTITUTIONAL LIABILITIES AS MEANS OF PAYMENT

As a matter of choice, one may define financial intermediaries so as to encompass chartered banks as well as other financial institutions. But it cannot be contended that merely because both chartered banks and other private financial enterprises can be *defined* as financial intermediaries, it necessarily follows that they are sufficiently similar from the viewpoint of policy to require a unique status vis-a-vis the distribution of legislative power in a federal state. In order fully to appreciate the significance of the recognizable common denominators isolated and examined in the previous section, it is necessary to ask whether there are material dissimilarities in the operations of banks and other financial institutions, dissimilarities which expose the superficiality of functional identities. The problem, in other words, is not whether chartered banks and other financial enterprises can be subsumed under the same term (as they surely can), but whether the differences, if any, between them warrant, and may be taken to have warranted, control by different levels of government.

The Distinction Stated

Banks, it is said, do not fall into the same category as other lenders because in making loans by creating deposits the bank is not lending the same thing as it borrowed. John A. Galbraith describes the difference in this fashion:[159]

> There are two general ways in which a lending institution may carry on its lending activities. One way is to lend assets (usually cash balances) that it owns or has

[155] R.S.C. 1970, c. I-15.

[156] R.S.A. 1970, c. 191, s. 34. This involves no unconstitutional delegation of legislative power. *Accord Coughlin v. Ontario Highway Transport Board* (1968) 68 D.L.R. (2d) 384.

[157] Under section 2(1)(c):

> 'investment contract' means a contract, agreement, certificate, instrument or writing containing an undertaking by an issuer to pay the holder . . . a stated or determinable maturity value in cash or its equivalent on a fixed or determinable date and containing optional settlement, cash surrender or loan values prior to or after maturity, to be made to the issuer in instalments or periodically, or of a single sum, according to a plan fixed by the contract . . .,

R.S.A. 1970, c. 191.

[158] *Infra,* at 210-211.

[159] Galbraith, *supra,* n. 14 at 15-16.

borrowed; the lender thereby alters the composition of his assets without changing their total or altering his liabilities. The other general way of lending is to create in favour of the borrower a liability on the lending institution that the borrower can use for his own purpose. The process is most commonly represented by an exchange of deposits for the debt instruments of borrowers, and the effect on the balance-sheet of the lender is a simultaneous and equal increase in assets and liabilities.

Clearly these are two completely different ways of lending. The first describes the lending mechanics of the financial institution that does not create deposits of any kind; the second, the lending mechanics of banking.

A true financial intermediary lends the same thing as it borrows: it borrows an asset, usually cash, and lends an asset of a like nature. Technically, banks are *not* financial intermediaries. The borrowing technique of a bank is as unique as its lending technique. Thus:[160]

> . . . [I]t is a complete misconception 'of the nature of Banking to say that bankers are merely agents or intermediaries between persons who wish to lend and persons who wish to borrow. This is entirely untrue in the ordinary sense of 'lending' and 'borrowing': because, in the ordinary case of 'lending', the lender deprives himself of the use of the thing lent. But when a person pays in money to his banker, he has no intention whatever of depriving himself of the use of it. On the contrary, he means to have the same free command of it as if it were in his own house. The customer, therefore, 'lends' his money to his banker, but at the same time has the free use of it.'

If the essence of banking lies in this unique lending and borrowing technique, it is obvious that an institution cannot be a bank unless its liabilities function as money. By money in this connection is meant instruments that have such general acceptability as means of payment that they can be spent directly by the holder without the necessity of taking them back to the originator for conversion. If an institution's own liabilities are not an accepted means of payment, it must be prepared like any other lender to give its borrowers cash.[161] And those who entrust their money to such an institution in return for non-monetary liabilities will have deprived themselves of money. This much then is beyond controversy: institutions issuing claims which serve as means of payment are distinctive. Whether this differentiation should be singled out for special constitutional treatment remains to be seen.[162]

The terms of the Constitution should be construed in the light of the meaning which they bore when the document was framed;[163] the nature of a grant of power remains always the same, although its extent and ambit may grow with the progress of history.[164] Usage current in 1867 ascribed to "banking" a meaning synonymous with financial intermediation. But to interpret section 91(15) from this foundation is not to place oneself fully in the condition of the men who framed the B.N.A. Act. Such historical evidence as exists of the commercial habits, needs and ideas of Canadians in 1867 appears to favour a construction of the banking power which limits its scope to lending institutions whose liabilities serve as means of payment.

"Canada's earliest monetary history," Professor Neufeld has reported,

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[160] *Id.* at 47 n. 83, quoting from 1 MacLeod, *The Theory and Practice of Banking* 336 (5th ed. 1892).

[161] *See* Porter Commission Report, *supra*, n. 29 at 101.

[162] *Infra*, at 188-194.

[163] *Bank of Toronto* v. *Lambe* (1887) 12 App. Cas. 575 at 581, 583; Wynes, *Legislative, Executive and Judicial Powers in Australia* 31-33 (3rd ed. 1962).

[164] *A.-G. Alberta* v. *A.-G. Canada*, *supra*, n. 8 at 516-517; *A.-G. Ontario* v. *A.-G. Canada* [1947] A.C. 127 at 154; Wynes, *supra*, n. 162 at 32.

"repeatedly reveals a woeful scarcity of a medium of exchange for settling transactions in ordinary domestic trade."[165] The contribution of banking institutions to the early economic development of Canada was conceived in terms of alleviating this scarcity. Thus:[166]

> . . . [T]he history of the early banks in Canada shows that the chief reason for their existence was the service they performed by exchanging their own credit obligations in the form of bank-notes for the credit obligations of their customers, which, however good they might be, were prevented by their very form from passing current as money.
>
> Proposals for the establishment of banks in the years before Confederation invariably cited the scarcity of cash and the lack of an adequate circulating medium of exchange as the problems to which banking institutions would provide a solution.[167]

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In early banking debates, the business of banking was described as the issuance of paper or notes exceeding in value that of the actual funds deposited for their redemption.[168] It was recognized, in other words, that bank profit lies in lending, and that bank lending involves the issuance of liabilities in exchange for the debt instruments of borrowers; these "derivative liabilities" do not increase the cash reserves of the lending bank, and they add to the supply of money in the economy.

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[165] Neufeld, *Money and Banking in Canada* 1 (1964).

[166] 2 Ross, *A History of the Canadian Bank of Commerce* 129-130 (1920), quoted in McIvor, *Canadian Monetary, Banking and Fiscal Development* (1958) at 55 n. 78.

[167] Neufeld, *supra*, n. 164 at 28-29, 31, 69.

[168] *Id.* at 33. In *Re Alberta Bill of Rights Act*, the Attorney General of Alberta argued before the Supreme Court of Alberta, Appellate Division, that banks in 1867 did not create in favour of borrowers liabilities against which was held no corresponding reserve of currency. The Privy Council, [1947] A.C. 503, found it unnecessary to deal with the argument, holding that the meaning of "banking" should not be tied directly to the activities of banks in 1867. But the activities of banks in 1867 are not irrelevant to the question "what is the meaning of the term itself in the Act". For this reason, it is useful to examine the factum of the Attorney-General inasmuch as it contradicts what is said here. Liabilities against which no reserve of currency was held were defined as "credit deposits" and it was submitted "that at the time of Confederation dealing in 'credit deposits' . . . was not a recognized function of banking in Canada." [at 13] The submission was supported as follows [at 37-38]:

> . . . [A]n analysis of the banking statistics . . . will definitely substantiate the submissions made concerning the meaning of the word 'banking' at the time of Confederation.
>
> *December 1867 (Year of Confederation):*
>
> | Total Paid-up Capital of Banks | Coin, Bullion and Provincial Notes | Total Deposits of the Public |
> |---|---|---|
> | $33,426,000 | $9,930,000 | $32,577,000 |
>
> From the foregoing it will be evident that in the conduct of their business, the banks were in a position to provide cash in the form of either notes or coin against their deposits.
>
> However by 1887 we find that gradually a fundamental change in banking practice was introduced, and that banks by their action in lending funds which they did not possess, entered the sphere of dealing in financial credit and accumulating deposits against which they could not provide a corresponding volume of cash or currency:
>
> *December 1887*
>
> | Paid-up Capital and Reserve Funds | Coin, Specie and Dominion Notes | Total Deposits of the Public |
> |---|---|---|
> | $78,146,000 | $16,067,000 | $105,599,000 |

The figures are quite accurate, but the interpretation apparently given thereto is absurd. In both 1867 and 1887 the cash reserves (coin, specie and notes) of the banks equalled some fraction only of their deposit liabilities. The difference between the two sets of figures is that the aggregate of capital plus cash was somewhat greater than deposit liabilities in 1867 and somewhat less than deposit liabilities in 1887. But this is manifestly irrelevant to the question whether deposit liabilities are matched by a corresponding reserve of currency. Whatever else one may do with figures representing capital and cash, one cannot add one to the other and hope to arrive at a meaningful figure. The essential point, misapprehended by the Attorney-General, is that banks in 1867 and 1887 issued liabilities against which they could not provide a corresponding volume of cash or currency. The profits of a bank necessarily depend upon an issue of paper or notes (or deposits) exceeding in value that of the actual funds deposited (or held) for their redemption.

There can be no doubt of the validity of the assertion that "historically it was the banks' note issuing powers that set them apart as 'banking' institutions."[169]

The early banking legislation of the Dominion, while having nothing unequivocal to say about the legislators' conception of banking, lends support to the view that the banking problems of 19th Century Canada were largely monetary in nature. The early legislation was concerned with institutional solvency, but its principal purpose was the maintenance of public confidence in the circulating medium of exchange, the criterion of public safety being the immediate and unconditional payment of bank note issues when presented. The first general banking statute,[170] passed in 1871, was preceded by two false starts. Resolutions presented to Parliament in 1869 would have deprived the banks of the power to issue notes against their general credit, limiting issue to notes secured by pledge of Dominion securities with the government.[171] In support of the resolutions the Minister of Finance stressed the duty of government "to see that the circulation which the public at large is bound to take should be placed on as sound and uniform a basis as possible."[172] These resolutions were withdrawn, under fire from many quarters, and replaced by a bill presented to the Commons in 1870. The Act which emerged[173] was the prototype for the 1871 statute, the first Dominion Bank Act under which the banks actually worked. These measures, according to Sir Francis Hincks, were precipitated by circumstances "which impressed upon the entire community the necessity of affording greater security to noteholders."[174] The Minister expressed concern over the mismanagement of banks generally, but felt it hardly possible to provide by legislation against it. He said: ". . . if provision is made for the security of note holders, the House will have done all it could in that direction, and it had no more to do with depositors who, if they choose to deposit in a Bank, must do so at their own risk."[175] Hence, the legislation applied only to Banks wanting a charter which allowed them to issue their own notes.

The Monetary Institutions

The Dominion appears to have lost its concern for the security of the circulating medium of exchange. True, it is a result of federal legislation that no private institutions have the power to issue notes payable to the bearer and intended to circulate as money,[176] but the note has been replaced by the demand deposit as the principal constituent of the money supply.[177] And banks chartered under the Dominion Bank Act[178] are no longer unique in having their debt circulate as part of the money supply. Today a host of financial institutions issue, in the course of their business, liabilities which provide the economy with the means of making payments. The chartered banks provide the economy with the

[169] Neufeld, *supra*, n. 48 at 144.
[170] An Act Relating to Banks and Banking, S.C. 1871, c. 5.
[171] *See* Neufeld, *supra*, n. 165 at 153.
[172] Quoted in Breckinridge, *The History of Banking in Canada* 96 (1910).
[173] An Act respecting Banks and Banking, S.C. 1870, c. 11.
[174] (1870) H.C. Deb. 215.
[175] *Id.* at 219-221.
[176] Bank of Canada Act, R.S.C. 1970, c. B-2, s. 21(1).
[177] Bank notes were simply deposits-at-large or bearer deposit obligations. McLeod, *The Mysteries of Credit Creation*, (1960) 67 The Canadian Banker 20 at 23.
[178] S.C. 1966-67, c. 87.

bulk of its means of payment through their deposit liabilities. However, similar services are provided by savings banks, trust and mortgage loan companies, caisses populaires and credit unions, and certain provincial government savings institutions. The institutions which perform this distinctive function are governed by an assortment of federal and provincial laws.

The Quebec Savings Bank Act[179] of the Dominion applies to only one Quebec institution and contains no legal machinery for setting up new savings banks. The deposit accounts of the savings bank are similar to chartered bank personal savings deposits: they are transferable by cheque and used as a means of payment. "Other institutions, notably the chartered banks, trust and loan companies and credit unions have filled the place originally intended for a system of federally chartered savings banks."[180]

Provincial legislation is responsible for the creation and regulation of credit unions and caisses populaires, which have emerged as substantial financial institutions.[181] Both credit unions and caisses populaires issue two types of liabilities, called "shares" and "deposits." Shares are analagous to savings deposits which are subject to withdrawal on demand or notice but are not chequable. The deposits of credit unions and caisses populaires, by contrast, are quite similar to the chequing accounts of Canadian chartered banks.[182] There is specific legislative authorization for the credit unions to create in favour of lenders and borrowers deposit liabilities that can be used as media of exchange. Under section 19(4) of the Alberta Credit Union Act,[183] for example, "a credit union may . . . permit its members to withdraw moneys from deposit accounts only, by means of negotiable or non-negotiable orders upon itself." Cheques drawn against the caisses populaires in the Province of Quebec and the credit unions in the western provinces are accepted as means of payment. Because its liabilities consist largely of chequable deposit accounts, the Caisse Populaire movement in Quebec "tends to increase the effective money supply of the Provincial economy."[184] This is because the caisses place purchasing power in the hands of borrowers while leaving lenders with debt instruments that serve as money. "Because of the nature of their deposit and credit operations, the Caisses must be regarded as banking institutions."[185]

The only federal law respecting credit unions is the Cooperative Credit Associations Act.[186] The credit unions and caisses populaires have established central credit societies to provide a variety of banking services for the local entities.[187] As bankers for the locals, the centrals consolidate their liquid assets and provide the main pool of reserves for the system. The centrals receive term deposits (and withdrawable

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179 S.C. 1966-67, c. 93.

180 Porter Commission Report, *supra*, n. 29 at 147.

181 In 1968 their combined assets in Canada increased by 14 per cent; this in contrast to a 12 per cent increase for banks, 11 per cent for the trust companies, eight per cent for mortgage loan firms, and only three per cent for finance and consumer loan companies. Financial Post, June 1, 1968, at T 11, col. 1.

182 Mercure, *Credit Unions and Caisses Populaires*, Working Paper prepared for the Royal Commission on Banking and Finance 73-74 (1962).

183 R.S.A. 1970, c. 74.

184 Bauer, *The Caisse Populaire Movement in Quebec: 1932-1950*, Unpublished Doctoral Dissertation, University of Chicago 6 (1967).

185 *Id.* at 68.

186 R.S.C. 1970, c. C-29.

187 *See* Mercure, *supra*, n. 182 at 45-47.

shares) and demand deposits, and grant loans to locals in temporary need of funds. Some centrals also execute a large part of the clearing with the banking system for the unions which conduct a chequing business. Since the depositors and borrowers of the centrals are not individuals but enterprises, the centrals "are much more comparable to commercial banks than most other types of financial institutions."[188] The 1953 federal Act was passed, according to the Porter Commission, "in order to remove any doubts about the constitutional position of the provincial centrals by permitting them to register under a federal act, and to establish a national central, The Canadian Co-operative Credit Society Limited."[189] Membership in the national central, incorporated by Special Act[190] and supervised by the Superintendent of Insurance, is open to any provincial central or local union but is not compulsory. Societies belonging to the national central are subject to "banking" controls: minimum reserve requirements,[191] limitations (tied to capital and surplus) upon the issuance of liabilities,[192] and inspection by the Superintendent.[193] The federal scheme has enjoyed only marginal success; the national central has inadequate membership and resources and conducts limited operations.[194] As a result the effective regulatory control of credit unions and caisses populaires is exercised at the provincial level. The federal Parliament has acquiesced in provincial assertions of competence, and, as observed by Tucker J. in *La Caisse Populaire Notre Dame Limitée* v. *Moyen,*[195] given implicit recognition in its enactments to the right of credit unions to engage in the business they were set up to do. Said Tucker J.: "It would appear from this Act [the Cooperative Credit Associations Act] that parliament has recognized the legal existence of co-operative credit societies as organizations that are not 'banks'."[196] It must be remembered, however, that legislative power is conferred by the B.N.A. Act and not by consent, implicit or otherwise.

Trust and mortgage loan companies are able to choose between federal or provincial incorporation and regulation. Apart from that respecting the estate, trust and agency business of trust companies, the governing legislation is strikingly similar. The majority of trust and loan companies are incorporated provincially.[197] Federal legislation provides for the incorporation of such institutions by special Act of Parliament;[198] the companies are then governed by the provisions of a general statute which, like the Bank Act,[199] contains extensive provisions regarding such corporate matters as incorporation, allocation of authority within the institution, capitalization, and audit, inspection and

[188] *Id.* at 152.

[189] Porter Commission Report, *supra*, n. 29 at 167.

[190] An Act to incorporate Canadian Co-operative Credit Society Limited, S.C. 1952-53, Part II, c. 58.

[191] R.S.C. 1970, c. C-29, ss. 44, 45.

[192] *Id.* s. 47.

[193] *Id.* ss. 56-60.

[194] *See* Mercure, *supra*, n. 182 at 160-162; Porter Commission Report, *supra*, n. 29 at 167.

[195] (1967) 59 W.W.R. 129 at 159.

[196] *Id.* at 160.

[197] Of the 60 loan and trust companies dealing with the general public in 1964, only 15 were federally incorporated. Porter Commission Report, *supra*, n. 29 at 175.

[198] Loan Companies Act, R.S.C. 1970, c. L-12, s. 3(1); Trust Companies Act, R.S.C. 1970, c. T-16, s. 3(1). Incorporation by Letters Patent under the Canada Corporations Act is not possible. R.S.C. 1970, c. C-32, s. 5(1)(c), (d). By recent amendment, S.C. 1969-70, c. 22, ss. 1, 2, a trust company may be incorporated by letters patent, in prescribed form, with the approval of the Minister of Finance.

[199] S.C. 1966-67, c. 87.

disclosure. Loan and investment powers are detailed. Loan companies have a general authorization to borrow money and to issue securities for moneys borrowed,[200] and a specific authorization to "receive money on deposit upon such terms as to interest, security, time and mode of repayment and otherwise as may be agreed upon. . . ."[201] Trust companies may not borrow by the issue of bonds or debentures,[202] but are empowered to "receive money on deposit in trust and allow interest thereon. . . ."[203] Deposits received by federal trust and loan companies are deemed to have been received on the condition that the company may require 30 days notice of withdrawal;[204] but there is nothing in the statutes to prevent deposits being subject to withdrawal by negotiable order.

Most provinces have trust company legislation,[205] some have loan company enactments.[206] Like their federal counterparts, loan companies incorporated in Nova Scotia, Manitoba, Ontario and Saskatchewan may borrow money and may issue bonds, debentures or other securities for money borrowed.[207] The Nova Scotia and Ontario firms are specifically authorized to receive money on deposit upon such terms as may be agreed upon;[208] in Manitoba the authorization is implicit;[209] in Saskatchewan it is denied.[210] The mortgage loan companies have evolved from the early mutual associations which pooled their members' funds for a common purpose—these were the building societies and savings and loan associations. Three provinces have special statutes dealing with this type of institution. The British Columbia Savings and Loan Associations Act[211] provides for the incorporation of permanent or temporary associations for the purpose of making mortgage loans to members. An association is empowered to borrow funds in such a manner as it thinks fit,[212] but the Act provides that no association shall take or receive money on deposit or carry any demand or commercial account or account operated by cheque.[213] By contrast, the Nova Scotia Building Societies Act authorizes a society formed thereunder to receive money on deposit or loan from any person or persons whether members or not, and give due receipts or obligations therefor and pay such interest thereon as may be agreed upon.[214] There is nothing in The Building Associations

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200 R.S.C. 1970, c. L-12, s. 64(1).

201 *Id.* s. 65(1). Total amount borrowed may not exceed 15 times the excess of the assets of the company over its liabilities. *Id.* s. 68.

202 R.S.C. 1970, c. T-16, s. 70(2).

203 *Id.* s. 63(k). The total amount entrusted to a company for investment the repayment of which is guaranteed by the company may not exceed 15 times the excess of company assets over liabilities. *Id.* s. 70.

204 *Id.* s. 67; R.S.C. 1970, c. C-32, s. 65(3).

205 Newfoundland and Prince Edward Island are exceptions.

206 In those provinces without special legislation governing the incorporation of mortgage loan companies, they are incorporated under the general companies legislation or by special act of the legislature. The Companies Act of Manitoba, R.S.M. 1970, c. C160 provides that trust and loan companies may be incorporated under the Act by letters patent [sections 245(1) and 246(1)] and contains special provisions governing the companies so incorporated.

207 Loan Companies Act, R.S.N.S. 1967, c. 171, s. 57(1); The Companies Act, R.S.M. 1970, c. C160, s. 289(1); Loan and Trust Corporations Act, R.S.O. 1970, c. 254, s. 78(2); Loan Companies Act, R.S.S. 1965, c. 133, s. 64(1).

208 R.S.N.S. 1967, c. 171, s. 58(1); R.S.O. 1970, c. 254, s. 78(2).

209 The Manitoba Act, R.S.M. 1970, c. C160, provides in section 244(1) that no loan (or trust) company may accept deposits from the public unless it is insured under a policy of deposit insurance issued by the Canada Deposit Insurance Corporation.

210 R.S.S. 1965, c. 133, s. 65: "The company shall not receive money on deposit."

211 R.S.B.C. 1960, c. 346.

212 *Id.* s. 14(1).

213 *Id.* s. 14(4).

214 N.S. Laws 1951, c. 2, s. 6 *as amended by* N.S. Laws 1954, c. 54, s. 1.

Act[215] of Alberta, or in the regulations thereunder, to indicate in what manner members may withdraw savings entrusted to a co-operative building association.

Regulations governing the financing of trust companies incorporated under provincial legislation follow the federal pattern: the companies are not permitted to borrow money by taking deposits or by issuing debentures,[216] but (and here lies the important factor) the companies may receive money on deposit in trust, repayable on demand or after notice.[217] No statute prevents the companies form according chequing privileges to their depositors; that is, from issuing claims which serve as means of payment.

Since the trust and loan companies are authorized to receive monies which the depositor can treat in much the same way as bank savings or chequing accounts, federal and provincial law requires a definite percentage of demand funds to be placed in certain investments. Federal loan companies are required to keep twenty per cent of deposits in cash, government securities or fully secured demand loans.[218] For the federal trust companies the requirement applies in respect of funds repayable on demand or coming due in less than one hundred days.[219] Some provincial acts, largely duplicating federal legislation, require trust and loan companies to maintain liquid assets equal in value to at least twenty per cent of demand liabilities.[220] With the exception of banks, the trust and loan companies are the only financial institutions required to abide by such liquidity restrictions.[221] It is inevitable that institutions with banking powers should be subjected to banking regulation.

The powers of loan and trust companies to accept deposits repayable on demand by written order have not gone unused. There is a natural tendency, according to Professor Sayers, for institutions *so authorized* to offer debt instruments more closely approximating those offered by the banks, as the growth in the range of their business and in their reputation makes it possible.[222] The loan and trust companies now offer two types of demand deposit accounts: those against which cheques can be written in exactly the same way as bank deposits, and those from which funds can be withdrawn only over the counter and cheques cannot be written. In 1970, about thirty per cent of all trust and loan company demand liabilities were chequable deposits.[223] Chequable deposits totalled over five hundred and fifty million dollars

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[215] R.S.A. 1970, c. 36.

[216] *See e.g.*, Loan and Trust Corporations Act, R.S.O. 1970, c. 254, s. 87(1); The Trust Companies Act, R.S.S. 1965, c. 132, s. 61(2); The Trust Companies Act, R.S.A. 1970, c. 372, ss. 96, 99(4).

[217] *See e.g.*, Loan and Trust Corporations Act, R.S.O. 1970, c. 254, s. 88; The Trust Companies Act, R.S.A. 1970, c. 372, ss. 99, 101; The Companies Act, R.S.M. 1970, c. C160, s. 282.

[218] Loan Companies Act, R.S.C. 1970, c. L-12, s. 65(4).

[219] An Act to amend the Trust Companies Act, S.C. 1969-70, c. 22, s. 11. [adding s. 683(1) to R.S.C. 1970, c. T-16].

[220] Loan and Trust Corporations Act, R.S.O. 1970, c. 254, ss. 81, 93; The Trust Companies Act, R.S.A. 1970, c. 372, s. 106; Loan Companies Act, R.S.N.S. 1967, c. 171, s. 58(4). The required percentage is 25 for British Columbia trust firms. Trust Companies Act, R.S.B.C. 1960, c. 389, s. 52(1) *as amended by* S.B.C. 1962, c. 65.

[221] Government of Quebec, *Report of the Study Committee on Financial Institutions* 46 (1969). Central credit societies which choose to become members of the national society under the Cooperative Credit Associations Act, R.S.C. 1970, c. C-29, must keep liquid 20 per cent of money on deposit (section 45). Provincial credit union legislation also requires the maintenance of liquid reserves to meet share and deposit withdrawals. *See e.g.*, The Credit Unions Act, R.S.M. 1970, c. C300, s. 59; Regulations under The Credit Union Act, Alta. Reg. 134/57 (1957), Art. XII *as amended by* Alta. Reg. 229/70 (1970).

[222] Sayers, *Modern Banking* 253 (7th ed. 1967).

[223] Bank of Canada, Statistical Summary, July, 1971.

and accounted for approximately six per cent of total liabilities.[224] In urban areas particularly cheques drawn on deposit accounts with trust and mortgage loan companies are accepted as means of payment.[225]

The Porter Commission was told that the use of chequable accounts by the trust firms has not been as spectacular as might be expected because the firms must apply to the chartered banks for clearing arrangements.[226] Moreover, the companies find it difficult to attract current accounts from the banks, because they are precluded from making commercial and personal loans.[227] Predictably the trust companies pressed for amendments which would broaden their investment powers to include unsecured personal and commercial loans.[228] Basket clauses in some trust company enactments represent a partial success. These enable trust companies to make loans without taking the security otherwise required by statute. But the clauses have restrictions. In Alberta the discretionary loans cannot exceed seven per cent of the company's own funds and its deposits and investment moneys;[229] in Ontario they cannot exceed the larger of fifteen per cent of the companies' unimpaired capital and reserve, or seven per cent of capital and reserve plus investment and deposit moneys.[230] To the extent that the lending powers of trust and loan companies begin to parallel those of banks, the former may be expected to attract increasing numbers of chequing accounts from the latter.

Federal institutions encounter competition for deposits not only from private institutions incorporated under provincial legislation, but as well from certain provincial government savings institutions. Two such institutions have been absorbed by the chartered banking system. The Newfoundland Savings Bank was established in 1834 and purchased by the Bank of Montreal in 1962.[231] The Province of Manitoba Savings Office was organized under The Provincial Savings Act[232] of 1920, subsequently replaced by The Provincial Savings Act, 1924.[233] The Act empowered the Lieutenant Governor in Council "to borrow money by means of deposits in any amounts and from any persons or corporations in Manitoba and to open offices for this purpose at such points in Manitoba as he might find necessary."[234] Money raised in this manner could be used for certain restricted purposes only, principally as funds for credit unions in the Province.[235] Sums standing to the credit of accounts in the Manitoba Savings Office were subject to transfer by cheque. Nonetheless, in *Winnipeg Trustee* v. *Kenny* Dysart J. was able cryptically to say "The Province of Manitoba Savings Office . . . is

[224] *Id.*

[225] Binhammer, *Money, Banking and the Canadian Financial System* 111 (1968).

[226] Porter Commission Report, *supra*, n. 29 at 182.

[227] *Id.*

[228] *See* Financial Post, May 11, 1968 at 7, cols. 1-3 and 8, col. 3; Financial Post, Feb. 15, 1969 at 11, cols. 1-5.

[229] The Trust Companies Act, R.S.A. 1970, c. 372, s. 111(3).

[230] Loan and Trust Companies Act, R.S.O. 1970, c. 254, s. 154. A similar basket clause applies to loan companies (section 151).

[231] *See* Binhammer, *supra*, n. 225 at 183.

[232] S.M. 1920, c. 118.

[233] S.M. 1924, c. 59.

[234] *Id.* s. 2.

[235] "Refusal by the banks in 1920 to issue funds at six per cent to the Manitoba credit unions resulted in the provincial government taking over the supply of funds." Powe, *The Social Credit Interim Program and the Alberta Treasury Branches,* Unpublished Master of Arts Dissertation, University of Alberta 27 (1951).

not a bank nor authorized to transact banking business."[236] In view of the marked similarity between chartered bank liabilities and those of the Manitoba Savings Office, it must be assumed that Dysart J. based his conclusion on the lack of any similarity between the lending powers of banks and those of the Office. This kind of approach was not regarded with favour by the Royal Commission on Banking and Finance.[237] In 1932 the Provincial Savings Offices were closed pursuant to an agreement with eight chartered banks whereby the banks took over the deposit liabilities of the Offices.[238]

In two provinces government savings institutions continue to thrive. The Agricultural Development Finance Act, 1921[239] empowered the Treasurer of Ontario to borrow money by means of deposits from the public and to open offices for this purpose anywhere in Ontario.[240] The original limitations upon the lending powers of the Savings Office[241] have been replaced by a provision which permits use of the moneys borrowed "for the public service, for works carried on by commissioners on behalf of Ontario, for the covering of any debt of Ontario on open account, for paying any floating indebtedness of Ontario, and for the carrying on of the public works authorized by the Legislature."[242] Moneys deposited are "subject to attachment in the same manner as money deposited in a chartered bank,"[243] and are repayable "(a) to the depositor in person on demand; or (b) to the order of the depositor in Form 1."[244] Unlike deposits with the federal Post Office Savings Bank, those of the Province of Ontario Savings Office have grown; in 1955 they were seventy-two million dollars, in 1965, eighty-one million dollars.[245] Perhaps the disparate growth pattern is attributable to the fact that deposits in the Ontario Office are accorded chequing privileges while those in the Post Office Bank are not.

The history of the Province of Alberta treasury branches is worth recounting. The Treasury Branches Act[246] of 1938 retained the essential features of earlier legislation found *ultra vires* as repugnant to section 91(15) of the B.N.A. Act. The Supreme Court of Canada, in declaring *ultra vires* three bills of the Alberta legislature,[247] passed upon the constitutional validity of the "central measure" of the scheme, which was the Alberta Social Credit Act.[248] J. R. Mallory has summarized the provisions of the Social Credit Act as follows:[249]

> Under the operation of that Act, Alberta Credit was to be made available to individuals by means of a monthly dividend and through a retail discount. The discount rate by which buyers of goods and services were to receive a rebate was to be

[236] [1924] 1 D.L.R. 952 at 956. This permitted Dysart J. to conclude that a cheque drawn on the Office was not a cheque drawn on an incorporated bank within the meaning of the Bills of Exchange Act, R.S.C. 1906, c. 119.

[237] *See* Porter Commission Report, *supra*, n. 29 at 377-378.

[238] *See* S.M. 1932, c. 38.

[239] S.O. 1921, c. 31.

[240] *Id.* s. 2.

[241] *Id.* s. 4.

[242] R.S.O. 1970, c. 11, s. 3.

[243] *Id.* s. 1(2).

[244] Regulations Under the Agricultural Development Finance Act, R.R.O. 5/60 (1960). Form 1 is identical in all material respects to a bank cheque.

[245] Binhammer, *supra*, n. 225 at 183.

[246] S.A. 1938 (2nd Sess.), c. 3.

[247] *Re Alberta Legislation* , *supra*, n. 4.

[248] S.A. 1937, c. 10.

[249] Mallory, *Social Credit and the Federal Power in Canada* 87-88 (1954), quoting from [1938] 2 D.L.R. 81 at 89.

> fixed by a commission, and was to depend on the ratio of the money value of the unused productive capacity of Alberta to the total productive capacity. The use of this discount procedure to increase purchasing power would only work where it was possible to pay both the price and the discount in Alberta Credit. 'The practicability of this scheme,' said Sir Lyman [Duff], 'postulates therefore, a willingness on the part of sellers of goods and services, in Alberta transactions, to accept Alberta Credit in payment; in other words acceptance generally in Alberta of Alberta Credit as the circulating medium.' This was to be accomplished through the Credit House, which was empowered to accept deposits of currency and securities, to transfer credit, and to receive deposits of credit vouchers and transfers of Alberta credit.

The Credit House was manifestly intended to perform the functions of a bank, a circumstance fully appreciated by Chief Justice Duff, who wrote the principal judgment:[250]

> A customer of the Credit House has no right to require payment of legal tender at his discretion, unless his deposit is a currency deposit, and cannot transfer such a right to another, but, save in that respect, he is, and must necessarily be, if the system is really to be operative, in relation to his account in the Credit House, in the same position as the customer of a bank.

The very essence of the plan was conceived to be the substitution, in the Province, of Alberta Credit for bank credit and legal tender as the circulating medium of exchange.[251] The conclusion was inescapable: "... this system of administration, management and circulation of credit ... constitutes in our view a system of 'banking' within the intendment of s. 91; and the statute in our opinion is concerned with 'banking' in that sense."[252]

The Supreme Court judgment was handed down on March 4, 1938; in November, 1938 the Legislature passed the Treasury Branches Act. The Act authorized the Provincial Treasurer to receive "deposits of money, bank cheques, legal tender, currency, coinage or orders upon treasury branches,"[253] and to use the deposits so received for investment in securities or for purchase of goods for resale.[254] The object of the statute, not obvious from its stark provisions, was that transactions in goods and services would be accomplished without the use of money by transferring claims against accounts in the treasury branches. Section 7 of the Act provided that the Treasurer could authorize any person on his behalf to enter into a contract with a merchant for the purpose of implementing the contracts entered into with depositors. Under the merchant agreements, a merchant agreed to accept in payment for goods sold transfer vouchers drawn by the purchaser upon his account in a treasury branch, to open an account in a treasury branch and to utilize as far as possible the services of the branch.[255] The relationship of the depositor to a treasury branch was also based upon individual contract; the contract was required to provide for the manner in which the money deposited might be used by the Treasurer and might be withdrawn or transferred.[256] Section 6(3) stated that each contract should provide for the payment of interest or "that in lieu of interest there shall be credited to the account of the depositor such amount as may be fixed ... by the Lieutenant Governor in Council on such portion ... of his

[250] *Supra*, n. 4 at 90.
[251] *Id.* at 92.
[252] *Id.* at 93.
[253] S.A. 1938 (2nd Sess.), c. 3, s. 5.
[254] *Id.* s. 6(4).
[255] Powe, *supra*, n. 235 at 78.
[256] S.A. 1938 (2nd Sess.), c. 3, s. 6(2).

deposit used in the purchase of specified goods from merchants who have entered into contracts with the Minister. . . ." Order-in-Council 1069/38, confirmed by section 9 of the Act, provided that a three per cent bonus was to be credited to the account of depositors who used their deposits to make purchases by means of orders drawn by the depositor in favour of the merchants. The Treasurer was authorized by section 8 to accept transfer vouchers for moneys owing to the government, and he was authorized to deposit them in the treasury branches. Transfer vouchers could be deposited only in a treasury branch account in the name of the transferee; they did not entitle the holder to legal tender of currency.[257] An individual obtaining a voucher was obliged to open an account in a treasury branch.[258] The principal object of the treasury branch system and transfer voucher mechanism was "to induce the public to use a medium of exchange other than national currency or chartered bank credit."[259] Treasury branches and transfer vouchers had replaced the Credit House and Treasury Credit Certificates of the Alberta Social Credit Act.

Two features of the early treasury branch legislation may be said to distinguish the branches from banking institutions. First, the treasury branches could use the funds deposited only in the manner provided for in the individual contracts with depositors;[260] the depositor's contract was in the nature of a trust indenture. A bank, while obliged to repay deposit moneys as and when agreed upon and to pay a fixed return, is free to use the funds deposited as it sees fit, subject to relevant banking legislation. The emphasis upon contract in the original Treasury Branches Act was intended to disguise the true character of the operations contemplated.[261] Second, the 1938 Act did not authorize lending activities. "The Act as it stood did not authorize the Minister to lend to others deposits made to the treasury branches. . . ."[262]

Within eighteen months after the branches began operations, these distinguishing characteristics were eliminated. The Treasury Branches Amendment Act, 1940[263] empowered the Minister to make investments and to purchase goods for resale, not "subject to the provisions of any contract," but "notwithstanding the terms and provisions of any contract."[264] Subsection 5 was added to section 6, authorizing the Minister, subject only to existing contracts, to loan any deposits received in the branches of the treasury upon such terms as might be agreed upon.[265] As of 1940, the branches of the Treasury became in effect provincial banking institutions.

The treasury branches now accept deposits from customers in current, savings and long-term accounts. In 1970 deposit liabilities totalled one hundred and fifty million dollars; current accounts, from which funds may be drawn by cash orders to third parties, totalled almost forty-four million dollars.[266] The current accounts are used by customers

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[257] Powe, *supra*, n. 235 at 85.

[258] *Id.* at 163.

[259] *Id.* at 164.

[260] S.A. 1938 (2nd Sess.), c. 3, s. 6(1), (4).

[261] Powe, *supra*, n. 235 at 76, 121.

[262] *Breckinridge Speedway Ltd., Green et al.* v. *The Queen* (1967) 61 W.W.R. 257 at 273 (Porter J.A.).

[263] S.A. 1940, c. 14.

[264] *Id.* s. 2.

[265] *Id.*

[266] Dominion Bureau of Statistics, *Canada Year Book* 1237 (1970-71).

of the branches as a substitute for currency and chartered bank deposits. The treasury branches "have been able to persuade the public to regard their deposit liabilities or promises to pay as the equivalent of legal tender by undertaking to convert them into legal tender on demand."[267] Treasury branch loans normally take the form of an exchange of deposits for the debt instruments of the borrowers.[268]

Monetary Institutions as Banks

Support is strong for the proposition that all lending institutions whose liabilities serve as means of payment are engaged in the business of banking within the meaning of section 91(15) of the B.N.A. Act. Historical evidence establishes beyond controversy that it was the banks' note issuing powers that in 1867 set them apart as "banking" institutions.[269] Surrounded textually as it is by references to "Currency and Coinage," "the Issue of Paper money" and "Legal Tender," the scope of the legislative authority conferred by section 91(15) must extend at least to those things which perform the monetary functions of the nation:[270]

> If Banking Corporations or private bankers might issue and circulate notes, bills of credit, or paper certificates of any kind, as money, the exclusive power conferred upon the Federal Government over the currency would be wholly ineffectual.

It can hardly be contended that by assigning to the Dominion currency, coinage and paper money the framers of the constitution did not intend to preclude the provinces from putting forth money in novel forms. The federal Parliament must have control over all institutions which issue money. A broad principle applicable to every business and institution is that the need for liquid assets is closely allied with the maturity of liabilities; for the institution whose liabilities take the form of transferable demand claims, liquidity is a foremost consideration, a distinct problem of public policy. Section 91(15) may be viewed as a vehicle through which public policy in respect of solvency and liquidity, complimentary objects of banking regulation, can be expressed. Professor Slater has expressed the matter well:[271]

> To allow private institutions to create monetary units offers great power and opportunity for abuse; it must be assured by the highest authority that the management of the institutions allowed this privilege does protect the holders of their debts.

The courts have seized upon the monetary nature of its liabilities as the distinguishing feature of a bank. In *Re Alberta Legislation*[272] Duff C.J. contrasted an ordinary money lender and a banker, concluding that the distinguishing feature of the business of banking is dealing in credit by means of "bookkeeping entries."[273] Banks extend credit by adjusting their deposit liabilities, other intermediaries by transferring means of payment to the borrower, that is, by adjusting the composition of their

[267] *Breckinridge Speedway Ltd., Green et al.* v. *The Queen, supra*, n. 262 at 274. (Porter J.A.). Restrictions on the withdrawal of funds from treasury branch accounts (except term savings accounts) were removed in 1943. See Powe, *supra*, n. 235 at 162.

[268] *See Breckinridge Speedway Ltd., Green et al.* v. *The Queen, supra*, n. 262 at 299 (evidence of treasury branch official).

[269] *See* n. 169 *supra*.

[270] Doutre, *Constitution of Canada* 168 (1880).

[271] Slater, *The 1967 Revision of the Canadian Banking Acts*, (1968) 1 (No. 1) Canadian Journal of Economics 79 at 80.

[272] *Supra*, n. 4.

[273] *Id.* at 101.

assets. A banker purchases money and promissory notes in the same manner, by creating a credit in favour of the depositor or borrower respectively.[274] In the same case Kerwin J. quoted with approval the following description of bank lending:[275]

> Two debts are created; the trader who borrows becomes indebted to the bank at a future date, and the bank becomes immediately indebted to the trader. The bank's debt is a means of payment. . . . It is a clear addition to the amount of the means of payment in the community. The bank does not lend money.

In *A.-G. Alberta* v. *A.-G. Canada*[276] the Privy Council was called upon to consider the validity of provincial legislation which required all credit institutions, including banks, to hold currency reserves equal to one hundred per cent of their deposit liabilities unless the institution held "Alberta Credit Certificates" equal in value to deposits having no corresponding reserve of currency. The object of the statute was to control the volume in the Province of "credit deposits," defined in the Act as deposits of credit made available as claims on goods and services and in respect of which credit institutions had no corresponding reserve of currency. Viscount Simon entertained no doubt that the term "Banking" as used in section 91 of the B.N.A. Act certainly includes operations by which an institution "makes loans to customers to a total amount which exceeds the liquid assets which the bank holds."[277] Viscount Simon's choice of words here is unfortunate; banks do not, because they cannot safely create deposits in favour of borrowers to an amount which exceeds the cash reserves of the institution.[278] What banks can do, and what the Alberta statute sought to control, is to assume deposit liabilities (to lenders *and* borrowers) which exceed in amount the liquid assets of the bank. The statute was concerned to control the volume of "derivative deposits," those created in favour of borrowers which do not increase the reserves of the lending bank. This undoubtedly was Viscount Simon's understanding of the legislation. Only those institutions whose liabilities serve as a medium of exchange create derivative deposits; if an institution's debt is not an accepted means of payment, it must be prepared to give the borrower cash.[279]

In a number of cases the courts have avoided any analysis of economic theory and focused simply on the chequing operation as the essence of banking. In *Re Bergethaler Waisenamt*[280] the Manitoba Court of Appeal held that institutions which do not receive deposits capable of being withdrawn by instruments in the nature of cheques are not banking institutions. In the *Quebec Vacant Property* case[281] Lord Porter defined the relationship of banker and customer as that of debtor

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[274] *Id.* at 99, quoting with approval from Macleod, *Theory of Credit* 368-369 (1890).

[275] *Supra*, n. 4 at 128, quoting from 3 Encyclopedia Britannica 48 (14th ed.). *See* n. 159 *supra*.

[276] *Supra*, n. 8.

[277] *Id.* at 516.

[278] *See infra*, at 188-189.

[279] It is interesting to note that Viscount Simon found the Statute *ultra vires*, not because a law which regulates the volume of derivative deposits is a law in relation to "Banking", but because the statute in question would interfere with the banking operations of the federally chartered banks. He did, it is true, speak in general terms about the unconstitutionality of provincial legislation which seeks to regulate the practice of making loans which involve an expansion of credit. But throughout his judgment are pregnant references to the chartered banks. [1947] A.C. 503 at 515, 516, 517. Certainly material to his disposition of the case was the finding that "credit institutions" would include banks chartered by the Dominion. *Id.* at 513-514. The decision of the Supreme Court of Alberta, *sub nom. Re Alberta Bill of Rights Act* [1947] 1 D.L.R. 337, was not necessarily predicated on a finding of interference with the chartered banks.

[280] [1949] 1 W.W.R. 323.

[281] *A.-G. Canada* v. *A.-G. Quebec* [1947] A.C. at 44, citing *Foley* v. *Hill* (1848) 2 H.L. Cas. 28.

and creditor, with the banker having an additional obligation of honouring the customer's draft. And in a non-constitutional discussion of what is banking, Lord Denning M.R. declared: ". . . no person can be considered a banker unless he handles cheques as freely as cash."[282]

It is clear that a number of institutions created and regulated provincially create deposit liabilities with all the characteristics of money. It follows that the provinces incorporate institutions with banking powers and regulate banking transactions, section 91(15) of the B.N.A. Act notwithstanding. How such a situation is permitted to prevail falls to be considered later.[283]

Monetary Liabilities: Difference or Distinction?

Having suggested the importance of the monetary nature of institutional liabilities, what remains of the earlier argument that all financial institutions are essentially similar in having the one common attribute of collecting and investing the savings of the public? Particularly in view of decisions such as that in the *Bergethaler* case,[284] is there room for the view that intermediaries whose liabilities do not serve as payment instruments engage in banking transactions?

Traditional monetary theory ascribes to "banks" a special place in the economic order because their distinctive role as issuers of means of payment gives them a peculiar ability to *create credit.* There is said to be a fundamental difference between an institution which transfers funds from savers to spenders and one which places effective purchasing power at the disposal of spenders by a mere exchange of obligations. The courts often subscribe to this view.[285] Economists challenge it:[286]

> One often cited difference between commercial banks and other intermediaries must be quickly dismissed as superficial and irrelevant. This is the fact that a bank can make a loan by 'writing up' its deposit liabilities, while a savings and loan association, for example, cannot satisfy a mortgage borrower by crediting him with a share account. The association must transfer means of payment to the borrower; its total liabilities do not rise along with its assets.

The Quebec Study Committee on Financial Institutions has also taken issue with the traditionalist's dichotomy:[287]

> Those who claim that banks create money while other institutions do nothing but administer and channel savings make an absolute distinction which is not only false, but above all irrelevant and meaningless.

The distinction is false because, as we have seen, banks are not alone in issuing payment instruments. But why is the distinction deemed superficial and irrelevant?

The answer is that economic effects do not differ with the lending technique used; ". . . the differences which do exist [between "banks" and other financial institutions] have little intrinsically to do with the monetary nature of bank liabilities."[288] There is no difference between a monetary and a non-monetary institution as far as the effect of lending

[282] *United Dominions Trust, Ltd.* v. *Kirkwood* [1966] 1 All E.R. 968 at 975.

[283] *Infra,* at 203-209.

[284] *Supra,* n. 280.

[285] *See infra,* at 186-188.

[286] Tobin, *Commercial Banks as Creators of "Money"* (c. 34 *Canadian Banking and Monetary Policy,* Cairns and Binhammer (eds.) 1965) 285.

[287] Government of Quebec, *Report of the Study Committee on Financial Institutions* 13.

[288] Tobin, *supra,* n. 286 at 290.

on the position of the lender is concerned.[289] If a lender is a "bank," whose own deposit liabilities are money and therefore acceptable to the customer as a means of payment, it may initially grant a loan or buy an asset by crediting the customer's account. At this stage the bank will have expanded without actually losing any cash, although the ratio of its cash holdings to total liabilities will have declined. However, this is not the end of the transaction for the borrowing customer is unlikely to leave his deposit account idle; money is borrowed for the purpose of expenditure. As he draws on his deposit account most, if not all, of these payments will be made to customers of other deposit institutions and the bank will therefore lose cash reserves. The bank, like any other institution, has acquired an earning asset at the cost of losing another asset, cash reserves, and the corresponding reduction in its deposits restores its liabilities to their previous level. The conditions which apply to institutions issuing money claims are thus fundamentally the same as those under which other institutions operate. It follows that the distinction made between institutions described as channels through which funds pass from lenders to borrowers and institutions which "create credit" is at best misleading. Says Galbraith: "The lending ability of a bank, like that of all other lenders, depends on its cash balances; not because it lends its cash balances, as other lenders do, but because it too loses cash balances when it lends."[290] The lending capacity of a bank, no less than that of other intermediaries, is determined by the size of its primary deposits.[291]

For the same reason, there is no valid distinction to be drawn between monetary and non-monetary institutions on the basis that loans by the latter only are matched by a loss of purchasing power in the hands of the depositor. The essential point is that expenditure by a bank depositor (whether borrower or lender) depletes the cash reserves of the bank. It does not follow from the monetary nature of its liabilities that a bank need not attract and hold deposits in order to finance expenditure.

But what of the banking system? True it is that each individual bank can in effect only re-lend money that is deposited with it, but the banking system can bring about a multiple expansion of deposits. The bank loses cash balances when it lends but the banking system does not, or, at least, does so to a much lesser extent.[292] As a result, the system is capable of extending loans (that is, financing expenditure) equal in amount to some multiple of any initial injection of cash.[293] This peculiar ability to "create credit" is sometimes said to distinguish members of the banking system (institutions whose liabilities circulate as means of payment) from financial intermediaries.[294]

It can be demonstrated, however, that credit creation results from the activities of institutions other than monetary institutions in the classical sense. Financial intermediaries whose liabilities do not serve as means of

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289 *See* Porter Commission Report, *supra*, n. 29 at 101-102; Galbraith, *supra*, n. 14 at 17-18; Tobin, *supra*, n. 286 at 285.

290 Galbraith, *supra*, n. 14 at 17.

291 Hence Galbraith concludes that the results of bank operations are the same as if it did function technically as an intermediary. *Id.* at 41 n. 74.

292 *See e.g.*, *id.* at 19.

293 *See* any monetary textbook for an explanation of the multiple expansion of bank deposits.

294 *See e.g.*, *La Caisse Pupulaire Notre Dame Limitee* v. *Moyen*, *supra*, n. 195 at 147-152, 161-162; *Breckinridge Speedway Ltd., Green et al.* v. *The Queen*, *supra*, n. 262 at 276-278.

payment are able, like banks, to engage in a process of multiple credit creation; admittedly they cannot create money (means of payment) but their activities expand the supply of loanable funds available to finance expenditure, even if there is not a parallel expansion of the money supply.[295] This is because there is no fixed relationship between the quantity of money and the rate of spending[296] and because intermediary operations increase the velocity of circulation of money.

Assume that X decides to deposit one hundred dollars in currency with a non-monetary intermediary. The intermediary can then lend some proportion of that deposit, say ninety dollars, to a borrower, Y. If Y then uses the loan to pay Z, who deposits the funds with another intermediary, that institution can lend some proportion of the deposit, say eighty dollars, to a borrower. The money supply has remained constant at one hundred dollars, but the intermediary system, with an initial injection of one hundred dollars, has financed expenditures totalling one hundred and seventy dollars. Further increases in credit will be possible in a manner which is almost identical in its operation to that of the bank credit multiplier.[297] Both monetary and non-monetary institutions can add to the net supply of loanable funds, the former by the net creation of money, the latter by mobilizing existing money balances in exchange for their own newly issued financial liabilities. The crux of "non-bank" credit expansion lies in the activation of idle money balances.[298] The similarity between the two processes is borne out by the fact that when only currency was regarded as money the use of bank deposits was regarded as a way of increasing the velocity of money.[299]

The process of multiple expansion of demand deposits by the banking system comes to a halt only if the system loses its reserves. But whether or not money paid out by a bank borrower stays in the banking system does not depend on the way the loan was initially made. It depends on whether somewhere in the chain of transactions initiated by the borrower's outlays are found depositors who wish to hold new deposits equal in amount to the new loan. Similarly, the outcome for the intermediary industry depends on whether in the chain of transactions initiated by the loan are found individuals who wish to acquire additional claims against intermediaries.[300] Of course the gap between actual and potential expansion is much wider for intermediaries than for the banking system. As it is sometimes put: "Credit expansion by intermediaries is subject to much more important leakages than is expansion by banks."[301] For every dollar withdrawn from an intermediary to finance expenditure, only part can be expected to return in the short run, as only part of the income of those who benefit by such expenditure will be saved, and only part of that saving will be used for investment in such institutions. But, according to Shelby: ". . . recognition

[295] *See e.g.*, Gurley and Shaw, *Financial Aspects of Economic Development*, (1955) 45 American Economic Review 515 at 534-536; Shelby, *Some Implications of the Growth of Financial Intermediaries*, (1958) 13 Journal of Finance 527 at 528-534.

[296] Bank of Canada, Annual Report of the Governor to the Minister of Finance (1956) at 24.

[297] As credit increases so, of course, do the assets and liabilities of the intermediaries.

[298] McLeod, *supra*, n. 177 at 23.

[299] Tobin, *supra*, n. 286 at 282.

[300] *Id.* at 285.

[301] Smith, *Financial Intermediaries and Monetary Controls*, (1959) 73 Quarterly Journal of Economics 533 at 537.

of this difference between banks and intermediaries should not lead us to hold further that they are not analogous."[302]

It is wrong to think that the expansion of credit by intermediaries is at the expense of bank expansion; it is in addition to bank expansion. Intermediaries generally hold their reserves in the form of bank deposits, so that any receipt of currency by an intermediary sets off a multiple expansion of bank deposits in the banking system. When the Bank of Canada undertakes to increase the supply of money by purchasing securities there is no interference with the process of multiple expansion of chartered bank assets and liabilities if a seller of securities deposits the proceeds in an intermediary rather than a bank.[303] The decision to deposit with an intermediary means that there will be more credit available than would otherwise be the case.[304] Equally, a shift by members of the public from bank deposits to intermediary claims increases the lending power of intermediaries without reducing that of the banks,[305] thus increasing the supply of loanable funds.[306]

In sum, no fundamental difference between monetary and non-monetary institutions arises because the former carry on their lending activities in unique fashion or because they are able to "create credit." It is argued, however, that the processes of credit expansion by monetary and non-monetary institutions "differ greatly in their economic significance."[307] An expansion of credit is contingent upon funds being withheld from spending in the case of non-monetary institutions but not in the case of banks. Galbraith is right when he states:[308]

> Intermediaries . . . can gain additional cash balances [and, hence, finance expenditure] only by inducing people to give up funds in exchange for the debt instruments of the intermediaries, and the funds given up must of course be withdrawn from other uses, either current spending or hoarding.

He is equally correct in observing that an expansion of loans by the banking system does not depend on withdrawing funds from other uses.[309] As a result, increased lending by banks has a greater expansionary potential for the level of expenditures than does increased lending by intermediaries.

It is important to appreciate the limitations in scope and utility of this distinction. First, as Galbraith himself makes clear,[310] it is patently false to consider the banking system capable at any time of expanding its loans without withdrawing funds from other uses. A banking system with fixed cash reserves depends upon savings in expanding its loans; it is only when the banking system receives additional cash reserves and expands loans on the basis of the new reserves that the consequences of bank lending depart from that of lending by interme-

[302] Shelby, *supra*, n. 295 at 533.

[303] Submissions by the Bank of Canada to the Royal Commission on Banking and Finance (1962) at 17.

[304] *Id.*

[305] Shelby demonstrates however, that because reserve requirements for demand deposits at commercial banks are generally higher than for time deposits, a shift from time deposits to intermediary claims produces an increase in credit which is less than the amount shifted. Shelby, *supra*, n. 295 at 535-536. *See infra* at

[306] Smith, *supra*, n. 301 at 539.

[307] *Id.* at 538.

[308] Galbraith, *supra*, n. 14 at 46.

[309] *Id.* Just as the banking system does not lose cash reserves in the course of lending to the public, nor does it lose cash reserves when primary depositors draw cheques to finance payments. This is due to the "virtually universal practice of depositing a check in a commercial bank promptly after receipt". Smith, *supra*, n. 301 at 536. The drawing of checks to finance payments to other customers of the banks leaves the position of the banks as a whole unaffected.

[310] Galbraith, *supra*, n. 14 at 41-47.

diaries. Second, no single institution obtains this peculiar ability to create loanable funds merely because its liabilities are a means of payment. It is only when virtually all recipients of income deposit the proceeds with members of the system that the system can bring about a multiple expansion of credit which is unaffected by the decisions of depositors to spend. It is because "the deposits created by the banking system constitute a major part of the money supply,"[311] and because "all the money in existence must be held by someone,"[312] that lending to the banking system by holding the existing supply of deposits is nearly automatic. Finally, the analysis of the English Radcliffe Report[313] challenges the basic assumptions upon which the distinction is based.

The assumption, of course, is that intermediaries can expand loans on the basis of additional cash balances only by inducing people to cut down their rate of spending. In other words, when intermediary claims are purchased the buyers have less money than before and will curtail their spending. The Radcliffe Report emphasizes the *store of value* function of money, a function in which money (in the sense of immediately transferable purchasing power) has a number of close substitutes capable of neutralizing any potential effect of a reduction in the money supply on spending.[314] Among the most important substitutes for money are the debt instruments of financial intermediaries, instruments so readily exchangeable into money with little or no loss that they are almost as relevant to the pace of spending on goods and services as money itself. According to the Governor of the Bank of Canada:[315]

> The Bank of Canada and the chartered banks are not the only debtors in Canada who issue obligations which serve as money or *close substitutes for money.* Trust companies, credit unions, Quebec savings banks, and provincial savings offices also issue deposit obligations which can be transferred by cheque or redeemed on demand in legal tender or its equivalent. Moreover, a wide variety of *short-term obligations* offered by trust and mortgage loan companies, instalment finance companies and investment dealers and indeed by governments and business corporations as well—provide the holder with interest-bearing claims which can be converted into money at early maturity dates (or even before maturity, if need be, with little risk of loss of capital value) and these compete with the deposits issued by chartered banks, especially time and notice deposits.

Claims against financial intermediaries are important substitutes for money even though they may not actually be used for making final payments. Those near-money assets that are completely liquid (that is, repayable, in fact, on demand) can perform all the functions of money but one: ". . . they are as good a store of value and as good a bearer of option as bank deposits; but they are not media of exchange."[316]

The cornerstone of the Radcliffe analysis is the proposition that decisions to spend are based not solely on the spender's supply of money but on his supply of liquid assets. "Decisions to spend on goods and services—the decisions that determine the level of total demand—are influenced by the liquidity of the spenders. . . ."[317] Hence there will

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311 *Id.* at 9.

312 *Id.*

313 Committee on the Working of the Monetary System, Report, Cmnd. No. 827 (1959) [cited hereinafter as Radcliffe Report].

314 Cramp, *Financial Intermediaries and Monetary Policy,* [1962] Economica 143.

315 Submissions by the Bank of Canada to the Royal Commission on Banking and Finance (1962) at 15 [emphasis added].

316 Lamfalussy, *Money Substitutes and Monetary Policy,* [1961] The Banker 44 at 46.

317 Radcliffe Report, *supra,* n. 313 at 132.

be little or no effect on the rate of spending if holders of money are induced to shift to intermediary claims which are close substitutes for money. The holders' liquidity position will be left virtually unaffected so that they "will not be induced to slow down their rate of spending."[318] While lenders to intermediaries are not necessarily induced to slow down their rate of spending (that is, to save), borrowers from intermediaries will be able to increase their spending.[319]

Commentators on the Radcliffe Report emphasize that a Radcliffe-type credit expansion is possible only if the supply of money is higher than the total sum of money balances necessary for performing the function of means of payment; if the two are equal nobody will be able to buy intermediary claims without feeling less liquid and therefore curtailing expenditure.[320] Cramp expresses the point this way:[321]

> Unless people have money balances which they would have held idle in the absence of intermediaries, then making a deposit with any intermediary which has not made long strides towards full banking functions will make them feel less liquid.

He finds "enough indications of the existence of idle balances to enable us to take their presence and relevance for granted."[322] Professor Neufeld, examining the implications of the Radcliffe Report for Canada, seems to accept the Report's assumption that individuals and institutions do hold cash balances as an asset as distinct from medium of exchange.[323] And the Quebec Committee on Financial Institutions was prepared to assume that "individuals or firms [can] always be found with idle funds they are prepared to invest."[324]

If it is accepted that the supply of liquid assets rather than the supply of money is the monetary quantity influencing total effective demand,[325] it is unrealistic to consider banks unique because they create "money." To the extent that monetary authorities seek to influence spending and the demand for goods and services,[326] they must concern themselves, directly or indirectly, as much with liquid assets as with money itself. An academic economist on the Radcliffe Committee has this to say:[327]

> So long as these alternative assets [the liabilities of intermediaries] are freely convertible into money without capital loss, they can be used with comparatively little trouble to make monetary payments, and the fact that they are not immediately acceptable without encashment is largely irrelevant to monetary management. It is the liquidity of an asset, not its acceptability in final payment, that marks it out as a potential source of embarrassment in inflationary conditions.

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318 Lamfalussy, *supra*, n. 316 at 47. This point is made by the Porter Commission:

> In general, the shorter the term and the closer to money are the liabilities issued by the institutions and final borrowers, the less impaired will lenders of funds feel their position to be, the more they will regard these assets as readily shiftable into money if necessary, and the greater will be their willingness to run down their holdings of money itself.

Porter Commission Report, *supra*, n. 29 at 97.

319 Cramp describes the effect as "an increase in the activities of non-bank financial institutions which makes some people (borrowers from intermediaries) feel more liquid, without making other people (lenders to intermediaries) feel significantly less liquid". Cramp, *supra*, n. 314 at 144.

320 Lamfalussy, *supra*, n. 316 at 49.

321 Cramp, *supra*, n. 314 at 147.

322 *Id.* at 148.

323 Neufeld, *The Implications of the Radcliffe Report for Canada*, (1960) 26 Canadian Journal of Economics and Political Science 413 at 424.

324 Government of Quebec, *Report of the Study Committee on Financial Institutions* 159.

325 Professor Sayers, a member of the Radcliffe Committee, argues that this proposition must be accepted. Sayers, *Monetary Thought and Monetary Policy in England*, [1960] Economic Journal 710 at 712.

326 This, of course, is the objective of monetary policy. *See* Submissions of the Bank of Canada to the Royal Commission on Banking and Finance (1962) at 9-11.

327 Address by Professor Cairncross, Wicksell Lectures, Stockholm, 1960, quoted in Rose, *Money Still Under Review*, [1961] The Banker 98 at 105.

Although Governor Rasminsky of the Bank of Canada denies the need for direct central bank control over the operations of intermediaries,[328] his opinion too is that if monetary policy is to be effective it must affect those operations:[329]

> From the point of view of inflationary potential . . . it does not really make very much difference whether an individual has a claim on a bank which he can spend, whether he has a claim on a trust company or whether he is holding another *short term liquid asset* which is very readily convertible into cash or which will automatically become cash in 30 days.

On these grounds, the means-of-payment characteristic of bank liabilities loses its quality as a meaningful differentiation. The upshot of the Radcliffe analysis is nothing less than an altered conception of "banking:"[330]

> The possibility of substituting near-money for money in liquid balances without affecting overall liquidity means that the dividing line between banks and other financial intermediaries has to be moved farther away from banks, so as to include among "banks" all financial institutions that are able to create adequate substitutes for money.

There is a good deal of responsible opinion to the effect that "banking" ought to comprehend the activities even of financial institutions whose liabilities do not serve as means of payment. In 1966 the Governor of the Bank of Canada stated before a Parliamentary Committee: ". . . the distinctive feature of the 'business of banking' is primarily borrowing by incurring obligations which are repayable on demand, or at short notice. . . ."[331] The Royal Commission on Banking and Finance defined the banking function as "the issuing of claims which serve as means of payment or as close substitutes for such money claims."[332] Banking liabilities would include "all term deposits, whatever their formal name, and other claims on institutions maturing, or redeemable at a fixed price, within one hundred days of the time of original issue or of the time at which notice of withdrawal is given by the customer."[333] The commissioners appear to have been influenced by the Radcliffe Report in suggesting this uniform treatment.[334] But perhaps more fundamental to their recommendations were these essential facts: first, the borrowing and lending activities of "banks" and other financial institutions have become in many respects indistinguishable[335] and, second, non-transferable demand claims pose exactly the same problems of asset management as transferable claims and thus raise the same problems with respect to protecting the interests of the public.[336]

Will the B.N.A. Act bear an interpretation wide enough to include within federal power "banking" as defined by the commissioners? If "banking" was used in the Bagehot-Ricardo sense of financial intermediation, then it plainly will. But if in 1867 the term contemplated

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[328] *See* Evidence of the Governor before the Royal Commission on Banking and Finance (1964) at 9-10.

[329] Standing Committee on Finance, Trade and Economic Affairs, Minutes of Proceedings and Evidence, H.C. First Sess., 28th Parl. (1969) No. 55, 2795 [emphasis added].

[330] Lamfalussy, *supra*, n. 316 at 47.

[331] Standing Committee on Finance, Trade and Economic Affairs, Minutes of Proceedings and Evidence, H.C. First Sess., 27th Parl. (1966) No. 19, 1002.

[332] Porter Commission Report, *supra*, n. 29 at 377.

[333] *Id.* at 378.

[334] *Cf., supra*, n. 318.

[335] Porter Commission Report, *supra*, n. 29 at 362.

[336] *Id.* at 378.

the issuance by financial institutions of money (in the traditional sense of transferable demand claims), can the ambit of the legislative power conferred by section 91(15) be said to extend to the issuance by financial institutions of close substitutes for money? Orthodox constitutional doctrine suggests a positive answer:[337]

> That the terms of the Constitution must be interpreted by reference to their meaning when the document was framed is undoubted, but this does not involve the consequence that they are to be read as comprehending only such manifestations of the subject matters named as were known to the framers.

The reference to "banking" in section 91(15) is, according to Viscount Simon, analogous to a reference to "skating."[338] And if "skating" were assigned to Parliament, ". . . it would be nothing to the point to prove that only one style of skating was practised in Canada in 1867 and to argue that the exclusive power to legislate in respect of subsequently developed styles of skating was not expressly conferred on the central legislature."[339] Given the flexible interpretation which the B.N.A. Act is said to require,[340] section 91(15) must comprehend the activities of institutions whose liabilities are perfect substitutes for bank chequing deposits in every sense but one. Consider in this connection *Re Alberta Legislation*[341] in which Duff C.J. relied heavily for his finding of invalidity on the fact that the provincial statute in question envisaged a form of credit which would serve as a substitute for bank credit. The B.N.A. Act is not incapable of incorporating new developments; the words used describe "a subject for legislation, not a definite object."[342]

The Monetary Institutions Reexamined

Intermediaries rely heavily on demand and short-term funds. The demand liabilities of trust companies represent about twenty-eight per cent of funds borrowed;[343] for mortgage loan companies the percentage is about twenty.[344] At the end of 1969, credit union and caisses populaires deposits totalled two thousand three hundred and thirty million dollars, of which only four hundred and thirteen million dollars was in the form of term deposits.[345] More than forty-five per cent of deposits with the Alberta treasury branches is represented by demand funds; moreover, the time deposits with the branches carry terms as short as thirty days.[346] Deposits with the Province of Ontario Savings Office, totalling one hundred and nine million dollars in 1970, are repayable on demand.[347]

For the sales finance and consumer loan companies[348] demand and

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[337] Wynes, *supra*, n. 162 at 32. Expositive of the Australian Constitution, the statement is equally true of the B.N.A. Act. *See e.g., Proprietary Articles Trade Association* v. *A.-G. Canada* [1931] A.C. 310 at 324; *A.-G. British Columbia* v. *A.-G. Canada* [1937] A.C. 391 at 402-403.

[338] *A.-G. Alberta* v. *A.-G. Canada, supra*, n. 8.

[339] *Id.* at 517.

[340] *A.-G. Ontario* v. *A.-G. Canada, supra*, n. 164.

[341] *Supra*, n. 4 at 89, 92.

[342] *Re Alberta Bill of Rights Act, supra*, n. 279 at 342 (Harvey C.J.A.).

[343] Bank of Canada, Statistical Summary, July, 1971. In some firms the percentage is as high as 40. *See* Financial Post, Oct. 26, 1968, at 47, cols. 1-8.

[344] Bank of Canada, Statistical Summary, July, 1971.

[345] Dominion Bureau of Statistics, Financial Institutions, Financial Statistics, First Quarter, 1971.

[346] Dominion Bureau of Statistics, *Canada Year Book* (1970-71) 1237.

[347] *Id.*

[348] "This group covers firms which are in the business of financing goods and services purchased at the factory, wholesale, or retail levels and of lending money to persons on the security of promissory notes and chattel mortgages." Dominion Bureau of Statistics, Financial Institutions, Financial Statistics, First Quarter, 1971, at 51.

short-term notes represent twenty-eight per cent of the companies' debt, and debt accounts for almost ninety per cent of funds employed.[349] As a general rule these institutions do not accept deposits. Federally incorporated small loan companies are subject to a statutory prohibition against acceptance of money on deposit;[350] there is no specific mention of the powers of other lenders in this respect,[351] but no deposit-taking institution could permit its cash holdings to be at the low levels maintained by the consumer loan companies.[352] According to the Porter Commission, the companies acts under which the finance companies are incorporated appear to prohibit, or at least do not clearly authorize, acceptance of deposits.[353] The companies acts generally prohibit the incorporation of companies to engage in "the business of banking."[354] The competition for funds between the deposit-taking institutions and the finance and consumer loan companies is not direct. But because they are able to compete for deposits through the sale of short-term obligations in the money market, the finance and loan companies "carry on an operation which is in all essentials banking."[355]

Debt instruments are not the only claims against financial institutions which constitute liquid assets in the hands of their holders. Equity investments too can be highly liquid. As earlier noted, the "shares" in credit unions and caisses populaires have little in common with the share capital of commercial companies. The institutions are authorized to repurchase their issued shares, and the holder may, on giving such notice as may be required, withdraw moneys standing to his credit in a share account.[356] Although nominally subject to notice of sixty to ninety days,[357] credit union and caisses populaires shares are in practice redeemable on demand at par.[358] In name an equity instrument, the share has many of the characteristics of debt: in practice it represents an enforceable obligation to pay a fixed sum of money;[359] like a demand deposit it lacks a fixed maturity date, but is redeemable at the instance of the holder, not the issuer;[360] while provision for interest is a characteristic feature of indebtedness and lacking in the share contract, demand deposits too are frequently non-interest bearing; the elemant of risk involved makes the investment analogous less to a contribution to capital than to a loan. If the debtor-creditor relationship is essential to banking, surely it is the substance and not the form of the relationship which gives it importance. Significantly, the liquid reserves requirement of section 59(1) of the Manitoba Credit Unions Act[361] applies equally to the shares and deposits of the societies.

349 Bank of Canada, Statistical Summary, July, 1971. Figures for the first quarter of 1971 show total liabilities of 5,552 million dollars, of which only 666 million dollars represents shareholders' equity.

350 Small Loans Act, R.S.C. 1970, c. S-11, s. 16.

351 *But see infra,* at 202.

352 Raynauld, *supra*, n. 38 at 260.

353 Porter Commission Report, *supra*, n. 29 at 201.

354 *See e.g.,* The Companies Act, R.S.A. 1970, c. 60, s. 13(a); Canada Corporations Act, R.S.C. 1970, c. C-32. s. 5(1)(e).

355 Bank of Canada, Annual Report of the Governor to the Minister of Finance (1956) at 26.

356 *See e.g.,* The Credit Union Act, R.S.A. 1970, c. 74, ss. 14(2), 18, 52; The Credit Unions Act, R.S.M. 1970, c. C300, s. 44.

357 *See e.g.,* Regulations under The Credit Union Act, Alta. Reg. 134/57 (1957); R.S.M. 1970, c. C300, s. 44(7).

358 Porter Commission Report, *supra*, n. 29 at 159; Mercure, *supra*, n. 182 at 76, 82.

359 Of course the credit union is not bound to redeem the share at par if it has insufficient funds. "All amounts paid in on shares . . . of [a] . . . withdrawing member . . . shall *as funds become available* . . . be paid to him". R.S.M. 1970, c. C300, s. 44(b) [emphasis added].

360 This distinguishes it from the ordinary redeemable preference share.

361 R.S.M. 1970, c. C300.

The mutual fund share, like that of the credit union, is redeemable on demand of the holder. But the mutual fund share does not constitute a debt or fixed obligation; ". . . its value fluctuates directly with the value of the proportionate interest which it represents in the mutual fund portfolio."[362] Losses and gains experienced by the portfolio are automatically passed through to the participants. As an asset, the mutual fund share is as liquid as a demand deposit, but no more useful as a store of value than a common share.

A mutual fund may be organized as a corporation or as a trust; the incorporated funds hold the greater share of industry assets.[363] Mutual funds may be incorporated federally or provincially. The Canada Corporations Act[364] and some provincial companies acts[365] make provision for "mutual fund shares," shares requiring the company to accept surrender on demand of the holder for net asset value. At the end of 1965 there were about twenty-one mutual funds incorporated federally, with a total of one and one-half billion dollars in assets, and about sixteen provincially incorporated funds, with total assets of one hundred and seven million dollars.[366]

Apart from the explicit authorization in company legislation to issue mutual fund shares, there is no special Canadian legislation to regulate the industry.[367] To the extent that a fund offers shares to the public in any province, it must file a prospectus under the provincial securities act. Regulations under the securities legislation call for the filing of a particular form of prospectus where securities of a mutual fund company are offered to the public.[368] The all-government committee studying mutual funds reported in 1969 that comprehensive legislation to govern the mutual fund industry is essential.[369]

Though the relationship between a fund and its shareholders is not based on security of investment as is the bank-depositor relationship, the fund must be prepared to honour its promise of redemption. Like other financial intermediaries issuing demand claims, mutual funds find their operating practices constrained by the need to maintain an acceptable level of liquidity in their portfolios.[370] Because the mutual fund shareholder can force the fund to redeem his shares at net asset value, his intention is not to take the risks of loss attendant upon the corporate adventure:[371]

> . . . [T]he mutual fund investor's position is more analogous to that of a depositor in a bank than to a shareholder in other types of corporations. His position differs from that of a bank depositor in that he may withdraw a pro rata share of the assets rather than a fixed sum. Because of this difference, the mutual fund investor's position is that of an equity holder rather than that of a creditor. However, the

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362 Mutual Funds Report, *supra*, n. 134 at 113.

363 Baum, *Catalyst for Change: Mutual Funds in Canada*, (1970) 59 Georgetown Law Journal 249 at 276. Incorporated funds are known as "open-end investment companies".

364 R.S.C. 1970, c. C-32, s. 14.

365 The Companies Act, R.S.A. 1970, c. 60, s. 71; The Business Corporations Act, S.O. 1970, c. 25, ss. 37-38.

366 Williamson, *Mutual Funds* (c. 15 *Studies in Canadian Company Law*, Ziegel (ed.) 1967) at 454. The number of companies has since grown to 62. Baum, *supra*, n. 363 at 276.

367 *See* Baum, *supra*, n. 363 at 249-280.

368 *E.g.*, Regulations under the Securities Act, 1967, Alta. Reg. 255/67 (1967) *as amended*, s. 9, Form 12. The applicable regulations in Ontario are described by Baum, *supra*, n. 363 at 265-274.

369 Mutual Funds Report, *supra*, n. 134 at 16.

370 Paper 13, *Liquidity and Fund Operations (A Study of the Canadian Mutual Funds Industry*, Quirin and Waters (eds.), 1969).

371 Paper 1, *Mutual Funds as Financial Intermediaries (A Study of the Canadian Mutual Funds Industry*, Quirin and Waters (eds.), 1969) at 6-7.

economic reality of his position is at arm's length, that of a depositor. There are other intermediaries in which depositors are legally shareholders but behave like, and are treated as depositors—notably credit unions, caisses populaires, and (in the United States) holders of savings and loan shares.

In recent years a number of other intermediaries have begun to offer securities with characteristics comparable to those offered by mutual funds. Trust company pooled accounts "confer on their participants privileges corresponding to those of a shareholder or unitholder in a mutual fund."[372] These "common trust funds," authorized under provincial legislation,[373] are composed of moneys belonging to various estates and trusts combined for the purpose of facilitating investment. Regulations governing the operation of common trust funds indicate how closely they correspond to mutual funds. A fund is divided into units of equal value and the proportionate interest of each participant is expressed by the number of units held.[374] Admissions to and withdrawals from a fund are based on the company's valuation of the fund as of a valuation date.[375] At the end of 1968, at least twenty Canadian trust companies sponsored such investment funds designed for public participation.[376] These, according to the Committee on Mutual Funds, "are and should be caught by our recommended definition of mutual funds."[377] The term "mutual fund" was defined to include any organization (or separate fund or trust account) which issues instruments that entitle the holder to receive, on demand or within a specified period after demand, an amount computed by reference to the value of a proportionate interest in the assets of the issuing organization (or of the separate fund or account).[378] Funds with fewer than fifty participants were excluded.

If trust companies operate trusts that cannot be distinguished from mutual funds, the label of trust can no more disguise the true character of the operation than it can in respect of receipt of deposit moneys. And if, as suggested, the business of banking includes any operation by which an institution obtains funds for lending or investment through the issuance of liquid claims to the public, then the public-participation investment funds of trust companies are banking operations.

Reacting presumably to the recommendations of the Mutual Funds Committee, Ontario added a new section to its Loan and Trust Corporations Act in 1970.[379] The section defines a "pooled trust fund" in terms identical to the Committee's definition of a mutual fund, and empowers the Lieutenant Governor to prescribe, *inter alia,* the content of trust instruments establishing pooled funds and the investment restrictions and reserves in respect of such funds. The responsible Minister is authorized to prohibit the operation of a pooled trust fund where the operation appears hazardous to the public. Section 86 is the first explicit grant of legislative authority to fashion comprehensive rules of conduct

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372 Mutual Funds Report, *supra,* n. 134 at 121.

373 *E.g.,* The Trust Companies Act, R.S.A. 1970, c. 372, s. 98; Loan and Trust Corporations Act, R.S.O. 1970, c. 254, s. 85.

374 Regulations under the Loan and Trust Corporations Act. R.R.O. 1960, Reg. 414, s. 4(1).

375 *Id.* s. 6(1).

376 Mutual Funds Report, *supra,* n. 134 at 122.

377 *Id.* at 125.

378 *Id.* at 117.

379 An Act to Amend the Loan and Trust Corporations Act, S.O. 1970, c. 129, s. 21 [section 86 of R.S.O. 1970, c. 254].

for "mutual funds"; it represents a novel kind of provincial banking legislation.

There is some dispute as to whether life insurance companies should be separated from the list of intermediaries whose liabilities, when held by the public, provide them with liquidity. Among the many financial assets that serve as close substitutes for money for precautionary and diversification purposes, John Gurley would include policy reserves in life insurance companies.[380] The Life Insurance Association of America refutes this categorization by reviewing the record of the extent to which policyholders draw on liquid assets in the form of policy reserves.[381] During the period 1952-1959, policy loans and cash surrenders (the two ways in which cash values may be drawn upon) averaged only two point four per cent of the total cash values of life insurance. From this the conclusion is drawn: ". . . policy reserves should not be classified as a 'close substitute for money' or as a 'highly liquid asset'."[382] The great majority of life insurance policyholders do not regard cash-surrender or policy-loan values as liquid assets. Professor Sayers agrees: ". . . in general people regard their policies as a hard core of savings, the existence of which has little bearing on the flow of spending."[383] The essential point is that life insurance savings are highly liquid but are not regarded as such by policyholders.

Like other financial intermediaries life insurance companies are able to finance increased expenditure without a parallel increase in the money supply. But unlike intermediaries whose liabilities are close substitutes for money, the life insurance companies are able to finance increased expenditure only at the cost of reducing the liquidity of those who become policyholders. The effect of their operations on the whole liquidity position of the economy is insignificant.[384] The question whether insurance companies can be regarded as banking institutions depends upon whether the essence of banking is seen to reside in the impact on money, finance, or liquid assets. Their operations have no effect on the supply of money, very little on the supply of liquid assets, but considerable effect on the supply of finance.

More Laissez Faire

The decennial revision of the Bank Act scheduled for 1964 was postponed pending the Report of the Porter Commission. Using its "short-term-liabilities" conception of banking as a bench mark, the Commission found that institutions not then regulated by the Bank Act had moved increasingly into the banking field with the result that the network of divided regulation over institutions performing similar functions was unduly arbitrary, inequitable and, in some cases, inadequate.[385] The Commission's recommendations were straightforward and sweeping:[386]

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[380] Gurley, *Liquidity and Financial Institutions in the Postwar Economy*, Study Paper No. 14 prepared in connection with the Study of Employment, Growth and Price Levels for consideration by the Joint Economic Committee of the Congress of the United States (1960) at 4 [cited in Life Insurance Association of America, *Life Insurance Companies as Financial Institutions* 236 (1962)].

[381] Life Insurance Association of America, *Life Insurance Companies as Financial Institutions* 236-238 (1962).

[382] *Id.* at 238.

[383] Sayers, *supra*, n. 222 at 166-167. This traditional attitude toward life insurance may be in the process of change. A. H. Jeffery, Q.C., president of London Life Insurance Co. commented recently: "The value of such insurance was recently demonstrated to many who were able to borrow on it when they needed money to carry them in the tight money period." Financial Post, Dec. 4, 1971, at 6, col. 3.

[384] *See* Shelby, *supra*, n. 295 at 536-537.

[385] Porter Commission Report, *supra*, n. 29 at 375.

[386] *Id.* at 364.

> . . . [W]e conclude that federal regulation should be compulsory for all private institutions doing a banking business and that other institutions should be prohibited unequivocally from operating as banks, that is from accepting funds from the public in demand form or short-term accounts.

The Bank Act revision of 1967[387] did nothing to restrict the creators of near-money as the Commission had recommended. Its chief thrust was a strengthening of the chartered banks to enable them to compete effectively with unchartered institutions.[388] Removal of the six per cent interest rate ceiling on loans,[389] extension of powers to make both commercial and residential mortgage loans,[390] and authorization of capital financing through the issue of debentures[391] were the principal means adopted to arrest the relative decline in the competitive position of chartered banks.

An oblique approach to federal regulation of institutions dealing in short-term claims was taken in the Canada Deposit Insurance Corporation Act[392] of 1967. Deposit insurance has a dual purpose:[393] on a macroeconomic level deposit insurance acts as a stabilizer by preventing reductions in the stock of money and near-money (represented by the liabilities of financial institutions);[394] on a microeconomic level deposit insurance provides for the consumer an absolutely safe vehicle for transaction and precautionary balances.[395]

The 1967 statute requires a broad group of deposit-taking institutions which Parliament has created—chartered banks, and federally chartered trust and mortgage loan companies—to insure customers' deposits through a Crown corporation created by the Act. The applicable regulations[396] define a deposit in terms somewhat wider than those accepted by the Porter Commission as descriptive of a "banking" claim. Obligations payable on demand are obviously included, but so too are obligations payable on a fixed date not more than five years after the date of deposit, or payable on notice of not more than five years. Given such wide coverage, it is perhaps not surprising that Parliament confined the compulsory ambit of the statute to federally chartered institutions. But by framing the enactment so as to avoid any challenge to federal legislative authority, Parliament conceded a wide measure of jurisdiction to the provinces.

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[387] S.C. 1966-67, c. 87.

[388] Governor Rasminsky said of the new Act:

> The trust and loan companies and the other deposit receiving institutions are formidable competitors and the chartered banks will have to meet the competition if they are to retain their share of the business. I think that some of the provisions in the proposed legislation will remove some of the inhibitions and some of the restrictions that the chartered banks have been under in competing with other financial institutions.

Standing Committee on Finance Trade and Economic Affairs, Minutes of Proceedings and Evidence, First Sess., 27th Parl. (1966) No. 20, at 1029.

[389] S.C. 1966-67, c. 87, s. 91.

[390] *Id.* s. 75(1)(c).

[391] *Id.* s. 77.

[392] S.C. 1966-67, c. 70.

[393] *See* Scott and Mayer, *Risk and Regulation in Banking: Some Proposals for Federal Deposit Insurance Reform,* (1971) 23 Stanford Law Review 857 at 858-861.

[394] "The primary function of the insurance system is not to replace the deposits of failed banks, but rather to reduce the incidence of failure by assuring the public that deposits are safe and hence preventing runs that can topple even sound banks." *Id.* at 858-859.

[395] "In this respect, the depositor occupies a somewhat special position because he does not usually consider his deposit as a form of investment, but rather as a convenient way to make payments and extend his cash resources over a period of time." Government of Quebec, *Report of the Study Committee on Financial Institutions* 111 (1969).

[396] By-law No. 1 (General) of the Canada Deposit Insurance Corporation, S.O.R./67-152, (1967) 101 Canada Gazette (Part II) 532, April 12, 1967.

Provincially created deposit-taking institutions of the trust and mortgage loan variety are given the opportunity, with the consent of the incorporating province, to enter into deposit insurance arrangements with the federal Crown corporation.[397] The opposition parties had argued strongly, but without success, for compulsory insurance of all deposits in all financial institutions in Canada, urging both in the House and before the Committee on Finance, Trade and Economic Affairs that the federal banking power was adequate for this purpose and, indeed, that deposit insurance was a matter exclusively federal.[398] One member pointed out quite correctly that provincial jurisdiction over an activity cannot be assumed merely because the institutions carrying on the activity are provincially incorporated.[399] As contemplated by the federal statute, most of the provinces authorize or require their trust and loan institutions to participate in the federal scheme.[400]

Ontario and Quebec have their own deposit insurance statutes. The Ontario statute[401] was essentially a transitional measure, and the corporation established thereby is now responsible only for provincial institutions ineligible for federal insurance.[402] While the Ontario legislation enlarges the scope of the federal insurance scheme, the Quebec statute[403] introduces a parallel scheme. Quebec requires the registration of all deposit-taking institutions (other than the chartered and Quebec savings banks)[404] and obliges the Quebec Deposit Insurance Board to guarantee deposits with registered institutions and banks.[405] The Quebec system is financed by the provincial treasury[406] rather than by insurance premiums. The introduction of this deposit insurance plan parallel to the federal scheme necessitated inter-agency agreement to preclude the requirement of double insurance or guarantee.[407] In the absence of agreement federally chartered institutions or institutions chartered by provinces requiring insurance with the Canada Deposit Insurance Corporation would be subject to double insurance when operating in the Province of Quebec. Under the agreement berween the C.D.I.C. and the Q.D.I.B.,[408] guarantee by the latter terminates insurance with the former in the case of provincially chartered institutions (with the consent of the institutions and the province of incorporation), while the C.D.I.C. undertakes to indemnify the Q.D.I.B. for liability incurred by the latter in respect of deposits in Quebec with federal institutions federally insured. The Q.D.I.B. is authorized by statute to guarantee, for a premium,

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[397] S.C. 1966-67, c. 70, s. 16.

[398] (1967) 12 H.C. Deb. 13011-13015, 13021-13022, 13027, 13038-39; Standing Committee on Finance, Trade and Economic Affairs, Minutes of Proceedings and Evidence, First Sess., 27th Parl, (1967) No. 46, *passim*.

[399] (1967) 12 H.C. Deb., 13038 [Mr. Lambert]. *See Re the Incorporation of Companies in Canada* (1913) 48 S.C.R. 331 at 410 [Duff J.]: "The division of powers (under the general scheme of the [B.N.A.] Act) is according to the subject matter of the legislation, not according to the persons to be affected by the legislation."

[400] *E.g.*, Regulations under The Trust Companies Act, Alta. Reg. 172/67 (1967), s. 14; Ontario Deposit Insurance Corporation Act, R.S.O. 1970, c. 307, ss. 22, 23; The Companies Act, R.S.M. 1970, c. C160, s. 244; Loan Companies Act, R.S.N.S. 1967, c. 171, s. 60A [added by S.N.S. 1968, c. 36, s. 3]; Trust Companies Act, R.S.N.S. 1967, c. 316, s. 58(j).

[401] An Act to establish the Ontario Deposit Insurance Corporation, S.O. 1967, c. 61.

[402] Ontario Deposit Insurance Corporation Act, R.S.O. 1970, c. 307, s. 25.

[403] Quebec Deposit Insurance Act, S.Q. 1966-67, c. 73.

[404] *Id.* ss. 1(d), 24.

[405] *Id.* s. 33.

[406] *Id.* ss. 49-54.

[407] The Quebec and Dominion Statutes authorize such agreement. *Id.* s. 55; Canada Deposit Insurance Corporation Act, R.S.C. 1970, c. C-3, s. 31.

[408] Reproduced as Appendix 2 in Government of Quebec, *Report of the Study Committee on Financial Institutions* (1969).

deposits made outside Quebec with an institution incorporated in Quebec.[409] Under the agreement with the C.D.I.C. the Q.D.I.B. agrees to terminate such guarantee upon the issuance of a policy by the C.D.I.C. insuring the deposits outside Quebec. The Porter Commission is surely right in charging that federal acceptance of provincial legislation in the banking field results in "a mixed and sometimes confused pattern of regulation."[410]

By requiring the registration of all institutions except banks taking deposits from the public, the Quebec statute effectively requires a company desiring banking powers to apply to the federal Parliament for a charter or to apply to a provincial authority for a permit to operate as a bank. Similar in effect is recent legislation in two other provinces which imposes prohibitive liquidity requirements on deposit-taking institutions not exempted by the statutes or by regulations made thereunder. Virtually identical statutes in Alberta[411] and Ontario[412] require every person or corporation receiving deposits[413] from the public to set aside as security for such deposits cash or short term securities[414] in an amount aggregating not less than sixty per cent of the total amount of deposits received.[415] Both statutes exempt chartered banks, post office savings banks, trust companies, insurance companies, credit unions, co-operative associations, issuers of investment contracts, and the appropriate provincial government savings institutions.[416] The Lieutenant Governor in Council of each province is authorized to make regulations exempting any person or corporation or any class thereof from the application of the statutes.[417] Since finance and consumer loan companies, for example, are unlicenced (that is, not exempted by the regulations), they are effectively precluded from accepting deposits in Alberta or Ontario.

Thus, federal legislation contains provisions for the chartering of institutions authorized to engage in "the business of banking," and prohibits the use of the word "bank" by institutions not so chartered, but nowhere prohibits others from engaging in banking activities.[418] Legislation in three provinces prohibits the exercise of banking powers unless a "licence" is obtained, either by adopting a recognized institutional form, federal or provincial, or by obtaining a permit from provincial authorities. Can such a regulatory pattern have been within the contemplation of those who assigned to the Dominion, notwithstanding anything elsewhere expressed, exclusive authority to make laws in relation to "Banking" and "Incorporation of Banks?"

409 S.Q. 1966-67, c. 73, s. 34.

410 Porter Commission Report, *supra*, n. 29 at 362.

411 The Deposits Regulation Act, R.S.A. 1970, c. 108.

412 Deposits Regulation Act, R.S.O. 1970, c. 127.

413 "Deposit" is defined to include any loan of money at interest other than a loan to any corporation in connection with the issue of its bonds, debentures, notes or other written evidences of indebtedness. R.S.A. 1970, c. 108, s. 2(c); R.S.O. 1970, c. 127, s. 1(d). Under the Ontario definition a loan is not a "deposit" unless made to a person or corporation "one of whose principal businesses is lending money, dealing in mortgages of real or personal property or purchasing accounts receivable". *Id.*

414 "Short term" securities are those maturing within 180 days from the date of acquisition thereof. R.S.A. 1970, c. 108, s. 2(e); R.S.O. 1970, c. 127, s. 1(h).

415 R.S.A. 1970, c. 108, s. 6(1); R.S.O. 1970, c. 127, s. 5(1).

416 R.S.A. 1970, c. 108, s. 3; R.S.O. 1970, c. 127, s. 2. The Ontario section, *id.*, also exempts mortgage loan companies and mortgage brokers. Loan corporations registered under the Ontario Loan and Trust Corporations Act, R.S.O. 1970, c. 254, and loan companies to which the federal Loan Companies Act, R.S.C. 1970, c. L-12, applies are exempted by regulations passed under the Alberta Act. Regulations under the Deposits Regulations Act, Alta. Reg. 269/64 (1964).

417 R.S.A. 1970, c. 108, s. 9(a); R.S.O. 1970, c. 127, s. 8(a).

418 The Bank Act, S.C. 1966-67, c. 87, ss. 75(1)(e), 157(1).

IV. THE COURTS AND THE BANKING POWER

Some decisions of the Privy Council and of the Supreme Court of Canada augured well for the development of an exclusively national banking system. In *Tennant* v. *Union Bank of Canada* it was declared that "banking" was "wide enough to embrace every transaction coming within the legitimate business of a banker."[419] In *A.-G. Alberta* v. *A.-G. Canada* the Privy Council stated that whatever is fairly included within the conception of banking is a matter exclusively reserved for the legislature of Canada.[420] Nor was the scope of the banking power to be measured only by "the extent and kind of business actually carried on by banks in Canada in 1867."[421] This was an important principle. Section 91(15) would be a narrow source of legislative power indeed, were it confined to granting and regulating the power of note issue. Equally important was the principle, apparently established by Duff C.J. in *Re Alberta Legislation*,[422] that the scope of the banking power must be determined functionally, that is to say, by considering primarily the true nature of the contribution made by banking to the economy rather than the formal relationship between banks and those who use them. Duff C.J. said:[423]

> . . . [C]redit (including credit in this novel form) as a medium for effecting the exchange of goods and services, and the machinery for issuing and circulating it, are among the matters assigned to the Dominion under section 91 and not among those intended to be assigned to the provinces under any of the categories of section 92.

The limits of the banking power were not to be determined by the *form* of credit obligations or of institutions issuing them. But the expansive conception of the banking power manifest in these decisions was not to survive.

It was first decided that while Dominion legislation might validly extend to every transaction coming within the legitimate business of a banker, it does not follow that no institution other than a federally chartered bank may perform *any* of the functions carried out by banks. In other words, certain functions are of the essence of banking while others are appropriate to all companies doing a financial business. A banking business can be carried on without performing all the functions of institutions called "banks," and institutions may perform some of the functions of "banks" without thereby carrying on a banking business. This reasoning permitted the Manitoba Court of Appeal to hold in *Re Bergethaler Waisenamt*[424] that a province can incorporate institutions which do not receive deposits capable of being withdrawn by instruments in the nature of cheques. Said Richards J.A.:[425]

> The right of a provincial Legislature to incorporate a loan, trust or financial corporation without authority to do a banking business is not questioned. That is all the Legislature purported to do here. The conduct of a banking business was not contemplated.

Later he said: "Here many important functions, including the important

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[419] [1894] A.C. 31 at 46.

[420] *Supra*, n. 8 at 517.

[421] *Id.* at 516.

[422] *Supra*, n. 4.

[423] *Id.* at 91.

[424] *Supra*, n. 280.

[425] *Id.* at 328.

or essential duty or obligation to pay the customers' orders, were lacking."[426] Adamson J.A. agreed:[427]

> The wide difference between taking deposits in 'chequing accounts' as the banks do and simply taking deposits as this company did is an important point in considering whether a banking business was or was not carried on. The bare fact of taking deposits does not constitute 'banking' and the province has jurisdiction to grant such a power to a company of its creation.

There is no need to repeat here the arguments which convert into one significantly less than wide the difference adverted to by Adamson J.A. It suffices to point out that in the lower court Dysart J. found the Bergethaler Waisenamt to be carrying on a banking business because it received money on deposit from the public and used that money for loaning to the public.[428] Ignoring that feature of the Court of Appeal judgment, the decision seems sound. If "banking" is not necessarily limited to nor co-extensive with the business actually carried on by banks in 1867, then the search must be for the essence of banking. If that essence is lacking in the activities of an institution, then the institution is not a bank and may be incorporated by a province.

Implicit in the *Bergethaler* case is the proposition that a province cannot create institutions with the power to carry out operations which are of the essence of banking. This proposition was severely qualified in *La Caisse Populaire Notre Dame Limitée* v. *Moyen*[429] where the Saskatchewan Court of Queen's Bench found the Credit Union Act to be validly enacted provincial legislation. The opinion warrants close analysis; first, however, an outline of the reasoning adopted by the Court. There is no "general area" or "domain" of banking which provincial legislatures may not enter. Thus, while an institution cannot be a bank unless it is authorized to do that which is essential to banking, it does not follow that an institution is necessarily a bank because it *is* authorized to do that which is essentail to banking. Therefore, a provincial institution may perform the distinctive banking function if the "pith and substance" of the authorizing legislation is not banking but some matter over which the provinces have jurisdiction by virtue of the enumerations of section 92 of the B.N.A. Act. So long as there is no conflict with the banking legislation of the Dominion and no interference with banks, a province may establish institutions to do *whatever* banks do, if the province is acting in pursuance of a valid provincial object. Though a credit union may accept deposits subject to withdrawal by negotiable order, it is not a bank but a local, co-operative society designed to promote thrift among its members and to provide credit to its members at reasonable rates of interest.

Tucker J. held that provincial legislation may confer power to perform all the functions of a chartered bank. In order to explain the apparent contradiction in permitting the province to confer powers which may also be conferred by Parliament in exercise of its "exclusive" banking power, he drew an analogy to legislation dealing with the irresponsible driver.[430] Parliament may prohibit negligent driving in exercise of

[426] *Id.* at 332.

[427] *Id.* at 337.

[428] *Supra*, n. 86.

[429] *Supra*, n. 195.

[430] *Id.* at 137-139, 152-154. He cites *O'Grady* v. *Sparling* [1960] S.C.R. 804; and *Mann* v. *The Queen* [1966] S.C.R. 238.

its criminal law power. A province has no power to enact criminal legislation, but it may validly enact a similar or identical statute as highway traffic regulation, a matter of property and civil rights. The subject of negligent driving is one susceptible of a double aspect. The validity of legislation depends upon its pith and substance, and this is to be sought not so much in the subject matter of the statute as in its object or purpose.

If the subject "negligent driving" does not constitute part of a domain of criminal law, said Tucker J., there is no obligation to hold that "chartered banking powers" constitutes part of a domain of banking.[431] To confer banking powers is not necessarily to enact banking legislation. The proper approach, he said, is to look for the pith and substance of the legislation, its "true object, purpose, nature and character."[432] Having emphasized that the purpose of the Credit Union Act is to provide service to members and credit at cost, Tucker J. concluded as follows:[433]

> I am satisfied that although The Credit Union Act sets up corporations which may engage in 'banking' its pith and substance is to provide for a means whereby its members may be encouraged to save and use such savings to assist each other and the powers given to it to engage in activities which banks are authorized to engage in are only ancillary to the carrying out of such a purpose, and so not an intrusion into the federal field of sec. 91(15) and therefore it is *intra vires* the province under sec. 92(11) and (13).

Tucker J. was called upon in *Moyen* to engage in a familiar process of constitutional interpretation; in Professor Lederman's terms, to attach relative importance to the provincial and federal features of a challenged statute.[434] He considered the federal feature to be quite unimportant ("ancillary") relative to the provincial features. To decide otherwise, to hold that only Parliament has authority to confer banking powers, would involve the contrary judgment that the provincial features of the legislation were relatively insignificant. Tucker J. was not prepared to make such a judgment.

But in two earlier cases the Privy Council deemed the property and civil rights features of challenged provincial legislation so unimportant in contrast to their banking features that classification for the purpose of determining legislative power was by the latter features only.[435] In the *Quebec Vacant Property* case[436] the Privy Council found *ultra vires* a provincial statute which provided that unclaimed deposits in credit institutions became the property of the provincial Crown. The essential question for the Court, said Lord Porter, was whether the receipt and payment of deposits is a banking matter or a matter of property and civil rights.[437] He admitted that the subject "may be regarded from more than one angle,"[438] but decided that legislation which interferes with the

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431 Tucker J. felt that the analogy was apt because "banks and banking" is a far-reaching and undefined field like "criminal law". He said: ". . . it would be impractical to say there is a 'general area' or 'domain' of banking which the legislature may not enter . . . as to do so would prevent the legislature exercising a great part of its powers under sec. 92." *Id.* at 139.

432 *Id.* at 154.

433 *Id.* at 161.

434 Lederman, *Classification of Laws and the British North America Act* (Part 3, c. 1 *The Courts and the Canadian Constitution,* Lederman (ed.) 1964 at 177-199.

435 *See id.* at 194-195.

436 *A.-G. Canada* v. *A.-G. Quebec, supra,* n. 281.

437 *Id.* at 44. Lord Porter found that the legislation primarily "affects banks and them alone." *Id.*

438 *Id.* at 43.

bank-depositor relationship is in pith and substance banking legislation. Lord Porter concluded this way:[439]

> In their [Lordships'] view, a provincial Legislature enters on the field of banking when it interferes with the right of depositors to receive payment of their deposits, as in their view it would if it confiscated loans made by a bank to its customers. Both are *in a sense* matters of property and civil rights, but *in essence* they are included within the category of banking.

In the *Alberta Bill of Rights* case[440] the Privy Council found *ultra vires* a provincial statute which proposed to regulate the creation of derivative deposits by credit institutions (including chartered banks). Said Viscount Simon:[441]

> Legislation which aims at restricting or controlling this practice must be beyond the powers of a provincial legislature. It is true, of course, that in one aspect provincial legislation on this subject affects property and civil rights, but if, as their Lordships hold to be the case, the 'pith and substance' of the legislation is 'Banking' . . . *this is the aspect that matters* and Part II is beyond the powers of the Alberta legislature to enact.

The Privy Council here upheld a finding of invalidity by the Supreme Court of Alberta.[442] Harvey C.J.A., delivering judgment for the Court, obviously felt that the subject matter of the legislation in question was susceptible of only a federal aspect. It fell *exclusively* within federal authority.[443]

The language of Lord Porter and Viscount Simon repeated above was quoted in the judgment of Tucker J. in the *Moyen* case. He felt, however, that it was the attempt to interfere with and regulate chartered banks which caused the Privy Council to classify the statutes as in pith and substance banking legislation.[444] Of the Credit Union Act he said: "It does not interfere with or attempt to regulate chartered banks."[445] This to a certain extent is quite true.[446] But it is far from obvious that the Privy Council would consider the conferral of banking powers a relatively insignificant feature of legislation. If the granting of such powers is in essence within the category of banking, that is the feature of legislation that matters. As Viscount Simon said in the *Alberta Bill of Rights* case: "[Whatever] is fairly included within the conception of 'banking' . . . is a matter *exclusively* reserved for the legislature of Canada."[447] There is authority against Tucker J. in the opinion of Duff C.J. on the validity of the Social Credit Act in *Re Alberta Legislation*.[448] The Chief Justice found it difficult to suppose that it could have been intended that a single province might direct its powers of legislation under section 92 to the introduction and maintenance of credit as a medium for effecting the exchange of goods and services.[449] He said that a statute which provides for the issuance and circulation of credit

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[439] *Id.* at 46 [emphasis added].

[440] *Supra*, n. 8.

[441] *Id.* at 518 [emphasis added].

[442] *Sub nom. Re Alberta Bill of Rights Act, supra*, n. 279.

[443] Hence this statement: ". . . provincial legislation though on a subject-matter assigned to the Provinces [Property and Civil Rights] cannot be permitted to infringe on subject-matters assigned to the Dominion [Banks and Banking]." *Id.* at 340.

[444] *Supra*, n. 195 at 151.

[445] *Id.* at 154.

[446] *But see infra*, at 211-214.

[447] *Supra*, n. 8 at 517.

[448] *Supra*, n. 4.

[449] *Id.* at 91.

is concerned with "banking" within the meaning of section 91.[450] And yet Tucker J. was able to say of this case that had the legislation limited itself to setting up a financial authority to accept deposits subject to withdrawal by negotiable orders and had it refrained from interfering with and trying to regulate chartered banks, it would not have been held *ultra vires*.[451] With respect, the opinion of Duff C.J. is not capable of any such interpretation. Although the Alberta Social Credit Act was not formally before the Court, the Chief Justice felt it necessary to examine it "to arrive at a proper conception of its character from the constitutional point of view."[452] The Act involved no interference with the chartered banks, but Duff C.J. found it *ultra vires* as an encroachment upon the federal power over "banking."[453]

The reasoning of Tucker J. may usefully be contrasted with that of Porter and Allen JJ. A. dissenting in *Breckenridge Speedway Ltd., Green et al.* v. *The Queen*.[454] They found that in enacting the Treasury Branches Act the Province of Alberta had authorized the branches to carry on a business with all the functional characteristics of banking. The legislation was therefore in pith and substance banking legislation and beyond the authority of any province to enact.[455]

It can hardly be doubted that banks and credit unions are different types of organization: credit unions are service organizations operating for the benefit of their members; banks are capitalist institutions operating for the benefit of their owners. However, the appropriate criterion by which to measure the scope of section 91(15) is not form but function. Surely Parliament was given jurisdiction in respect of banking not because banks traditionally are capitalist, non-specialized and public institutions, but because banks make some peculiar contribution to the functioning of the economic system and require particular types of regulation and control.[456] If an institution performs the distinctive banking function it is part of the banking system irrespective of the form of the organization. If in determining the scope of section 91(15) one adds to narrow functional criteria considerations of form, as did Tucker J., the banking power will be left with little content or vitality.

An even more generous interpretation of provincial power than that of Tucker J. is found in the decision of Murphy J. in *Re Dominion Trust Company*.[457] It was argued there that provincial legislation authorizing a trust company to accept money on deposit and to allow customers to issue cheques against such deposits was *ultra vires* the province. The argument was rejected, apparently on the ground that there is no functional limitation on the provincial power of incorporation under section 92(11); in other words, that a provincial company can be authorized as a legal entity to engage in any type of business or industry and that

[450] *Id.* at 93.

[451] *Supra*, n. 195 at 151.

[452] *Supra*, n. 4 at 83.

[453] *Id.* at 93, 98.

[454] *Supra*, n. 262. The majority of the Appellate Division of the Supreme Court of Alberta managed to dispose of the case without determining the validity of the Treasury Branches Act, which was challenged as *ultra vires*. It was held that the borrower could not plead *ultra vires*. In the Supreme Court of Canada, [1970] S.C.R. 175, it was held, Hall and Spence JJ. dissenting in part, that even if the statute were *ultra vires* the borrower had no answer to an action for money had and received. Hall and Spence JJ. agreed with Porter J.A. on the question of the validity of the Act. *Id.* at 196.

[455] *Supra*, n. 262 at 278, 303-304.

[456] ". . . [I]n most European countries, institutions similar to caisses populaires and credit unions are considered without question part of the banking system." Mercure, *supra*, n. 182 at 181.

[457] *Supra*, n. 86.

there is no necessary limitation to businesses or industries that, as such, fall legislatively within the scope of section 92 of the B.N.A. Act.

It is important to appreciate how far this reasoning goes beyond what was said in the *Moyen* case. It was said in the latter that the provinces cannot enact legislation for the incorporation of banks; they may, it is true, confer upon their corporate creations all the powers of a bank, but this only if the pith and substance of the authorizing legislation is something other than banking and the incorporation of banks. *Dominion Trust* suggests, *albeit* none too clearly, that the provinces can enact legislation for the incorporation of banks[458] in reliance upon their power to enact legislation in relation to "The Incorporation of Companies with Provincial Objects," the limitation imposed by the last three words having territorial connotation only. *Moyen* involved a value judgment, that the conferral of banking powers was not the constitutionally significant feature of the legislation: *Dominion Trust* doubts the need to find any other feature in the legislation.

There is still much controversy over the question whether the phrase "with Provincial Objects" in section 92(11) imposes a functional as well as territorial limitation on the provincial power of incorporation.[459] Lederman argues that no functional limitation is imposed, that the subjects of potential corporate activity are unlimited.[460] Reasoning correctly that the power to incorporate and the power to regulate do not follow the same pattern under the B.N.A. Act, he cites the following example:[461]

> . . . [S]ome provincially chartered financial institutions (the so-called 'near banks') certainly engage to some extent in the banking business, and banking as a business is clearly under federal regulatory jurisdiction by virtue of s. 91(15) and (16) of the B.N.A. Act. In this respect, if it chooses to do so, the federal Parliament can regulate provincial corporations with legislation that is in pith and substance banking Legislation.

In other words, the fact that Parliament can regulate the activities of a provincial corporation in exercise of jurisdiction under one of the enumerated heads of section 91 does not mean that the incorporation of that entity by the province is invalid.

Of the opinion that section 92(11) contemplates a functional restriction are McNairn,[462] Ziegel[463] and Cudney.[464] The history of section 92(11) favours this view. The original wording of the item in the Quebec resolutions was in these terms: "The Incorporation of private or local Companies, except such as relate to matters assigned to the General Parliament."[465] The intention to preclude the provinces from incorporating companies whose activities would be subject to federal regulatory control seems clear. The difficulty, however, with the view that the provincial power to incorporate is limited to subjects over which the provinces have legislative jurisdiction is that the B.N.A. Act does not

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458 So long as use of the word "bank" is not authorized. *Id.* at 1025.

459 For an examination of the opposing points of view *see* Ziegel, *Constitutional Aspects of Canadian Companies* (c. 5 *Studies in Canadian Company Law*, Ziegel (ed.) 1967) 187-190.

460 Lederman, *Legislative Power to Create Corporate Bodies and Public Monopolies in Canada* (Essay 6 *Contemporary Problems of Public Law in Canada*, Lang (ed.) 1968) 116-119.

461 *Id.* at 116.

462 McNairn, *Transportation, Communication and the Constitution: The Scope of Federal Jurisdiction*, (1969) 47 Can. Bar Rev. 355 at 361 n. 37.

463 Ziegel, *supra*, n. 459 at 188-190.

464 Cudney, *Incorporation of Companies*, (1948) 26 Can. Bar Rev. 1182 at 1183.

465 Pope, *supra*, n. 111 at 47.

distribute general jurisdiction over particular subjects; it distributes authority to enact particular kinds of statutes.[466] Davies J. has appreciated this difficulty:[467]

> A subject matter that in some aspects and for some purposes comes under Dominion legislation, in other aspects and for other purposes comes under provincial. I need not elaborate the point. I think the contention called the object-subject theory, if adopted, calculated to introduce endless trouble and confusion.

Perhaps considerations such as these lead Clement to adopt a compromise position: a province may incorporate a company to carry out objects other than those which are *manifestly* not provincial objects.[468] He cites as an example undertakings declared by Parliament to be for the general advantage of Canada.[469] Banking, too, is patently not a provincial object.

Whatever the merits of this controversy, it is somewhat beside the point when the question is whether the province may incorporate a company with the object or purpose of banking. Such is an object which by the *express terms* of section 91 only the Dominion Parliament may incorporate companies to carry out. "Incorporation of Banks" is a specific federal power. Thus Lefroy argues that while a province may incorporate navigation or shipping companies, section 91(10) notwithstanding, but subject to relevant federal legislation, ". . . a province cannot incorporate a company with the object or purpose of banking. . . ."[470]

Whether or not the phrase "with Provincial Objects" has general functional connotations, section 92(11) must be read as if it said "The Incorporation of Companies other than Banks." Insofar as there is an apparent overlap between the federal power to incorporate banks and the provincial power to incorporate companies, the declaratory words of section 91 statutorily interpret every matter that comes within the former as a matter that does not come within the latter.[471] The respective powers of Dominion and provinces are mutually exclusive. In the Australian *Banking* case[472] Rich and Williams JJ. contrasted the banking powers under the Australian and Canadian constitutions respectively, saying:

> [Section xiii] authorizes the Commonwealth Parliament to make laws with respect to the incorporation of banks. . . . The banking power in the Australian Constitution is not, like the banking power in the Canadian Constitution, an exclusive power. It is a concurrent power. Unless the Commonwealth Parliament legislates with respect to the incorporation of banks, banks, like other bodies, can be incorporated under state laws.

Whether or not the Canadian Parliament legislates with respect to the incorporation of banks, the provinces cannot enact valid legislation in relation to the incorporation of banks.[473]

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[466] O'Connor, *supra*, n. 121 at 40.

[467] *Canadian Pacific Railway Co.* v. *Ottawa Fire Insurance Co.*, *supra*, n. 6 at 426.

[468] Clement, *supra*, n. 10 at 731-732.

[469] *Id.* at 731.

[470] Lefroy, *Canada's Federal System* 472 (1913). Cudney also states that a province could not incorporate a bank, but he uses this only as an example of the general principle that the words "with Provincial Objects" relate to the objects for which the company is incorporated. Cudney, *supra*, n. 464 at 1183. If Lederman is right, Cudney's conclusion falls but Lefroy's does not.

[471] O'Connor, *supra*, n. 121 at 32.

[472] *Bank of New South Wales* v. *The Commonwealth*, *supra* n. 12 at 259.

[473] Dysart J. expressed no doubt on this point in *Re Bergethaler Waisenamt*, *supra*, n. 86 at 314. This is also the opinion of the federal Department of Justice. *See* Standing Committee on Finance, Trade and Economic Affairs, Minutes of Proceedings and Evidence, First Sess., 27th Parl. (1966) No. 18, 902 [Mr. J. W. Ryan].

It was recognized in the *Moyen* and *Dominion Trust* cases, and by Lederman, that if Parliament passed legislation under section 91(15) forbidding anyone other than a chartered bank from carrying on the business of banking, provincial legislation authorizing institutions to engage in the banking business, whatever the pith and substance of such legislation, would be invalid.[474] Ignoring the recommendations of the Porter Commission, the federal Parliament did not act in this respect. There was some doubt as to whether the courts would uphold the wide definition of banking adopted by the commissioners.[475] And it was undoubtedly recognized that to act on the Porter recommendations might be politically disastrous. This is particularly true so far as any effect on the credit union movement is concerned.[476] Governor Rasminsky of the Bank of Canada perceived the realities of the situation when he observed:[477]

> Some of the non-bank financial institutions are incorporated under provincial legislation and the question of bringing them under federal jurisdiction raises important political and constitutional questions.

But is federal prohibitory legislation necessary? The federal *power* to enact laws in relation to the incorporation of banks provides, it seems, weak support for saying that the operations of the provincial financial intermediaries are *ultra vires:* the suggestion is made that the power is not exclusive;[478] the courts are willing to find in legislation authorizing banking activities a pith and substance other than "banking;"[479] and the business of banking is gauged by narrow functional criteria.[480] But if the federal power in this respect is virtually devoid of negative operation as a restriction on provincial legislative power, is the situation altered in any way by the existence of federal *legislation* authorizing the chartered banks to perform "such business generally as appertains to the business of banking?"[481]

Section 91(15) has had its greatest effect in creating for the chartered banks a broad area of immunity from provincial regulation. For the purpose of resolving any conflict between provincial legislation and the federal banking statute, the term "banking" has been construed broadly.[482] Direct provincial regulatory interference with the operations of the chartered banks is not tolerated. Provincial legislation requiring a bank to have a licence as a condition of doing business is invalid,[483] as is legislation imposing reserve requirements in respect of deposit liabilities.[484] Provincial laws of general application, laws the pith and sub-

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474 *La Caisse Populaire Notre Dame Limitee* v. *Moyen, supra,* 195 at 156; *Re Dominion Trust Company, supra,* n. 86 at 1024-1025; Lederman, *supra,* n. 460 at 116.

475 *See* Standing Committee on Finance, Trade and Economic Affairs, Minutes of Proceedings and Evidence, Third Sess., 28th Parl. (1970) No. 2, 4-5 [Mr. Humphrys, Superintendent of Insurance].

476 Among credit union leaders there is a "widespread fear of federal legislation", which is seen as a "threat to their expansion and even to their existence". Mercure, *supra,* n. 182 at 182.

477 Standing Committee on Finance, Trade and Economic Affairs, Minutes of Proceedings and Evidence, First Sess., 27th Parl. (1966) No. 20, 1025.

478 *Re Dominion Trust Company, supra,* n. 457.

479 *Supra,* n. 195.

480 *Re Bergethaler Waisenamt* [1949] 1 W.W.R. 323.

481 Bank Act, S.C. 1966-67, c. 87, s. 75(1)(e).

482 It was in this context that Lord Watson stated that section 91(15) "comprehends 'banking' [as] an expression which is wide enough to embrace every transaction coming within the legitimate business of a banker." *Tennant* v. *Union Bank of Canada* [1894] A.C. 31 at 46.

483 *Re Alberta Legislation, supra,* n. 4 at 122 [Kerwin J.]; *A.-G. Alberta* v. *A.-G. Canada, supra,* n. 8. Hence the exemption in favour of banks in the Quebec Deposit Insurance Act, S.Q. 1966-67, c. 73, ss. 1(d), 24.

484 *A.-G. Alberta* v. *A.-G. Canada, supra,* n. 8.

stance of which is not "banks and banking," may validly apply to the chartered banks.[485] But this only if there is no conflict with federal banking legislation, no sterilization or destruction of the capacity of the chartered banks, and no intereference with the operation of banks in the conduct of their banking business.[486]

What is the status of provincial legislation, otherwise valid, which authorizes institutions to engage in an activity in direct competition with banks chartered under federal legislation? Is there in this competition an unconstitutional frustration of the activities of institutions created by Parliament in exercise of an exclusive power? No answer is possible without an understanding of the precise nature of the competition between banks and intermediaries.

Financial institutions compete with the chartered banks on two fronts:[487] as borrowers, the institutions offer their liabilities to purchasers of financial assets as substitutes for chartered bank deposits; as lenders, the institutions find themselves in competition with the chartered banks in seeking to find profitable outlets for their borrowed funds in the form of attractive earning assets. It was demonstrated earlier[488] that the individual bank can invest in earning assets only by being prepared to give up cash. Therefore, it cannot expand unless it succeeds in convincing the public to hold more of its liabilities. Competition for funds between the individual bank and other financial institutions is direct and immediate. If a bank depositor decides instead to hold an intermediary claim, the cash position and hence the earnings potential of the bank normally suffers to the extent of the substitution. "Competition for funds by the sale of liabilities is as important to a bank as to an institution whose liabilities do not serve as money."[489] The obligations of financial intermediaries, particularly those which serve as close substitutes for money, compete with the deposits issued by chartered banks.[490]

But our concern here is not so much with the individual bank as it is with the chartered banking system as a whole, for it is the system that is sponsored by federal legislation. Assuming that the public's preference for holding currency remains stable, the banking system cannot increase the amount of its cash reserves unless the Bank of Canada acts to produce such an increase.[491]

> . . . [B]anks as a group cannot through their own acts gain from the public an increase in their cash balances; they cannot add to their cash reserves either by issuing or creating more deposit liabilities or by disposing of other assets.[492]

It follows that the banking system has nothing to gain from vigorous competition for deposits with non-bank depositories. Nor does the banking system stand to lose cash balances when non-bank intermediaries induce the public to shift to their claims from bank deposits.

[485] *Gregory Co.* v. *Imperial Bank of Canada* [1960] Que. S.C. 204; *Sommers* v. *Sturdy* (1957) 22 W.W.R. (N.S.) 49; *Brantford* v. *Imperial Bank* [1930] 4 D.L.R. 658; *Re The Validity of Section 31 of the Municipal District Act Amendment Act, 1941* [1943] S.C.R. 295 at 303 [Duff C.J.].

[486] *Gregory Co.* v. *Imperial Bank of Canada, id.*, at 208; *Sommers* v. *Sturdy, id.*, at 59; *Brantford* v. *Imperial Bank, id.*, at 663.

[487] Porter Commission Report, *supra*, n. 29 at 101.

[488] *See supra*, at 188-198.

[489] Porter Commission Report, *supra*, n. 29 at 101.

[490] Submissions by the Bank of Canada to the Royal Commission on Banking and Finance (1962) at 15.

[491] "The total amount of cash reserves available to the chartered banks as a group is determined by the Bank of Canada. . . ." *Id.*

[492] Galbraith, *supra*, n. 14 at 10-11.

Trust companies, mortgage loan companies, credit unions and finance companies hold most of their cash reserves in the form of deposits with the chartered banks.[493] When non-bank intermediaries gain cash as a result of bank customers transferring deposits to them and place the cash they gain in accounts or deposits maintained with the banking system, the banks as a group lose neither cash nor deposits: total deposits in the banking system remain constant, although their ownership is changed.[494] And the use of the newly-obtained funds for the expansion of loans likewise leaves the reserves of the banking system unaltered. To the extent only that intermediaries add to their currency holdings when their deposit liabilities expand[495] do the banks as a group lose deposits when rival institutions gain deposits at the expense of individual banks.[496] The conclusion to be drawn from this is that the competition for funds between banks and intermediaries has no effect on the banking system.

This is perfectly true when the public shifts from bank demand deposits to intermediary claims but it is not true when the shift to intermediary claims is away from time deposits.[497] The demand deposits at chartered banks are subject to a reserve requirement of twelve per cent, while time deposits (those payable after notice) are subject to a reserve requirement of only four per cent.[498] Hence, any shift from time to demand deposits requires the banks to hold additional reserves, which can be obtained only by the banks' contracting their outstanding demand deposits in order to comply with reserve requirements. When an individual substitutes an intermediary claim for a time deposit, total deposits in the banking system remain unchanged, but the proportion of demand to time deposits is increased if intermediaries hold their reserves as demand deposits. Since intermediaries either lend their cash balances or hold them as reserves against their own demand liabilities issued to borrowers, most if not all of the intermediary balances must be held as demand deposits with the banks. As a result, a shift from bank time deposits to intermediary claims has a direct adverse effect on the reserve position of the chartered banks, forcing a contraction of their outstanding loans.[499]

Regarded from another angle, a person who receives income in the shape of demand deposits and decides not to spend the whole of his income may shift to a time deposit or may, for example, purchase a credit union share. The former choice will result in an increase in total bank deposits and total customer indebtedness to banks;[500] the latter choice will leave the position of the chartered banking system unchanged. The two-rate structure of minimum cash reserves provides an incentive for banks to persuade customers to shift deposits away from current accounts.[501] Intermediary obligations are directly competitive with the time deposits of the banking *system.*

The impact on the chartered banks of public shifts from bank de-

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493 Submissions by the Bank of Canada to the Royal Commission on Banking and Finance (1962) at 15.

494 Galbraith, *supra*, n. 14 at 140.

495 This addition is never great. *See id.* at 141.

496 *Id.*

497 *See* Shelby, *supra*, n. 295 at 535-536 and Galbraith, *supra*, n. 14 at 142 n. 5.

498 Bank Act, S.C. 1966-67, c. 87, s. 72(1).

499 Shelby, *supra*, n. 295 at 536.

500 Sayers, *supra*, n. 222 at 230.

501 Slater, *supra*, n. 271 at 84.

posits to intermediary claims is not limited to the direct effect on their reserve positions. Even when the shifts are from demand deposits to intermediary claims, the growth of the chartered banks tends to be retarded. Shelby summarizes the indirect repercussions as follows:[502]

> The indirect and adverse effect accompanying the public's shift from bank deposits to [intermediary claims] develops out of the intensified demand for investable assets. As the supply of finance increases . . ., if the demand for . . . funds remains constant, intermediaries must offer financing at lower rates of return. Although the uses of funds by banks and intermediaries may not always be directly competitive, interdependence among the various segments of the market exists. Consequently, the loan and investment conditions under which banks must operate are influenced. As old loans are renewed and new ones sought, commercial banks must provide financing at less remunerative rates in order to remain competitive.

Thus, outside competition can reduce bank profits by affecting the return on bank assets, even though total deposits remain constant. "The only action banks themselves can take against the effects of outside competition is to raise the effective rate of interest they pay on deposits or reduce their charges for loans."[503] Only if new reserves are made available to them by the Bank of Canada, can banks offset their declining yields by expanding their volume of lending operations.[504]

The Porter Commission found that the competitive position of the chartered banks deteriorates during periods of monetary restraint, when the demand for credit exceeds the available supply.[505] The six per cent interest rate ceiling on bank loans restricted their earnings during such periods thereby limiting the rates they could afford to offer for deposits. By raising their borrowing and lending rates relative to those of the banks, the near banks were able to capture a larger share of total financing. Said the commissioners:[506]

> The distorting effects of the six per cent ceiling have been most acute in periods of credit restraint when the banks have been prevented from raising their rates on loans and deposits in line with market forces.

The banks' competitive position suffered due to the ceiling. In 1951, banks controlled fifty-three per cent of the assets of Canadian financial intermediaries; by 1962, they held less than forty-eight per cent.[507] Acting on the Porter recommendations, the six per cent ceiling was removed.[508] Since the 1967 revision, the banks' competitive position has improved.[509]

Three effects upon the system established under the Bank Act have been distinguished. First, intermediary claims are directly competitive with chartered bank time deposits and a shift from the latter to the former must force a contraction in the scope of the banks' operations and curtail their loans and investments. Second, as intermediaries compete against banks for the available investment opportunities, bank earnings tend to decline and the banking system grows less profitable. Third, competition from near banks necessitated the removal of a Bank

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502 Shelby, *supra*, n. 295 at 537-538.

503 Galbraith, *supra*, n. 14 at 144.

504 Shelby, *supra*, n. 295 at 538.

505 Porter Commission Report, *supra*, n. 29 at 122.

506 *Id.* at 365.

507 Baum, *supra*, n. 42 at 1138.

508 Bank Act, S.C. 1966-67, c. 87, s. 91.

509 Baum, *supra*, n. 42 at 1138.

Act restriction on lending rates if banks were not to be disproportionately hampered by monetary restraint.

A landmark decision in Canadian law places formidable obstacles in the way of an argument that the chartered banks are constitutionally protected against competition from provincial institutions. *Bank of Toronto* v. *Lambe*[510] established the validity of provincial taxation of federal chartered banks. Lord Hobhouse, who delivered the opinion for the Privy Council, failed to see "how the power of making banks contribute to the public objects of the provinces where they carry on business can interfere at all with the power of making laws on the subject of banking, or with the power of incorporating banks."[511] To the suggestion that the provinces might impose taxes so heavy as to crush a bank out of existence, and so nullify the power of Parliament to erect banks, Lord Hobhouse answered that the courts would not deny the existence of provincial legislative power "because by some possibility it may be abused, or may limit the range which otherwise would be open to the Dominion parliament."[512] In so deciding his Lordship refused to follow *McCulloch* v. *Maryland*,[513] a decision of the Supreme Court of the United States holding that the power to destroy, inherent in state taxation, is inconsistent with the federal power to create and so must be denied to the states as against federal banks.

But the power of the provinces to affect adversely, by taxation or otherwise, the operations of federal chartered banks is not unlimited. Prohibitive taxation aimed simply at banks is invalid. In holding unconstitutional the Ablerta Bank Taxation Bill,[514] the Privy Council found that the object of the Bill was not taxation in order to the raising of a revenue, but that it was part of a legislative plan to prevent the operation within the Province of banking institutions called into existence and given the necessary powers by the Parliament of Canada.[515] In the Supreme Court of Canada Duff C.J. characterized the provincial Bill as legislation in relation to "banks and banking."[516] Though in the form of a taxing statute, it was directed to the frustration of the system of banking established by Parliament and to the controlling of banks in the conduct of their business, and was therefore in pith and substance banking legislation.[517] Lord Maugham, speaking for the Privy Council, did not go so far as to expressly classify the Bill as banking legislation, but it is clear that he found it lacking in a valid provincial object because it was directed to frustrating the activities of the chartered banks.[518]

Whatever the effect upon chartered banks of competition from provincial institutions, it cannot be assumed that the authorizing legislation is *directed to* the frustration of the system of banking established by the Bank Act, or to controlling banks in the conduct of their business,

[510] (1887) 12 App. Cas. 575.

[511] *Id.* at 586.

[512] *Id.* at 587.

[513] (1819) 4 Wheat. 316.

[514] *A.-G. Alberta* v. *A.-G. Canada* [1939] A.C. 117.

[515] *Id.* at 133, quoting with approval from the judgment of Kerwin J. in the Supreme Court of Canada, *sub nom. Re Alberta Legislation, supra*, n. 4 at 124.

[516] *Sub nom. Re Alberta Legislation, supra*, n. 4 at 103.

[517] *Id.* at 106.

[518] He said at one point: "It is not competent either for the Dominion or a Province under the guise, or the pretence, or in the form of an exercise of its own powers, to carry out an object which is beyond its powers and a tresspass on the exclusive powers of the other. . . ." [1939] A.C. 117 at 130.

or to forcing the discontinuance of the chartered banking business. The important question is whether provincial legislation is valid where it has some or all of these *effects* but lacks an object which can be characterized as "banks and banking."

It is true that provincial legislation which is properly classified as being in relation to matters embraced by section 92 is valid even if the effect of the legislation is to prevent some Dominion companies from carrying on business.[519] But this is true only where federal legislative power (and hence federal legislation) extends only to the creation of the corporate legal entity and to the endowment of corporate status and capacity, and where the business activities of the company fall to be regulated by provincial legislation.[520] In such case there is no federal legislation to which a provincial statute regulating business activities may be said to be repugnant. Where provincial legislation interferes with the corporate status and capacity of a Dominion company, it is invalid as repugnant to the federal incorporation power though enacted in relation to a provincial object.[521] As Viscount Sumner remarked in the case cited, it is the effect of the legislation rather than its purpose that will determine its validity.[522] Federal legislative power and federal legislation extends to the business activities of the chartered banks. Provincial legislation, however valid in object and purpose, is invalid when repugnant to federal banking legislation and to powers exercised thereunder in the same way as is provincial legislation when repugnant to federal company legislation and to the status and capacity conferred thereby.[523] The essential points are these: (1) federal paramountcy is not necessarily avoided where provincial legislation expresses valid provincial objects and purposes;[524] and (2) the immunity to which federal companies are entitled in respect of matters essential to corporate status is no greater than the immunity to which banks are entitled in respect of their particular business activities. From this it follows that the business of banking authorized under the Bank Act may not be impaired in a substantial degree; banks, like other federal undertakings, are protected against destructive provincial legislation.[525]

When carefully read it seems clear that Lord Maugham's decision in *A.-G. Alberta* v. *A.-G. Canada*[526] was not necessarily predicated upon his finding that the Alberta Bank Taxation Bill lacked a valid provincial object. The decision in *Bank of Toronto* v. *Lambe*[527] was distinguished on two grounds: first, that the purpose of the Quebec statute in question there was the legitimate one of raising a revenue for provincial pur-

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519 *R.* v. *Arcadia Coal Co.* [1932] 2 D.L.R. 475 at 487-488; *Motor Car Supply Co. of Canada Ltd.* v. *A.-G. Alberta* [1939] 3 W.W.R. 65 at 74-75; *British Columbia Power Corp. Ltd.* v. *A.-G. British Columbia* (1963) 44 W.W.R. 65 at 115. Cases apparently to the contrary are explained by Ziegel, *supra*, n. 459 at 177-187.

520 ". . . [A] clear distinction is drawn between the status and corporate powers of a Dominion company and the subject of its business activities to provincial legislation which falls exclusively under a head of provincial power." Ziegel, *supra*, n. 459 at 173.

521 *E.g., A.-G. Manitoba* v. *A.-G. Canada* [1929] A.C. 260.

522 *Id.* at 268.

523 It was said in *Gregory Co.* v. *Imperial Bank of Canada*, *supra*, n. 485 at 208, that the company principles are applicable to banks. This can be a dangerous proposition if it is forgotten that a bank is a peculiar type of Dominion company in that the powers of incorporation and regulation in respect thereof are not divided.

524 *See* Laskin, *Occupying the Field: Paramountcy in Penal Legislation*, (1963) 41 Can. Bar Rev. 234 at 241-242.

525 *Cf. Campbell-Bennett Ltd.* v. *Comstock Midwestern Ltd. and Trans Mountain Pipeline Co.* [1954] S.C.R. 207.

526 *Supra*, n. 514.

527 *Supra*, n. 510.

poses;[528] and second, that "... the taxation was [not] of such a character that it might hamper the Dominion in exercising their powers under s. 91."[529] Effect and not purpose was the key to this second distinction.

The way is open for the courts to find invalid the provincial legislation under which intermediaries operate on the ground that the competition of "provincial banks" with those created by Parliament is a direct and serious obstacle to the maintenance of an efficient national banking system. Parliament has had to endow the chartered banks with powers which may or may not have been appropriate for the effective execution of its banking power but which were essential to enable the banks to survive the competition with provincially chartered institutions. Removal of the six per cent interest rate ceiling is one example of the measures that were necessary. The banks sought and obtained removal of the prohibition against their engaging in conventional mortgage lending,[530] a restriction which they argued had reacted adversely on their competitive position.[531] In its submission to the Porter Commission, the Canadian Bankers' Association challenged the assumption that there is no necessary reduction in the lending and investing capacity of the chartered banks as a result of the attraction of savings by competing institutions. Since the volume of financing done outside the banking system influences the decisions of the central bank authorities as to the amount of cash reserves to be allowed the chartered banks, increased financing by intermediaries contributes indirectly to a reduction in the lending and investing capacities of the banks.[532] Galbraith has made the same point: if outside competition meets more and more of the total financing needs of an economy, the banking system must be reduced in size, in the interest of stability.[533] The Bankers' Association concluded: "There is, in short, no way of avoiding the fact that the loss of deposits to competing institutions affects the chartered banks in exactly the same way as the loss of business affects any other commercial institution."[534] The increasingly close competition in lending markets between banks and near banks[535] means that the banks must provide financing at less remunerative rates in order to remain competitive; outside competition exerts pressure on the banking system to narrow the gap between the deposit rate and the loan rate. If the gap becomes too narrow, the stability of the entire system is jeopardized.[536]

V. CONCLUSION

Concern over the rapid expansion of financial intermediaries other than federal chartered banks goes well beyond the academic. The emerging pattern of regulation is at best haphazard and leaves considerable room for inadequate regulation. The regulated persons can choose

[528] *Supra*, n. 514 at 134.

[529] *Id.*

[530] *See* Bank Act, S.C. 1966-67, c. 87, s. 75(1)(c).

[531] *See* Porter Commission Report, *supra*, n. 29 at 366.

[532] *Submissions by the Canadian Bankers' Association to the Royal Commission on Banking and Finance*, (1963) 70 The Canadian Banker 101.

[533] Galbraith, *supra*, n. 14 at 142-143.

[534] *Supra*, n. 531.

[535] *See* Porter Commission Report, *supra*, n. 29 at 360-361.

[536] The major problem here is that the banks must meet competition from institutions which are not required to maintain reserves nor subject to regulation in the way that banks are. *See* Bank of Canada, Annual Report of the Governor to the Minister of Finance (1956) at 25-27.

the jurisdiction, federal or provincial, to which they will be subject; the severity of the control offered at the competing levels of government is a factor to be weighed in making the choice. The federal Parliament, convinced of the need for more vigorous regulation of a particular type of financial institution, limits its controls to those members of the group which happen fortuitously to have been incorporated federally. Obligations having all the characteristics of money are issued by institutions beyond the reach of the national government.

In addition to anxiety about the financial safety of the public, there is a growing concern that the rapid rise of intermediaries may threaten the general monetary powers of the Bank of Canada. According to one member of the Porter Commission, the need for a national code for banking activities is more evident today than it was when the Commission's report was published:[537]

> The grey area between federal and provincial jurisdiction now inhabited by the so-called 'near' banks has been the area where the most rapid expansion has been occurring and to leave it grey may well leave a bigger problem for the future which might ultimately become a problem of monetary control as well as one of supervision.

The present Governor of the Bank of Canada has consistently asserted that the growth of financial intermediaries has not hindered the effectiveness of monetary policy.[538] And yet his predecessor, Mr. James Coyne, found that federal controls were weakened by the operations of institutions such as instalment finance companies. The 1956 Annual Report of the Governor contains this statement:[539]

> The existence of what amounts to a rival banking system, competing for deposits and short-term funds in order to make short-term loans to finance consumption (and to an increasing extent the instalment finance companies also make loans to industrial, contracting, transportation, merchandising and other businesses) without supervision or regulation, and out of step with the trend of credit policy in the regular banking system, can be a definite handicap to monetary policy during a boom, and will also have de-stabilizing effects during any recession of activity that may ensue.

The English Radcliffe Committee was convinced that when the demand for liquidity can be so well satisfied from other sources, restriction of the supply of bank deposits can be expected to become increasingly ineffective as a curb on total demand.[540] That the Canadian courts may prove receptive to constitutional arguments based on the effect of near-bank operations on monetary policy is evident from the dissenting opinions of Porter and Allen JJ.A. in the *Breckinridge Speedway* case.[541]

Lest this paper be taken as a call for a monolithic banking system in which only a few federally chartered institutions are authorized to engage in borrowing from and lending to the public, let it end on this note: regional specialist or co-operative banks can be attractive additions to the competitive structure of Canadian banking, providing that they are integrated into a national baking system.

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537 Standing Committee on Finance, Trade and Economic Affairs, Minutes of Proceedings and Evidence, First Sess., 27th Parl. (1966) No. 27, 1719 [Mr. J. Douglas Gibson].

538 *See* Evidence of the Governor before the Royal Commission on Banking and Finance (1964) at 9-10.

539 Bank of Canada, Annual Report of the Governor to the Minister of Finance (1956) at 27.

540 Radcliffe Report, *supra*, n. 313 at 129-135. *See also* Sayers, *supra*, n. 325 at 723.

541 *Supra*, n. 262 at 276-279, 308-309.

> If every province in Canada were to legislate as the province of Alberta has done with regard to the operation of treasury branches with no effective control on the amount of credit which can be extended by these branches, the purposes of important provisions of the Bank Act and the Bank of Canada Act designed to exercise control of credit, could be frustrated.

Id. at 308 [Allen J.A.].