THE UNIVERSITY OF MANITOBA

MANITOBA'S MONEY MARKET

A Thesis

Submitted to

The Faculty of Graduate Studies and Research

In Partial Fulfillment of

the Requirements for

the Master's Degree in Economics

by

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March 1969

ABSTRACT

The Canadian money market was formally established by the Bank of Canada in the early 1950's in an effort to improve the effectiveness of the Bank's ability to direct and influence the state of the Canadian economy. By a series of moves, the Bank of Canada broadened the market for government of Canada treasury bills to include not only the banking community but also investment dealers, industrial corporations and individuals. As the money market grew, new instruments and techniques were developed and new institutions made use of the facilities of the money market making more efficient the flow of short-term capital within Canada.

Section I outlines in some detail the steps involved in the establishment of a money market in Canada. The history of the money market is traced through the early 1930's down to the middle 1950's with our attention drawn towards the role played by government of Canada treasury bills in the early years of the money market's development.

In Section II the roles of some of the more important participants in the Canadian money market are outlined. The Bank of Canada and the commercial banks are the dominant institutions directly involved in the money market. The commercial

banks are playing an increasingly important role in the activities of the money market as a result of revisions to the Bank Act in 1967. Sales finance companies and others such as non-financial corporations now are major participants in the money market both as borrowers and as lenders.

Section III deals specifically with the money market as it is found in Manitoba. The province of Manitoba's activities in the money market are dominated by four major types of institutions. First of all there are the grain companies with head offices in Winnipeg who finance to a considerable degree the movement of grain in Canada by means of short-term capital borrowed through the money market. The second major borrower is the provincial government who, through successive issues of short-term bonds and then treasury bills, has been an active money market participant since the late 1950's. Thirdly, there are a number of public utilities and other corporations that have, from time to time, made use of the money market as a source of short-term finance. The fourth main group of money market participants in Manitoba are the large life insurance and mutual fund companies with head offices located in Winnipeg. These companies are major short-term lenders.

The facilities of Canada's money market have been used by Manitoba institutions ever since the early 1950's and its use increased substantially in the early 1960's when the grain companies entered the market. However, in recent years Manitoba's use of the money market has declined somewhat. This decline can be contributed to the narrowing trend of the spread between money market interest rates and bank borrowing costs making, in the process, money market borrowings less attractive.

However, Manitoba, in the past has made fairly extensive use of the facilities of the Canadian money market and it has contributed a number of innovations to the market - namely grain paper and provincial treasury bills. These activities and innovations have shown that Manitoba has sophisticated financial organizations and personnel with a high degree of expertise in a relatively little known aspect of finance, and these attributes have contributed towards the establishment in Canada of a more national financial system.

PREFACE

The author's initial contact with the Canadian money market came in May 1964 when we were required to act as a messenger in delivering over $1 million of negotiable securities to an investment dealer. The informal nature of the market based upon mutual trust so impressed us that we have been a student of the money market ever since. This thesis would not have been possible had it not been for the exposure to the operations of the Canadian money market we gained through practical experience obtained in Regina and Toronto. We, therefore, would like to acknowledge the help, trust, and understanding received from Mr. A.L.M. Nelson of Regina and Mr. F.R. Smith and Mr. G.A. Wright both of Toronto in enabling us to obtain a rudimentary understanding of the workings of the Canadian money market.

In addition, we would like to express our appreciation for the helpful comments and suggestions Dr. C.L. Barber gave us in the course of writing this thesis and we greatfully acknowledge our indebtedness to the Graduate School, University of Manitoba for financial assistance in the form of a Graduate Fellowship.

We also would like to thank the many members of Winnipeg's financial community who gave us so much of their time and in particular, Mr. T. Lang of McLeod, Young, Weir and Company for his many useful comments. Finally, our appreciation must go to my wife who always gave us encouragement and who provided the incentive to complete this thesis.

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CHAPTER I

INTRODUCTION

Obtaining a precise definition of the Canadian money market was a difficult undertaking because the market has been constantly evolving and changing. In addition, another factor that complicated a definition of the money market was the fact that the money market had no sharp boundary lines setting it off from other Canadian financial markets. In fact, the money market was not one market but was in reality a collection of many markets, for example the Call Loan market, the Treasury Bill market, the markets for Municipal, Provincial and Federal bonds, and the market for Corporate short-term bonds and notes.

One of the writers who has tried to define what was meant by the term money market defined it in the following terms:

> The term money market has a fairly common and precise usage in Canada. According to this usage it relates to transactions involving Government of Canada treasury bills and bonds with less than three years to maturity (in addition to central bank loans to banks and dealers).[1]

We found this definition to be too restrictive in that it omitted all transactions involving the short-term obligations

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[1]William C. Hood, <u>Financing of Economic Activity in Canada</u> (Ottawa: The Royal Commission on Canada's Economic Prospects, 1959), p. 11n.

of industrial corporations as well as the obligations of the provincial and municipal governments. All of these institutions have been very active participants in the money market. A more general and broader definition of the money market was, therefore, required. Mr. Graham Towers, former Governor of the Bank of Canada gave a broad definition to a parliamentary committee in 1954.

> I think a general definition would include any markets for financial assets in which individuals, corporations and financial institutions invest their short-term funds, and in which a certain amount of turnover ... goes on fairly continuously. It is a market for the temporary employment of cash balances.[2]

The term "temporary employment of cash balances" was the key to any generalized definition of the money market as the main characteristic of a money market consisted of the equating of the supply of and demand for short-term funds.

> The prime function of a mature money market is to equate supply and demand of short-term capital ...[3]

Thus, the money market can be said to have encompassed the activities of the Federal, Provincial and Municipal governments, investment dealers, financial institutions,

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[2]Canada, House of Commons, Proceedings of the Standing Committee on Banking and Commerce, 1954, p. 845.

[3]Investment Dealers' Association of Canada, Submission to the Royal Commission on Banking and Finance, June 1962, Appendix G, p. 445.

industrial corporations and individuals in either temporarily lending or borrowing cash balances through the medium of debt instruments varying in term from as little as a few hours to up to three years.

WHY A MONEY MARKET?

A money market has fulfilled a great number of needs. For the individual or corporation with temporary surplus funds a money market has provided attractive opportunities for investment. On the other hand, for individuals or institutions borrowing funds a money market has provided short-term funds at rates of interest usually lower than could be obtained from conventional lenders such as the banks. In addition, for both the lender and borrower a money market has provided a mechanism whereby the effects of temporary cash fluctuations may be smoothed over. That is, those firms that from time to time have funds in excess of their operational needs lent these funds to those firms that at that time were short of operational funds with the result that although each firm may have had fluctuating cash flows, firms as a group were able to balance a good deal of their cash needs with the supply of cash available without resorting to the banking system.

Finally, a money market was one of the mechanisms whereby the central monetary authorities of a country could influence and effect monetary policy. The power of a central bank to influence credit conditions within an economy was greatly facilitated if a money market was existent because it was in the money market that the use of open market operations became most effective. As J.S.C. Wilson wrote :

> In the absence of a short-term money market, the central bank in the country concerned is by no means entirely powerless to control the activities of the commercial banks and thereby the supply of money that is made available to the economy. In these circumstances, however, if the central bank is to exert more than a moral authority, it must usually be prepared to intervene directly to control commercial bank liquidity and interest rates. Yet in its formative years, when these conditions are most likely to apply, the central bank will be feeling its way and somewhat loath to adopt measures that smack too obviously of dictation, since in the successful implementation of their policies the authorities must always depend to quite a considerable extent on the co-operation of the rest of the financial community.
>
> By the way of contrast, where a market in short-term monetary assets already exists, the central bank can buy or sell the relevant securities in the open market and thereby exert an influence both on yields and on money rates consistent with the reactions of market institutions. Such indirect action, though it may be supplemented by other measures, is likely to facilitate a smoothness in adjustment that is improbable when the authorities are obliged to depend solely on the direct variation of bank liquidity and/or of interest rates. In addition, the commercial banks can resort to the short-term market for the purpose of employing their temporarily surplus funds or, whenever necessary, of restoring depleted cash reserves to their required level.[4]

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[4]J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, Pp. 19-20.

A money market also has acted as an indicator of credit conditions. A money market absorbed temporarily excess funds and it quickly reflected changes in other financial markets through changes in the level of its interest rates. As such it has acted as a guide to monetary policy and it has provided an area where the Bank of Canada could come into direct contact with the financial markets of Canada. The financial community, on the other hand, has looked to the behavior of the money market as an indicator of the monetary authority's policy.

In short, a money market mobilized short-term funds which was to the benefit of each institution either lending or borrowing these funds and the money market has operated as one of the vehicles through which the monetary authorities have influenced and directed the behavior of the Canadian economy.

MONEY MARKET INSTRUMENTS

There have been numerous debt instruments sold in the money market by the various borrowers that make use of the money market to raise temporary funds. The investments as well as the role of each of the major participants in the market will be examined in detail later, but for convenience they have been summarized in Table I.

TABLE I

CANADIAN MONEY-MARKET INVESTMENTS

Security	Obligation of	Usual Basis	Secondary Market
Day to Day Loans	Dealers	Yield Basis	No
Treasury Bills	Government of Canada	Discounted	Yes
	Provinces	Discounted	Yes
Short-Term Bonds	Government of Canada	Yield Basis	Yes
	Provinces	Yield Basis	Yes
Finance Paper or	Finance Companies	Discounted	No
Acceptance Paper		Yield Basis	No
Buy-Backs	Dealers	Yield Basis	No
Commercial Paper	Corporations	Yield Basis	No
Term Deposits	Banks	Yield Basis	No
	Trust Companies	Yield Basis	No
U.S. Bank Swaps	Banks	Yield Basis	No
Deposit Receipts	Banks	Yield Basis	No
	Trust Companies	Yield Basis	No
Bankers Acceptances	Banks	Discounted	Yes

SECTION I

THE ESTABLISHMENT OF THE CANADIAN MONEY MARKET

CHAPTER II

THE EARLY HISTORY OF THE MONEY MARKET

Before 1930 there was no organized short-term market in Canada.[5] Any funds that were invested for short periods of time were invested in either the New York or London money markets. The first step in the long road to the establishment of a Canadian money market occurred in 1933 when the MacMillan Commission was established by Parliament to study "Banking and Currency in Canada". Its objectives, among others, were to examine the provisions and effectiveness of the existing legislation in Canada as well as to determine "the advisability of establishing a Central Banking Institution".[6]

It was a year before the Bank of Canada Act was established by Parliament, incorporating many of the recommendations of the MacMillan Commission including provisions providing the new central banking institution with sufficient powers to enable it to engage in open market operations and to invest without limit in certain short-term securities.[7] As a contemporary writer said:

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[5]Bruce MacLaury, The Canadian Money Market (Cambridge: Harvard University, 1961), p. 9.

[6]Ibid. p. 9.

[7]Ibid. p. 10.

> These short-term securities will no doubt for the most part be treasury bills, and greater use of these bills by the provinces may be encouraged by the Bank in an effort to build up a short-term money market in Canada. The policy of the Dominion Government in this regard may be inferred from the action of the Minister of Finance during the past year, in calling for tenders for short-term issues.[8]

It was in March of 1934 that the government through the Bank of Canada began auctioning three month treasury bills on a regular basis.[9] This action was no doubt designed to assist the Bank of Canada in carrying out its new monetary responsibilities as well as to provide for relatively inexpensive treasury borrowings for the government. The amount of treasury bills outstanding was gradually increased as both the Bank of Canada and the commercial banks became more familiar with this new financial instrument until by the beginning of 1937 there was $150 million of treasury bills outstanding.

This rudimentary form of a money market was established purposely by the Bank of Canada. Evidence from its early Annual Reports pointed out this active promotion of the new market in treasury bills.

> It is universally recognized that a central bank is hampered in its operations where an active bill market does not exist. Few countries, however, have the bill

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[8]A. W. Rogers, "The Bank of Canada" , Journal of the Canadian Bankers Association, October 1934, p. 32.

[9]Bruce MacLaury, The Canadian Money Market (Cambridge: Harvard University, 1961), p. 11.

market they would like. Under present conditions a fairly satisfactory market can be established, if there is a sufficient volume of Treasury bills, if there is a good institutional distribution of these, and, in particular, if it is the commercial banks' policy to hold Treasury bills as their secondary reserve. The mere existence of a central bank at once widens and strengthens the market for first class bills, since the central bank itself will be a large holder and will engage in purchases and sales in pursuance of its open market policy, and for other reasons. In so doing, it is likely to have the effect of steadying the rate. The Bank of Canada can, I feel, claim that it has been of assistance in both these respects.

In times past, New York call loans and bankers' acceptances were, to a large extent, regarded as the secondary reserve of Canadian banks. Fluctuating exchange rates have particularly ruled out these items as means of employment of that portion of a bank's Canadian assets which need not be kept in cash, but which can be convertible into cash, in large volume and without sacrifice, at a moment's notice. Canada has been lacking in facilities of this kind. I hope the deficiency will be remedied. Treasury bills can be made to play an increasingly important part in our banking life, if further experience and a further widening of the market demonstrate - as I believe they will - the utility of this form of temporary investment. One should not think of such Bills as being a means of cheap governmental financing, and nothing more.[10]

At the Second Annual Meeting of the Bank of Canada, the governor, Mr. Graham Towers indicated that his high hopes for the establishment of a short-term market had diminished.

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[10]Bank of Canada, Report of Proceedings, First Annual General Meeting of Shareholders February 25th, 1936, Ottawa, Pp. 16-17.

I referred last year to the desirability of an active bill market, and expressed hope that we should make some progress towards the establishment of such a market in this country, at least so far as Dominion Government Treasury Bills are concerned. One must recognize, however, that the goal is a long way off. I feel it is quite likely that if money conditions ever become less easy than they have been in the last few years, Treasury Bills may be rather neglected, and that holders may tend to allow their Bills to run off through a desire to obtain additional cash. Such development would call for the refunding of a suitable portion - perhaps a substantial portion - of the Bills now outstanding. The market would then be short of assets which can properly be classified as second line reserves.

I think it is probable that experience over a period of years, and of a variety of conditions in the money market, will be necessary before we achieve a satisfactory bill market in Canada.[11]

In the early years it was the chartered banks that created the demand for the treasury bill market as the dealings were usually always between the Bank of Canada and the commercial banks. Banks did not as a general rule deal amongst themselves.

There were several reasons for this: (i) the Bank of Canada, given the chosen level of rates, always operated with a narrow spread between its buying and selling prices for bills, thereby reducing the risk of loss and ensuring their liquidity; (ii) direct sale to the Bank of Canada enabled a chartered bank to adjust its cash position without the delay associated with going through the clearing; and (iii) sales made to the central bank would be concealed from the prying eyes of competitors.[12]

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[11]Bank of Canada, Report of Proceedings, Second Annual General Meeting of Shareholders, February 23rd, 1937, Ottawa, p. 13.

[12]J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, p. 20.

During this early period 8 to 20 million dollars worth of treasury bills had at one time or another been held outside the banking system.[13] These bills were predominately held by foreign investors because although the investment dealers had purchased a few bills from time to time they never maintained an inventory of bills during the 1930's. It was not until World War II that the investment dealers began looking seriously at the advantages of holding sizeable inventories of treasury bills but no action in this regard was taken at that time as the growth in treasury bills and consequently the market was very slow.[14] Contributing to this slow growth was the fact that short-term interest rates were extremely low and there was not a great deal of incentive for individuals to invest in short-term assets such as treasury bills. For example, as Table II shows, by 1941 (eight years after the introduction of treasury bills) there was only $270 million of treasury bills outstanding and there was no change at all in the number of treasury bills outstanding from 1945 until 1953.

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[13]Bruce MacLaury, The Canadian Money Market (Cambridge: Harvard University, 1961), p. 14.

[14]J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, p. 21.

TABLE II

GOVERNMENT OF CANADA TREASURY BILLS OUTSTANDING

Year End	$ Million
1935	93
1936	150
1937	150
1938	155
1939	155
1940	230
1941	270
1945	450
1946	450
1947	450
1948	450
1949	450
1950	450
1951	450
1952	450
1953	650
1954	780

Source: Bank of Canada Statistical Summary February 1939, p. 23; Dec. 1942 - Jan. 1943, p. 9; and Financial Supplement 1957, p. 35.

After the initial introduction of treasury bills into Canada in 1934 there came a long period of official silence and it was not until 1953 that there was another official announcement by the Bank of Canada concerning the establishment of a money market. This silence for over fifteen years was due partly to the Second World War and its aftermath and the resulting financial problems and partly to the fact that monetary policy to restrict credit by means of open market operations was not seriously used prior to 1950.[15] When, however, the Bank of Canada finally did come to utilize open market operations in the early 1950's to restrict credit conditions it found that the establishment of a money market was desireable in order to facilitate the Bank's activities and make its policies more effective.

The Bank of Canada's early position regarding the establishment of a money market in Canada was set out in its 1953 Annual Report.

> A broad and active demand for short-term securities is an essential feature of an effectively functioning money market. The Bank of Canada has always endeavored to encourage the growth of a short-term market in this country and several further steps in this direction were taken during 1953. ... Development of a broader market in Treasury bills and short bonds is of value to chartered banks wishing to adjust their cash positions either by increasing or reducing their portfolios.[16]

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[15]Bruce MacLaury, The Canadian Money Market (Cambridge: Harvard University, 1961), p. 15. and p. 32.

[16]Bank of Canada, Annual Report, Ottawa, 1953, p. 8.

The Governor of the Bank of Canada, Mr. Graham Towers gave his views concerning the establishment of a money market to a Parliamentary Committee.

> In general, I believe that one can say that the function of a money market is basically the same as that of any market in a competitive economy whether it deals in financial or physical assets. A good market, by promoting wide competition between sellers and providing wide choices to users, tends to distribute resources where they are used with maximum efficiency. Short-term capital, like any other commodity or service, is likely to be forthcoming in optimum amounts and to be most efficiently used if it is subject to the incentives and disciplines which are provided by a broad market. In Canada, where I think we can look forward to rapid growth and a correspondingly large demand for capital, and where there is considerable scope for Canadian capital to displace external sources of financing, we clearly need to use our own sources of short-term as well as long-term capital as effectively as possible. Moreover, the kind of financial machinery needed to provide a good short-term Government securities market will also help to provide better facilities for long-term financing.[17]

By these pronouncements the Bank of Canada committed itself to the formal establishment of a money market in Canada.

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[17]Canada, House of Commons, Proceedings of the Standing Committee on Banking and Commerce, Ottawa, 1954, p. 846.

CHAPTER III

FORMAL ESTABLISHMENT OF THE MONEY MARKET

As mentioned, by 1953 the Bank of Canada was determined to establish a money market in Canada so as to facilitate the effective implementation of its open market operations in treasury bills. In order for the Bank of Canada to conduct open market operations on a large scale it was imperative that the market for treasury bills be expanded greatly to include investors beyond the banking system. To do this the Bank of Canada required the active participation in the money market of the investment dealers who had built up very extensive relationships with the investing public as a result of their underwriting and stock brokerage activities and who were thus ideally suited to broaden the market for treasury bills.

For the investment dealers to participate in and to extend the market in treasury bills to the public and to non-financial corporations, it was necessary that the dealers have more adequate financial resources available to them. Therefore, in January 1953 in order to improve the financial resources of the investment community a number of investment dealers who were already active in the long-term government security market were granted access to credit at the Bank of Canada - a privilege that had previously only been granted to the commercial banks.[18]

The credit that was extended by the Bank of Canada to the dealers was by means of repurchase agreements because the Bank of Canada was not authorized to extend direct credit to those outside the banking system. Under the arrangement that was developed a dealer would sell government securities to the Bank of Canada with the understanding that they would repurchase the securities at a later date with the difference between the buying and selling prices constituting the interest cost to the dealers. The interest rates charged for this service were lower than the rates charged on loans by the commercial banks so as to encourage the dealers to hold treasury bills in their inventories for resale to non-bank investors.[19]

> The houses concerned were drawn from firms that already acted as jobbers in the market for short-term government securities. Their lines of credit were based on their volume of business, the range of their contacts in the money market, and their understanding of the relevant mechanism, all of which were taken as indications of their ultimate capacity to undertake expanded operations in Treasury Bills. To distinguish them from other dealers in securities, they came to be referred to as "jobbers", though this term is not invariably applied.[20]

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[18]J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, p. 21.

[19]J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, p. 21.

[20]*Ibid.*, p. 22.

Originally there were twenty dealers who voluntarily tried their hand at this new business but subsequently a number of them dropped out until only twelve dealers remained.[21] As the money market developed and expanded and as dealers gained more expertise additional dealers joined the market until there were fifteen investment dealers actively engaged in money market activities.[22]

The granting to investment dealers of lines of credit with the Bank of Canada was the first of a series of steps in the formation of a viable money market operation in Canada. The credit arrangements were provided by the Bank of Canada on a more or less steady basis for about one and a half years with the maximum amount of repurchase agreements outstanding during that time reaching $73 million in June 1954 as can be seen from Table III.

THE DAY-TO-DAY LOAN MARKET

By April 1954 the Bank of Canada thought that the fledgling money market was ready for the next step in its development.[23] At that time the chartered banks were invited

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[21] Ibid., p. 21.

[22] J.J. Dowsley and Hart Buck, "The Short-Term Money Market and Instruments", The Canadian Banker, Vol. 73, Autumn 1966, p. 81.

[23] J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, p. 22.

TABLE III

CANADIAN GOVERNMENT SECURITIES HELD BY THE BANK OF CANADA UNDER PURCHASE AND RESALE AGREEMENTS

($ millions)

		Amount Outstanding	
Year	End of	End of Month	Maximum During Month
1953	January	8	10
	February	5	9
	March	12	16
	April	11	13
	May	17	17
	June	22	22
	July	16	23
	August	23	25
	September	21	26
	October	13	21
	November	16	19
	December	22	23
1954	January	25	27
	February	31	37
	March	28	35
	April	39	40
	May	43	43
	June	-	73
	July	-	-
	August	-	-
	September	-	-
	October	14	32
	November	1	5
	December	-	-

Source: Bank of Canada Statistical Summary Financial Supplement 1954, p. 50.

to replace the Bank of Canada in making available to the money market dealers facilities for borrowing substantial amounts of money to finance their treasury bill inventories. This action led to the introduction of what became known as day-to-day loans. As the Bank of Canada stated:

> The introduction in mid-June of what are known as day-to-day loans was an important development affecting both banking practices and the short-term securities market or "money market." These loans are made by chartered banks against the pledge of treasury bills and Government of Canada bonds maturing within three years. The borrowers are those bond dealers who are prepared to act as jobbers in the short-term market and who have entered into purchase and resale arrangements with the Bank of Canada. Day-to-day loans may be called for payment at any time and the willingness of the Bank of Canada to purchase securities under resale agreements provides an underlying assurance of liquidity ... Day-to-day loans from the chartered banks ... varied between a low of $44 million and a high of $135 million, and Bank of Canada facilities were infrequently used.[24]

The day-to-day loans made by the commercial banks were far more liquid than their call loans and as such carried a lower rate of interest. Call loans had been found to be not really callable in practice because of long established bank-customer relationships.[25] The Bank of Canada wanted to introduce a more liquid type of loan into the financial system which would not be subject to the interaction of personal relationships.

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[24]Bank of Canada, Annual Report 1954, p. 11.

[25]J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, p. 22.

This liquidity was found in the new day-to-day loan, and when one of these loans was called by the bank it was treated as a normal eventuality and not as an onerous imposition on the investment dealer.

A more general description of the characteristics of the day-to-day loan was given by J.J. Dowsley and Hart Buck.

> Day-to-day loans are terminable by either party, provided notice is given before 12 noon. The only securities acceptable for collateral are Government and Canada Treasury Bills and bonds, with not longer than three years to run, and bankers' acceptances drawn on another bank. Margin requirements are not onerous, and the lending rates are very competitive between banks. The rates are determined through over-the-counter negotiations and are kept competitive with the help of two special "brokers" who serve on a salaried basis as an information centre for the banks. The day-to-day loan rate, from its inception, has generally been below the tender rate for three month Treasury Bills, enabling the jobbers to earn a small profit...[26]

Table IV shows the growth and development of commercial bank day-to-day loans from June 1954 to the end of 1955. The loans varied from as low as $44 million to as high as $116 million. Comparison of this table with Table III showed that the day-to-day loan introduced in June 1954 superceded repurchase agreements with the Bank of Canada as the primary source of funds for the financing of dealer inventories of treasury bills.

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[26]J.J. Dowsley and Hart Buck, "The Short-Term Money Market and Instruments", The Canadian Banker, Vol. 73, Autumn 1966, p. 82.

TABLE IV

CHARTERED BANK DAY-TO-DAY LOANS

			Interest Rates	
Year	End of	$ million Outstanding	Day-to-day loans daily average	91- day Treasury Bills
			%	%
1954	June	56	1.25	1.57
	July	68	1.16	1.38
	August	52	1.06	1.32
	September	63	.95	1.21
	October	102	.96	1.18
	November	101	.78	1.17
	December	68	.76	1.08
1955	January	47	.69	.99
	February	92	.69	.90
	March	69	.98	1.13
	April	99	.97	1.23
	May	116	.77	1.24
	June	95	1.11	1.36
	July	109	1.11	1.43
	August	90	1.36	1.60
	September	44	1.64	1.77
	October	86	1.99	2.07
	November	54	2.20	2.33
	December	56	2.45	2.59

Source: Bank of Canada Statistical Summary December 1955, p. 321 - 322.

Repurchase agreements ended in June 1954 except for a few loans during October and November while day-to-day loans, starting in June 1954, grew in size to reach $102 million by October of that year.

During the first week that the new day-to-day loans were made the loan rate was set at 1.5 per cent, but thereafter, the rates were determined competitively.[27] The rates on day-to-day loans already on the books of a bank could be re-negotiated once a day, however, in an active market the rate on new day-to-day loans could change many times during the course of one day.[28] Generally speaking, as can be seen from Table IV the rate on day-to-day loans was lower than the rate on 91 day treasury bills. This spread in rates provided the dealers with a small profit and provided an incentive for them to carry an inventory of treasury bills and other short-term government securities.[29]

Day-to-day loans became more important to the operations of the commercial banks as a result of a change in mechanical technique which was introduced into the workings of the money market by the Bank of Canada in June 1954. This new technique

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[27] J.S.C. Wilson, "The Canadian Money Market Experiment", _Banca Nazionale del Lavoro Quarterly Review_, Vol. 44, March 1958, p. 24.

[28] _Ibid._, p. 24.

[29] _Ibid._, p. 22.

comprised the issuance of clearing vouchers by the Bank of Canada in payment for the treasury bills that it bought from the chartered banks. In the past the banks had received credit for their sales to the Bank of Canada on the following day, but with the clearing voucher system the banks were entitled to credit at the Bank of Canada only after the vouchers had passed through the clearing house and this process took another day. The result was, then, that a bank selling treasury bills received credit for its funds at the Bank of Canada two days after the initial sale. On the other hand, since day-to-day loans were also considered as part of the bank's reserves, a day-to-day loan called before noon provided a bank with funds the next day. That is, a day-to-day loan called by a bank before noon was paid by the dealer that same day, and credit was received at the Bank of Canada on the day following the day-to-day loan settlement. This meant then, that day-to-day loans came to replace treasury bills as the banks' most liquid asset and as such, the day-to-day loan rate was usually below the 91 day treasury bill rate.

R. M. Macintosh summarized the effects of the clearing voucher technique as follows:

> Until June the only methods available for obtaining Bank of Canada funds immediately were to sell treasury bills to the Bank of Canada or to borrow from it.

In practice, the banks have not in the past resorted to advances from the Bank of Canada for quick cash, partly because it was easier to sell treasury bills, and partly because of a tradition against being in debt to the central bank. However, in order to encourage the use of the Bank of Canada's facilities for making advances, and also to encourage the use of the new day-to-day loan procedure, the Bank of Canada has recently been paying for treasury bills by means of "clearing vouchers," which are received the day following the sale and which become Bank of Canada funds only on the succeeding day. Hence, the proceeds of treasury bills sold to the Bank of Canada are no longer as "quick" as a net favourable balance in the clearing settlement. It is, therefore, more advantageous from the point of view of obtaining cash reserves, and possibly cheaper in terms of minimizing the loss in revenue arising from the sale of assets, for a chartered bank to call in day-to-day loans rather than sell treasury bills for quick cash.[30]

THE REDISCOUNT RATE

In conjunction with the introduction of day-to-day loans the Bank of Canada announced that it would act as the lender of last resort for the money market dealers as well as for the commercial banks.

In order to encourage the dealers to carry as much inventory as was consistent with the available supply of day-to-day money and as a means of underwriting the experiment, the Bank of Canada stood prepared to act as "the post of last resort". Not being specifically authorized to lend to dealers, the Bank arranged to make accommodation available up to negotiated limits to certain dealers on the basis of a sale and repurchase

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[30] R. M. Macintosh, "Broadening the Money Market", The Canadian Banker, Vol. 61, Autumn 1954, Pp. 68-69.

agreement, whenever it proved impossible to raise sufficient money elsewhere with which to carry inventory.[31]

Applications for these loans had to be made by the dealers before 2 P.M. on any day so as to allow time for the handling of mechanical details such as the computation of purchase and repurchase prices. However, in an emergency one or two dealers could be accommodated until up to 3 P.M.[32] The cost to the dealers of this service was the difference between the sale and repurchase prices which in practice, was equal to the rediscount rate prevailing at that time, and it was, therefore, a penalty rate, since it was higher than the day-to-day loan rate.[33]

This service was emphasized by the Bank of Canada as a privilege and not as a right because the dealers were required to tap all other sources of funds first (i.e. from trust, insurance and industrial companies), before applying to the Bank of Canada for accommodation. As the Bank of Canada expressed it:

> In standing ready to make such purchases, the purpose of the Bank is to provide an underlying assurance of liquidity to the money market and to encourage the use of the money market mechanism in the adjustment of cash reserves. The Bank is willing to provide funds to the market in this way for short periods and makes a charge equivalent to the Bank Rate. Repurchase of the relative

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[31] J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, p. 25.

[32] *Ibid.*, p. 25.

[33] *Ibid.*, p. 25.

> securities may be made at any time within varying periods not exceeding 30 days. The average period has been $2\frac{1}{2}$ days. The Bank held securities purchased under resale agreements on 62 business days in 1956. The maximum amount outstanding on any one day was $37 million and the daily average for the year was $2 million.[34]

Prior to the introduction of this innovation, the effect of changes in the rediscount rate had been largely psychological.[35] The result of this action was to now make the rediscount rate a more effective tool of monetary policy. If a commercial bank called a day-to-day loan the dealer would try to obtain a loan from another bank to replace it. However, if credit conditions were tight the dealer might not be able to obtain another day-to-day loan from another bank or lending institution. In such a case, the dealer may be forced to turn to the Bank of Canada for accommodation at a penalty discount rate.

The possibility of this action forced the dealers to pay close attention to the discount rate in order to give them an indication as to when they might have to borrow from the Bank of Canada as well as to signal the possible trend in money market interest rates.

> Since the dealer must always bear in mind the possibility that he may be forced to turn to the Bank of Canada, he will pay close attention to the latter's rediscount rate. Similarly, the chartered banks themselves might find their

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[34]Bank of Canada, <u>Annual Report 1956</u>, p. 45.

[35]R. M. Macintosh, "Broadening the Money Market", <u>The Canadian Banker</u>, Vol. 61, Autumn 1954, p. 71.

cash reserve positions so tight that they would be forced either to borrow from the Bank of Canada or sell treasury bills on a falling market, so they too would be influenced by changes in the central bank's rate. An increase in the rate would signal a warning of tightness in the money market, and probably lead to a rise in interest rates on treasury bills, day-to-day loans and eventually other short-term rates. Conversely, a lowering of the rediscount rate would tend to promote easier rates throughout the market. Hence, the broadening of the short-term money market has made the rediscount rate a more effective instrument of monetary control by establishing a direct mechanical relationship between it and the market in short-term securities.[36]

OVER - CERTIFICATION

The over-certification rate was a charge made by a bank to the money market dealers for daylight overdrafts.

A dealer in securities is both a buyer and seller; as buyer, he frequently requires large sums of money which he will not actually obtain until he resells the securities later in the day. He, therefore, applies to a bank for certification of his cheques with the understanding that he will "cover" before the end of the day with the proceeds of his security sales. Without this overdraft service, it would be necessary for the dealer to hold a very large working capital balance in order to finance the comparatively large amounts involved in his transactions.[37]

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[36]R. M. Macintosh, "Broadening the Money Market", The Canadian Banker, Vol. 61, Autumn 1954, p. 71.

[37]R. M. Macintosh, "Broadening the Money Market", The Canadian Banker, Vol. 61, Autumn 1954, p. 69.

The original charge for this service was 1/100 per cent per day and the money market dealers were of the opinion that this charge was too prohibitive to the carrying on of extensive dealings in treasury bills so by agreement, the rate was reduced to 1/250 per cent per day or $40 per $1,000,000 a day.[38] However, this reduced charge still impeded the flow of funds in the money market, as one observer concluded:

> In theory, the dealers should have borrowed on a day-to-day basis from the bank(s) offering the cheapest money, but when the cost of "over-certification" was taken into account, it was not always worth their while to respond to small changes in money rates. For this reason, they tended to remain tied to a particular bank, leaving elsewhere in the system unused pools of money, which, in a less imperfect market would have been mopped up. Thus, there were occasions, when money was easy, where a reduction in the rate on day-to-day money of 1/8 to 1/4 per cent made no difference to the demand. There were two reasons for this: (i) the "over-certification" charge made it expensive for dealers to move from one bank to another in search of cheaper money, when no more than 1/8 to 1/4 per cent would be saved in interest; and (ii) especially in the earlier stages of the experiment, when funds were plentiful, dealers were loath to repay day-to-day loans because of the fear that "they would not be able to get back into the market" when money was short.[39]

The banking community tried to minimize the effects of over-certification charges by stressing the methods developed by the money market dealers to minimize their charges on over drafts.

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[38] Ibid., p. 69.

[39] J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, Pp. 30-31.

> Suppose, for instance, that a dealer has bid successfully at the Thursday treasury bill tender for $5,000,000 in new bills. These must be picked up at the Bank of Canada agency by 3:00 P.M. Friday (until April 1955 the deadline was noon Friday). The dealer usually attempts to arrange his bank loans on Friday, and his "cage man" plans and executes the mechanics of the banking process, with the aid of one or more messengers to carry out the physical transfers involved. The dealer obtains a certified cheque for $1,000,000 at Bank A, paying $40 in over-certification charges; he presents the certified cheque to the Bank of Canada agency, and receives delivery of $1,000,000 in treasury bills; with these bills as collateral, he obtains a day-loan of $1,000,000 from Bank B,C,D, or perhaps A. He draws out the loan in the form of a certified cheque, and returns to the Bank of Canada for a second $1,000,000 in bills. This process is repeated three times more, and on the final trip the dealer pays off the original $1,000,000 over-certification at Bank A with his fifth day-loan of $1,000,000. He now has $5,000,000 in treasury bills at a cost of only $40 plus the day-loan rate, plus insurance and messenger service. By the use of this roundabout technique, the jobber manages to cut down his over-certification charges appreciably.[40]

The commercial banks were unwilling at first to make any further concessions but from March 18, 1957 the banks agreed to waive completely their "over-certification" charges in respect of all actual money market transactions.[41] One of the results of this action was to increase the turnover of loanable funds in the money market as it was now worth the dealers time to seek out the cheapest source of money at all times, and this has been reflected in the finer adjustment of interest rates that

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[40]R. M. Macintosh, "The Day-to-Day Loan Market", The Canadian Banker, Vol. 62, Winter 1955, p. 36

[41]J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, p. 32.

occurred after the over-certification chargers were removed.[42]

EFFECT OF THE INNOVATIONS

The effect of the Bank of Canada's innovations was to create, in Canada, a money market in treasury bills. Not only did the market for treasury bills grow considerably in size but it also grew in breadth. The volume of outstanding treasury bills was increased by about 50 per cent between June 1954 and the end of 1955 from $650 million to $1225 million to satisfy the increased demand for bills generated by the investment dealers participating in the money market. These increased bills were absorbed mainly by investors from outside the banking system. At the end of May 1954 only 11 ½ per cent of the $650 million in bills was held by the public and the dealers, whereas, by the end of 1955 the public and the dealers together held 43 per cent of all outstanding treasury bills.

This larger participation in treasury bills by the general public was one of the aims of the Bank of Canada's decision to establish a money market and the results, as shown in Table V, demonstrate that they were entirely successful in their objective.

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[42]*Ibid.*, p. 33.

TABLE V

GOVERNMENT OF CANADA
TREASURY BILLS

($ million)

Year	End of	Total Outstanding	Held by Bank of Canada	Held by Chartered Banks	Others
1953	January	425	184	219	22
	February	550	251	265	34
	March	600	236	288	76
	April	650	304	283	63
	May	650	289	321	41
	June	650	340	267	43
	July	650	354	253	42
	August	650	335	282	33
	September	650	332	282	36
	October	650	407	195	47
	November	650	380	221	49
	December	650	374	244	31
1954	January	650	335	282	33
	February	650	325	278	47
	March	650	301	292	57
	April	650	315	287	48
	May	650	310	266	74
	June	650	256	303	91
	July	675	165	361	148
	August	695	134	401	161
	September	715	94	431	190
	October	740	161	371	207
	November	760	219	361	180
	December	780	168	360	252
1955	January	810	115	464	231
	February	850	149	433	268
	March	890	165	435	290
	April	940	221	382	337
	May	980	200	424	356
	June	1020	296	376	348
	July	1055	276	412	367
	August	1075	241	418	416
	September	1100	234	369	496
	October	1150	298	337	515
	November	1170	301	327	542
	December	1225	264	415	526

Source: Bank of Canada Statistical Summary Financial Supplement 1954, p. 50 and Financial Supplement 1955, p. 42.

The money market has matured and developed considerably over the years, but its basic form today has not changed much from the form that existed back in the early 1950's following the introduction of the Bank of Canada's innovations. This then, was how the money market as we know it today was established.

CHAPTER IV

TREASURY BILLS

Numerous references have been made about treasury bills but as yet, we have not described the method of their issuance or their characteristics in any detail. The treasury bill was a relatively recent entrant into the Canadian financial system and as we have already seen it was the basic security instrumental in the early history of the money market.

> The treasury bill originated in England in 1877 as a means of financing the government's need for money. It was introduced into Canada in 1934 by the Bank of Canada and the Department of Finance.[43]

Treasury bills were simply promissory notes of the government of Canada issued in bearer form and they were the most liquid form of short-term investment available to the public, as banks and investment dealers were usually always prepared to purchase them at any time.

Treasury bills have been issued since 1953 through a weekly tender conducted every Thursday by the Bank of Canada on behalf of the Minister of Finance. The bills have been issued mainly in 91 or 182 day maturities with the result that treasury bills matured on Friday of every week of the year, providing

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[43]Brian Land, "How Canada's Money Market Keeps Idle Cash at Work", Canadian Business, Vol. 31, February 1958, p. 29.

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SÉRIE T
No E260300

A MARI USQUE AD MARE

CANADA

TREASURY BILL

BILLET DU TRÉSOR

DUE AND PAYABLE
ÉCHÉANT PAYABLE

MAY 31 1968

THE GOVERNMENT OF CANADA, for value received, will pay to bearer the sum of

ONE THOUSAND DOLLARS

on the above mentioned due date, at any Agency of the Bank of Canada, out of the Consolidated Revenue Fund of Canada.

This Treasury Bill is issued under the authority of an Act of the Parliament of Canada.

LE GOUVERNEMENT DU CANADA payera, pour valeur reçue, au porteur, la somme de

MILLE DOLLARS

à la date d'échéance susmentionnée, à toute agence de la Banque du Canada, à même les Fonds Consolidés du Revenu du Canada.

Ce Billet du Trésor est émis d'après l'autorisation d'une décision du Parlement du Canada.

DATED AT OTTAWA
DATÉ A OTTAWA
MAR 1 1968

CONTRESIGNÉ
COUNTERSIGNED

R. J. Rioux

OF THE BANK OF CANADA, FISCAL AGENT OF THE GOVERNMENT OF CANADA
DE LA BANQUE DU CANADA, AGENT FINANCIER DU GOUVERNEMENT DU CANADA

R. B. Bryce

DEPUTY MINISTER OF FINANCE
SOUS-MINISTRE DES FINANCES

investors with a wide range of possible maturities. Beginning in January 1953, $10 million of 273 day treasury bills were issued every week but since they never became very popular with the investing public they were subsequently discontinued in November 1955.[44]

One week in advance of a tender, details regarding the amounts and maturities to be offered were announced by the Bank of Canada. Sealed tenders were then offered on these treasury bills by the commercial banks and the investment dealers. Only primary distributors of treasury bills were invited to bid for new bills, and in practice, it was usually only the 15 money market jobbers that bid on the bills from among the 300 odd members of the Investment Dealers Association of Canada who were eligible to submit bids.[45] Bids were made in terms of $1000 lots or multiples thereof and the price was quoted as so much per $100. The difference between the accepted bid prices and $100 constituted the interest. The Bank of Canada also submitted a reserve bid for all the offered treasury bills so as to guarantee that the whole issue was marketed.

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[44] J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, p. 38.

[45] Ibid., p. 38.

The price calculation for treasury bills was made on a present value basis using simple interest. The formula was as follows:[46]

$$\text{Price} = \frac{100}{(1 + \text{interest}) \times \frac{\text{number of days}}{365}}$$

For example:[47]

A \$500,000 91-day bill is purchased to yield 1.75%

From the formula $\dfrac{100}{1 + .0175 \times \frac{91}{365}}$ price is 99.56559

Cost of \$500,000 bill at 99.56559	\$497,827.95
Value of \$500,000 bill at maturity	500,000.00
Income, subject to Canadian income tax laws	\$ 2,172.05

Sealed tenders were to be submitted to the Bank of Canada by noon on Thursday a day before the bills were actually issued. They were opened by the Bank of Canada and allocations made among the various banks and dealers on the basis of the highest bids. That is, bills went first to the institution offering the highest bid price, then bills were allocated to the next highest bidder and so on until the full amount of the issue was taken up.

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[46] Ibid., p. 39n.

[47] Wood, Gundy and Company Limited, Discount Paper in Canada (Toronto: October 1958) p. 9.

Those with the lowest bids often failed to obtain any treasury bills. Because of this scaled allocation practice, most dealers put in a "spread bracket" which was a tender for various amounts of treasury bills at various prices. This ensured that each bidder was likely to get some bills at each auction.[48]

About 2 P.M. on each Thursday the Bank of Canada advised the successful bidders of the results of the auction and at the same time it released a press statement to the public announcing the yield of the highest and lowest successful bidders as well as the average yield.[49] Payment was made by the successful bidders in full to the Bank of Canada by 3 P.M. on Friday and the bills were delivered then in any city that had an agency of the Bank of Canada, as requested by the purchasers - namely, Halifax, Saint John, Montreal, Ottawa, Toronto, Winnipeg, Regina, Calgary and Vancouver. The Banks made payment for their treasury bills in clearing house funds which had the effect that they really did not lose the money from their cash reserves at the Bank of Canada until the following Monday.

> Prior to January 1957, Treasury bills were paid for in Bank of Canada funds, with the debit coming against the bank for the proceeds of maturing bills. This was one reason for the popularity of "pre-tender contracts", since bills bought from a dealer were settled in clearing

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[48] J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, p. 39.

[49] J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, p. 40.

house funds. Hence, a bank received the proceeds of maturing bills on the Friday, but would not have to face the loss of cash associated with new bills taken up on a pre-tender basis until the following Monday. In the absence of off-setting action by the authorities, this would have meant that for one working day the Bank of Canada would have been out of funds to an extent equivalent to the amounts owing by the banks on account of new bills bought by pre-tender contract. However, it recouped itself by drawing down in the normal proportions Government balances held with the chartered banks. Nevertheless, any bank that used extensively the pre-tender contract system could gain cash from the other banks for one day. Under the new arrangements, this is no longer possible.[50]

Any member of the public who desired to invest in treasury bills in turn purchased them from the successful bidders among the commercial banks or investment dealers. Treasury bills were a virtually riskless investment in that they were the obligations of the government of Canada, and since issues matured every week, the investor usually always was assured of obtaining a sound investment with a maturity that coincided with the date he needed his money returned, and these features greatly enhanced the marketability of treasury bills. In fact, because of the broad market that developed for treasury bills, an investor could usually always sell his holdings to a dealer or bank on virtually any date prior to maturity and it was this characteristic of high marketability that made treasury bills such a desired form of short-term investment.

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[50] J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, p. 40n.

SECTION II

MAJOR PARTICIPANTS IN THE CANADIAN MONEY MARKET

CHAPTER V

THE BANK OF CANADA

As has been mentioned previously, the money market fulfilled a number of needs. For individuals it provided investment opportunities for the efficient use of excess cash. For the monetary authorities it provided a mechanism whereby monetary policy could be implemented and it was the central bank that was most concerned with the carrying out of monetary policy.

> Its basic objective, as laid down by statute, is to manage the supply of money, that is, the total amount of currency and bank deposits, with a view to contributing both to economic growth and to general stability of prices.[51]

We did not wish to examine in detail the monetary record of the Bank of Canada as our emphasis was on the money market in Manitoba where the Bank of Canada's money market activities were minimal but in the context of the money market as a whole, we cannot entirely ignore its role. We, therefore, decided to very briefly outline some of the Bank of Canada's techniques in the management of the money market in Canada, fully realizing that we are only partially covering the subject.

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[51] Bank of Canada, Annual Report, 1956, p. 49.

LEGAL CASH RESERVE REQUIREMENTS

Traditionally, the central bank had its most direct impact on an economy through its ability to influence the level of commercial bank deposits and this,in turn, depended upon the ability of the central bank to alter the relationship between a banks actual reserves and its required reserves. Until 1954, the Bank of Canada could only affect this relationship through actual bank reserves.[52]

Prior to the 1954 Bank Act revisions, the commercial banks were required to maintain, on a daily basis, a minimum cash reserve ratio of 5 per cent of their total deposits. Cash reserves constituted Bank of Canada notes plus deposits with the Bank of Canada. In practice, however, the banks held cash reserves close to 10 per cent of their total deposits which they considered a "traditional" conservative level required by sound management.[53]

The revisions to the Bank Act in 1954, which became effective July 1, 1954, required the commercial banks to maintain, on a monthly basis, a reserve ratio between 8 and 12 per cent

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[52]Bruce MacLaury, The Canadian Money Market (Cambridge: Harvard University, 1961), Pp. 24-25.

[53]J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, p. 34.

instead of the old 5 per cent daily ratio. The Bank of Canada had the power to vary the reserve ratio between 8 and 12 per cent as it was fit but in practice, the commercial banks were required to operate near the 8 per cent ratio.

> The ratio was computed by taking the average of a chartered bank's Canadian deposit liabilities at the close of business on the four consecutive Wednesdays ending with the last Wednesday but one in the preceding month. To this was related the sum of the bank's holdings of Bank of Canada notes (calculated on a basis similar to that for deposits) and the average amount of the bank's deposit with the Bank of Canada "at the close of business on each juridical day of the current month". This made it possible for the banks temporarily to run down their cash provided they made it good later and maintained the required average minimum.[54]

One of the advantages of this formula was that it made it clear to the banks before the end of the month, just what they had to hold as an average deposit at the Bank of Canada for the following month.

The immediate effect of this revised reserve ratio and its method of calculation was that the commercial banks reduced their cash reserves from 10 per cent to very close to the required minimum of 8 per cent as can be seen from Table VI. Having the banking system operating with reserves close to the minimum made the banking system more sensitive to possible Bank of Canada policies affecting the size of their reserves.

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[54]J.S.C. Wilson, The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March Pp. 34-35.

TABLE VI

CANADIAN CHARTERED BANK
CASH RESERVE RATIOS

Year	Month	Reserve Ratio
1953	January	10.8
	February	10.7
	March	10.5
	April	10.1
	May	10.1
	June	10.1
	July	10.1
	August	10.1
	September	10.1
	October	10.1
	November	10.0
	December	10.2
1954	January	10.3
	February	10.0
	March	10.4
	April	10.0
	May	10.0
	June	10.1
	July	9.4
	August	8.9
	September	8.8
	October	8.9
	November	8.8
	December	8.7
1955	January	8.9
	February	8.7
	March	8.6
	April	8.5
	May	8.4
	June	8.3
	July	8.4
	August	8.3
	September	8.2
	October	8.3
	November	8.3
	December	8.2

Source: J.S.C. Wilson, "The Canadian Money Market Experiment", _Banca Nazionale del Lavoro Quarterly Review_, Vol. 44, March 1958, p. 52.

In November 1955 the Bank of Canada, in an effort to exercise still tighter control over the banking system, was able to obtain the agreement of the commercial banks to have them maintain, on a daily average basis, a 15 per cent ratio of liquid assets to deposits.[55] This meant that in addition to their statutory 8 per cent cash reserves, the commercial banks had to maintain a 7 per cent secondary reserve composed of treasury bills and day-to-day loans. The main objectives of this request by the Bank of Canada was to enable it to exercise a more adequate control over the banks' commercial lending as well as to ensure that there was appropriate activity maintained in the money market.

> Such a ratio would make monetary restraint measures more quickly effective, since the banks would no longer be free to liquidate their treasury bill holdings in order to satisfy a growing demand for loans. They would have to start selling longer term government securities sooner. It also assured a supply of day loans available to the jobbers with which to carry their inventories, and a maintained demand for treasury bills, ensuring a substantial and continuing interest in them.[56]

The new regulations caused the commercial banks to be very heavy buyers of treasury bills during the first part of 1956 and from May of that year the agreed upon 15 per cent reserve ratio was achieved on a daily basis.

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[55]J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, p. 36.

[56]J.J. Dowsley and Hart Buck, "The Short-Term Money Market and Instruments", The Canadian Banker, Vol. 73, Autumn 1966, p. 83.

TABLE VII

CANADIAN CHARTERED BANKS
RATIOS OF LIQUID ASSETS TO TOTAL CANADIAN DEPOSITS

Month	Per Cent 1955	1956	1957
January	13.5	13.1	16.2
February	14.0	14.2	17.1
March	13.8	14.3	17.1
April	13.3	14.6	16.6
May	13.7	16.0	16.6
June	13.6	16.2	16.7
July	13.3	16.1	16.4
August	13.1	16.4	16.5
September	12.4	16.6	17.5
October	12.2	16.4	17.3
November	11.7	16.4	17.1
December	12.4	15.9	17.2

Source: J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, p. 52.

RECENT CHANGES IN RESERVE REQUIREMENTS

The recent Bank Act passed by the House of Commons on March 21, 1967 and effective May 1, changed a number of the operational areas for the commercial banks.[57] One of the most significant changes was in the calculation of cash reserves. As mentioned earlier under the Bank Act of 1954 the commercial banks were required to maintain an 8 per cent cash reserve against deposits. The most recent revision to the Bank Act made the requirement a 12 per cent reserve against demand deposits and a 4 per cent reserve against time deposits. The formulae were as follows:[58]

$$.04 = \frac{\text{Bank of Canada Notes Held + Deposits at the Bank of Canada}}{\text{Canadian dollar time deposits}}$$

and

$$.12 = \frac{\text{Bank of Canada Notes Held + Deposits at the Bank of Canada}}{\text{Canadian dollar demand deposits}}$$

For the first two months under the new Bank Act the old 8 per cent reserve was to be maintained but thereafter for 8 months, the reserves would gradually be shifted to the new split basis with the requirement rising for demand deposits and falling

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[57] For further information see Bill C-222, An Act Respecting Banks and Banking, as published by the Queen's Printer.

[58] G. Edmund King and Peter A.T. Campbell, "The Bank Act and the Money Market", The Canadian Banker, Vol. 74, Summer 1967, p. 94.

for term deposits by $\frac{1}{2}$ per cent per month respectively.[59] The reserve change when completed resulted in an average reserve requirement for the banking system as a whole of just over 6 per cent. The banking system reached this level by the middle of 1968 when average cash reserves amounted to 6.22 per cent as seen on Table VIII.

However, little effect on the money market was forecast by at least one contemporary writer as a result of the new reserve requirements.

> From an operational point of view, there will be no obvious effect on the money market of the new cash reserve provisions. As under the old system, in the current cash averaging period, two of the three elements that comprise each ratio are determined by the experience of the previous month and are constants for the current period. These are, the Canadian deposit liability element and the amount of Bank of Canada notes held by each bank. The only remaining variable at the banks' disposal through which to achieve the required ratios during the current period is their deposit at the Bank of Canada.[60]

OPEN MARKET OPERATIONS

One of the most effective methods the Bank of Canada has at its disposal to influence bank reserves was through open market operations. Open market operations consisted of the purchase and

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[59] *Ibid.*, p. 94.

[60] G. Edmund King and Peter A.T. Campbell, "The Bank Act and the Money Market", *The Canadian Banker*, Vol. 74, Summer 1967, p. 94.

TABLE VIII

CHARTERED BANKS
CANADIAN CASH RESERVES

(per cent)

Year	Daily Average For	Required Minimum Monthly Cash Ratio	Average Cash Reserve Ratio
1967	March	8.00	8.06
	April	8.00	8.06
	May	8.00	8.06
	June	8.00	8.09
	July	7.82	7.91
	August	7.64	7.72
	September	7.44	7.51
	October	7.23	7.38
	November	6.98	7.07
	December	6.74	6.86
1968	January	6.65	6.73
	February	6.48	6.55
	March	6.42	6.51
	April	6.37	6.45
	May	6.33	6.42
	June	6.23	6.33
	July	6.13	6.22
	August	6.18	6.24

Source: Bank of Canada Statistical Summary, Sept. 68, p. 651.

sale of treasury bills and other government securities by the Bank of Canada. When a commercial bank sold a treasury bill to the Bank of Canada it added to its cash reserves because it added to its deposit with the Bank of Canada. Conversely, a purchase of treasury bills by a bank reduced its cash reserves. Sales or purchases of treasury bills by investment dealers or others also affected cash reserves the same way, but only to a differing degree.[61]

> By varying its buying and selling prices for government securities, the central bank can increase or reduce its portfolio with consequent effects on cash reserves. These open market operations, and changes in treasury bill holdings at a weekly auction, are the principal techniques of cash management.[62]

Therefore, whenever the Bank of Canada wished to change the level of the banking system's reserves it did so by buying or selling additional treasury bills.

DISCOUNT RATE

We have already discussed in Chapter III how the discount rate became a more effective tool of policy on the dealers and banks who utilized the Bank of Canada's position as a lender of last resort, by making them more sensitive to changes in the discount rate.

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[61] H.H. Binhammer, Money, Banking and the Canadian Financial System (Toronto: Methuen, 1968) p. 229.

[62] Report of the Royal Commission on Banking and Finance, (Ottawa: Queen's Printer, 1964), p. 460.

Changes in the level of the discount rate also signalled changes in credit conditions and as such, its influence was great in the effect that it had on the direction and level of money market interest rates as the two usually moved in sympathy with one another. Thus, if it wished, the Bank of Canada could influence money market interest rates by changing the level of the discount rate.

> The management of the rates at which the central bank is prepared to act as lender of last resort to banks and money market dealers can assist in the task of maintaining stable market conditions or moving them smoothly and decisively as the occasion demands.[63]

In practice, the discount rate has been tied to the level of interest rates on three month treasury bills during most of the history of the Canadian money market. From 1954 to November 1956 the discount rate was an administered rate that was changed from time to time to ensure that it remained above the three month treasury bill yield. From November 1956 to June 1962 the bank rate floated at a level $\frac{1}{4}$ of 1 per cent above the three month treasury bill level. Since June 1962 the Bank of Canada has operated a dual rate. There was an official discount rate for the banks which was fixed from time to time and there was a "money market rate" for investment dealers which floated $\frac{1}{4}$ of 1

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[63] Report of the Royal Commission on Banking and Finance, (Ottawa, Queen's Printer, 1964), p. 464.

per cent above the three month treasury bill rate.[64] Some idea of the history of the bank rate in Canada can be seen from Table IX.

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[64] H.H. Binhammer, Money, Banking and the Canadian Financial System (Toronto: Methuen, 1968) p. 244.

TABLE IX

HISTORY OF THE BANK RATE IN CANADA

Date of Change	Rate Set (per cent)
1935	2 ½
1944, February	1 ½
1950, October	2
1955, February	1 ½
1955, August	2
1955, October	2 ¼
1955, November	2 3/4
1956, April	3
1956, August	3 ¼
1956, October	3 ½
1956, November	Floating Rate
1962, June	6
1962, September	5 ½
1962, October	5
1962, November	4
1963, May	3 ½
1963, August	4
1964, November	4 ¼
1965, December	4 3/4
1966, March	5 ¼
1967, January	5
1967, April	4 ½
1967, September	5
1967, November	6
1968, January	7

Source: H.H. Binhammer, Money, Banking and the Canadian Financial System (Toronto: Methuen, 1968) p. 245.

CHAPTER VI

COMMERCIAL BANKS

> ... the heart of the money market in any country is in the banks and the apparatus that exists among and around them for maintaining the individual liquidity of each.[65]

Banks were the heart of the money market because they, more than any other institution, required the liquidity that the money market provided, because the commercial banks needed a good proportion of their assets in liquid form as most of a banks' liabilities were notice deposits subject to momentary withdrawal.[66] A ready supply of liquid assets such as treasury bills was needed, then, to meet any possible fluctuations in deposits. Day-to-day fluctuations in deposits did affect a bank's reserve position and this often required that a bank make some adjustment in its assets to compensate for the change. This action ensured that a bank would maintain an active interest in the money market on a continuous basis because banks used the facilities of the money market to adjust their assets.[67]

On the other hand, if a bank maintained excess reserves any fluctuation in its deposit liabilities would be automatically absorbed by the excess reserves. However, the Bank of Canada

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[65]Robert V. Roosa, Federal Reserve Operations in the Money and Government Security Markets (New York: The Federal Reserve Bank of New York, July 1956), p. 12.

[66]Bruce MacLaury, The Canadian Money Market (Cambridge: Harvard University, 1961), p. 109.

[67]*Ibid.*, p. 110.

did not pay any interest on reserves so that funds tied up in cash reserves became a lost source of income for the banks.[68] This fact led banks to keep the bulk of their assets invested in earning assets and consequently they maintained minimal cash reserves as Table VIII indicated.

One of the major influences on a bank's cash reserves was the net balance resulting from each days clearing activities. There were a number of centers across Canada where local branches exchanged debits and credits and the differences in these local centers were settled daily at the Bank of Canada. Any net gain or loss was determined usually by 11 A.M. so as to give the commercial banks time to adjust their reserve positions during the remainder of the day.[69] However, it was not often possible to settle accounts by 11 A.M. as the clearing results from British Columbia, due to time differences, were often late in arriving in Ottawa.

> ... the Western clearings have become increasingly important as a result of the economic growth of British Columbia and, from time to time, the consequent delay in establishing the money position of the banks has caused some embarrassment in the market.[70]

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[68]Bruce MacLaury, The Canadian Money Market (Cambridge: Harvard University, 1961), p. 111.

[69]*Ibid*., p. 113.

[70]J.S.C. Wilson, "The Canadian Money Market Experiment", Banca Nazionale del Lavoro Quarterly Review, Vol. 44, March 1958, p. 23n.

For this reason the banks had to be able to act quickly to adjust their cash reserve positions and the money market provided the vehicle whereby reserves could be changed rapidly.

There was a second major reason why banks required the liquidity of the money market. Banks utilized the money market to invest in securities when the demand for loans was slack. When credit demands increased, the banks could dispose of their investments to facilitate their borrowers.

> Since the banks are primarily interested in making loans, they arrange their investments so as to be in a position to accommodate their customers when economic conditions cause the demand for bank credit to increase. In practice, this means that the banks try to limit their investments to relatively short maturities that can be sold or allowed to run off when the demand for loans picks up. It is not difficult to understand, therefore, why the money market should come to play an important role in facilitating cyclical swings in the composition of bank assets.[71]

In summary then, banks were the heart of the money market because they needed its liquidity to compensate for the reserve effect of deposit fluctuations and in order to be able to meet increased demands for short-term credit.

Did the Canadian money market provide the needed liquidity that the banks required?

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[71]Bruce MacLaury, The Canadian Money Market (Cambridge: Harvard University, 1961) p. 117.

> In the light of events since 1954, there can be little doubt that the initial impact of the money market's development was to make the chartered banks more liquid, both in terms of the maturity distribution of their government securities portfolio and in terms of the liquidity of any given maturity of short-term asset.[72]

The commercial banks relied heavily on treasury bills and day-to-day loans to provide the liquid assets they required to meet day-to-day fluctuations in cash reserves. As we have seen in Chapter III, day-to-day loans had a greater degree of liquidity than did treasury bills but in practice, the demand for these loans was not sufficient at any price to provide enough funds to meet both their primary and secondary reserve requirements.

> The chartered banks now, as a matter of course, adjust their cash position through the day-to-day loan market; although at times they run down their day-to-day loans so low, or dealers provide such a small demand for loans, that the market temporarily disappears.[73]

Thus the banks balanced their portfolios between day-to-day loans and treasury bills, with treasury bills predominating in the composition of the banks' secondary reserves.

MONEY MARKET INSTRUMENTS OF THE BANKS

With the establishment of the money market in 1954, a whole new range of short-term investment instruments developed.

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[72] *Ibid.*, p. 139.

[73] E.F. Neufeld, *Bank of Canada Operations and Policy* (Toronto: University of Toronto Press, 1958) p. 56.

With the advent of the commercial paper market, which we shall discuss later, the banks found that they were losing first class loans as corporations utilized cheaper sources of finance. The banks attempted to fight the competition from non-financial lenders by attracting depositors with idle balances away from the commercial paper market with a series of new money market instruments.

In December 1955 the banks began paying interest on _term deposit_ balances of $100,000 or over placed for 90 days or more at 1/4 of 1 per cent below the last three month treasury bill tender rate.

> This was in effect for some time, but proved not to be sufficiently attractive compared to the rates available on other money market instruments. The commercial paper borrower, for example, could afford to pay a sufficiently higher rate than that on Treasury Bills, and still maintain a cost advantage over borrowing from the banks (except in occasional periods of credit stringency such as in 1959 and 1962).[74]

In January 1961 the banks began offering instruments known as _deposit receipts_[75] which were evidences of funds on deposit with the bank with a special rate of interest for a certain period of time. These were usually issued in amounts from $5,000 to $500,000 with terms ranging from 30 to 364 days.

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[74]J.J. Dowsley and Hart Buck, "The Short-Term Money Market and Instruments", _The Canadian Banker_, Vol. 73, Autumn 1966, pp. 86-87.

[75]_Ibid._, p. 87.

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THE MERCANTILE BANK OF CANADA

Affiliated with

FIRST NATIONAL CITY BANK

№ 3596

DEPOSIT RECEIPT

NOT NEGOTIABLE AUTOMATICALLY RENEWABLE

$5,000.00 .... November 21st ...... 19 68.

RECEIVED FROM .... ***Lorne W. Rae*** .... (the "Depositor"),

THE SUM OF .... M.B.C. $5000.00 .... DOLLARS,

Canadian $ .... currency, repayable .... 32 days .... after the date hereof to the
(days/months/years)

Depositor or assigns with interest at the rate of ..6¼..... % per annum upon presentation and surrender of this

Receipt at the..... Winnipeg, Manitoba .... branch of the Bank subject to the provisions set forth on the reverse hereof.

THE MERCANTILE BANK OF CANADA

MATURITY... Dec. 23/68 ....

Interest computed actual days on 365 day basis

vh ....

The interest was paid only at maturity but the deposit receipts could be redeemed before maturity but at a penalty of 1/4 per cent on the yield.

As the competition for funds increased a new instrument, the <u>certificate of deposit</u>[76] was introduced by the banks with special rates of interest and with terms to maturity of one to six years. These certificates were also evidences of funds on deposit with the bank on which a special rate of interest was paid and they differed from deposit receipts mainly in term. They were issued in the name of the lender, were transferable, but were not redeemable prior to maturity and as such, they were relatively illiquid investments. The rates paid on amounts over $200,000 were very flexible and were subject to negotiation between the lender and the bank.

To counter the illiquid features of the certificates of deposit, the banks issued to clients on a discount basis <u>bearer deposit term notes</u>[77] of up to 7 years maturity. These instruments were usually sold to investment dealers who kept them in inventory for use as buy-backs with their commercial clients. The rates on these notes were competitive.

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[76] J.J. Dowsley and Hart Buck, "The Short-Term Money Market and Instruments", <u>The Canadian Banker</u>, Vol. 73, Autumn 1966, p. 87.

[77] <u>Ibid</u>., pp. 87-88.

The small depositor was not overlooked by the banks and he was wooed with savings certificates[78] ranging in amount from $10 to $50,000. These instruments were issued at a discount and were non-transferable and non-negotiable but they could be redeemed prior to maturity at a penalty rate.

A swap deposit[79] occurred when Canadian dollars were swapped into United States dollars while simultaneously Canadian dollars were purchased forward, for settlement to coincide with the need for the money. U.S. branches of Canadian banks were not subject to the Federal Reserve regulation of rates paid on deposits nor did they require reserves to be held against them in Canada. These factors made U.S. swap deposits a very competitive money market instrument. They were available in virtually any amount over $100,000 and the interest rate depended on the going market rate as well as on the forward rate for Canadian funds which often augmented the basic interest rate.

The banks generally speaking, were successful in their ability to attract money market funds from the public as well as from the larger institutions. The growth of term deposits, following the introduction of short-term securities by the banks,

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[78] Ibid., p. 88.

[79] J.J. Dowsley and Hart Buck, "The Short-Term Money Market and Instruments", The Canadian Banker, Vol. 73, Autumn 1966, pp. 88-89.

can be seen from Table X which showed that while total deposits doubled in size between 1957 and 1965, other notice deposits increased six fold.

BANKS AND THE MONEY MARKET - A CASE HISTORY 1967

> In general, the banks have been reluctant to engage in "price competition" for deposits; but to the extent that the deposit structure has merged into the money market, the banks have found such competition useful as a means of controlling the amount of funds acquired by way of money market instruments. By raising its rates above current market rates, an individual bank can attract additional deposits; by decreasing rates it can reduce them. These special deposit instruments have attained an important, and seemingly permanent position as both a source of bank deposits and a high grade money market instrument.[80]

Despite the quotation by Dowsley and Buck concerning the fact that banks have been reluctant to engage in price competition for deposits, events subsequent to their article has proven that banks have indeed competed for deposits on a price basis. The main impetus for this action was the change in the *Bank Act* effective May 1, 1967 which raised the interest ceiling on loans made by commercial banks from 6 per cent to over 7 per cent during the year 1967. Section 91 of the Bank Act said in part:

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[80] J.J. Dowsley and Hart Buck, "The Short-Term Money Market and Instruments", *The Canadian Banker*, Vol. 73, Autumn 1966, p. 88.

TABLE X

CHARTERED BANKS
CANADIAN DOLLAR DEPOSITS

($ million)

Year	Other Notice	Total
1957	548	11,407
1958	618	12,690
1959	558	12,279
1960	576	12,921
1961	929	14,186
1962	997	14,699
1963	1191	16,099
1964	1505	16,697
1965	2044	18,594
1966	2346	20,016
1967	3255	22,663

Source: Bank of Canada Statistical Summary, January 1962 p. 7 and February 1968 p. 92.

> The maximum rate of interest or rate of discount per annum that the bank may charge on a loan ... is ... for the period commencing on the coming into force of this Act and ending on the 31st. day of December 1967, seven and one-quarter per cent.[81]

Up until the new Bank Act revisions were made, the commercial banks were hindered to some extent in their attempts to compete effectively for term deposits in the money market because interest rates in the money market were close to the banks' 6 per cent lending maximum.[82] This had two effects on the banks. Firstly, since investors were able to obtain competitive interest rates from other borrowers there was no special incentive to lend to the banks. Secondly, since banks could not lend money at over 6 per cent per annum, their margin of profit on large corporate loans was too narrow to make it worthwhile to actively borrow funds from the public via the money market in order to lend these funds in turn to their corporate clients. Funds that were raised by deposit receipts and the other money market instruments the banks issued were earmarked for personal loans because these loans were usually repaid in monthly instalments

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[81] Canada, House of Commons, Bill C-222, an Act Respecting Banks and Banking (Ottawa: Queen's Printer, 1967) p. 79.

[82] Province of Manitoba treasury bill yields fluctuated in 1966 from a low of 5.40 per cent to a high of 6.40 per cent. Source: Wood Gundy Securities Limited.

and thus yielded the banks an effective interest rate of over 10 per cent.[83]

> Deposit receipts and certificates of deposit were introduced by the banks about two years ago, and first gained the serious attention of corporation treasurers in 1964 ... the Toronto-Dominion Bank is one of the few banks that publish interest rates. Most other banks undertake only to meet the competition. The Toronto-Dominion has established a scale ranging from $4\frac{1}{4}$ per cent on 30-day receipts up to 4 3/4 per cent on certificates of deposit with terms of one to six years.
>
> This is expensive money for the banks, which are limited to a 6 per cent interest rate ceiling on their loans - especially since, of the money raised this way, 8 per cent must be deposited with the Bank of Canada as a legal reserve, and an additional 7 per cent must be invested in liquid assets such as treasury bills ...
>
> Because of the relatively high cost of the money, the banks are earmarking the proceeds from sale of the certificates for financing consumer loans, which (because they are repaid in monthly instalments instead of at the end of a fixed period) earn an effective interest rate of 10 to 11 per cent.[84]

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[83] The formula: $r = \frac{2m\,D}{P(n+1)}$ will calculate the effective interest rate on a loan repaid in instalments, where:

r = the effective rate
m = the number of payments in one year
n = number of payments to discharge the debt
D = charge in dollars
P = principal or cash advance

[84] Ronald Anderson, "New Bank Weapon Puts the Squeeze on Finance Firms, The Globe and Mail (Toronto: October 13, 1965).

However, when the interest ceiling was raised to 7 1/4 per cent it became profitable for the banks to attract funds by offering higher interest rates than their competitors because they could lend out the borrowed money to their large corporate clients as well as to individual borrowers at a higher rate than the money market borrowing rate and thus obtain a more substantial profit.

It was during 1967 then, following the introduction of the new _Bank Act_ that the commercial banks began to attract term deposits on the basis of price competition.

> The growth in the banks' non-personal term and notice deposits varied considerably over the course of the year. From August to October the banks competed vigorously for Canadian dollar fixed-term deposits, and both the amount of such deposits and the interest rates paid on them rose to record highs: some banks were reported to have paid rates in excess of 7 per cent for very short-term deposits. In early November the banks became less aggressive in bidding for short-term funds, and their term deposits began to decline.[85]

Table XI and Chart 1 showed the trend of short-term interest rates during 1967. The deposit receipts for 30 to 40 day terms of the commercial banks started the year 1967 at just over 6 per cent in line with the going rate on Prime Finance paper of the same term. This close relationship in interest rates remained until the end of September as Chart 1 shows. All three

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[85]Bank of Canada, _Annual Report 1967_, p. 54.

TABLE XI

SHORT-TERM INTEREST RATES

(per cent)

Selected Dates	30-40 day Bank Paper	30-59 day I.A.C. Finance Paper	35 day Treasury Bills
1966			
December 30	6.36	6.50	4.90
1967			
January 20	6.25	6.00	4.74
February 17	5.64	5.75	4.51
March 23	4.92	5.00	4.04
April 21	4.66	4.625	3.91
May 5	4.70	4.625	4.00
June 8	5.15	5.00	4.28
July 28	5.23	5.375	4.23
August 25	5.40	5.50	4.23
September 22	5.80	5.625	4.35
October 27	7.00	6.125	4.79
November 24	6.25	6.00	5.28
December 29	6.25	6.00	5.82

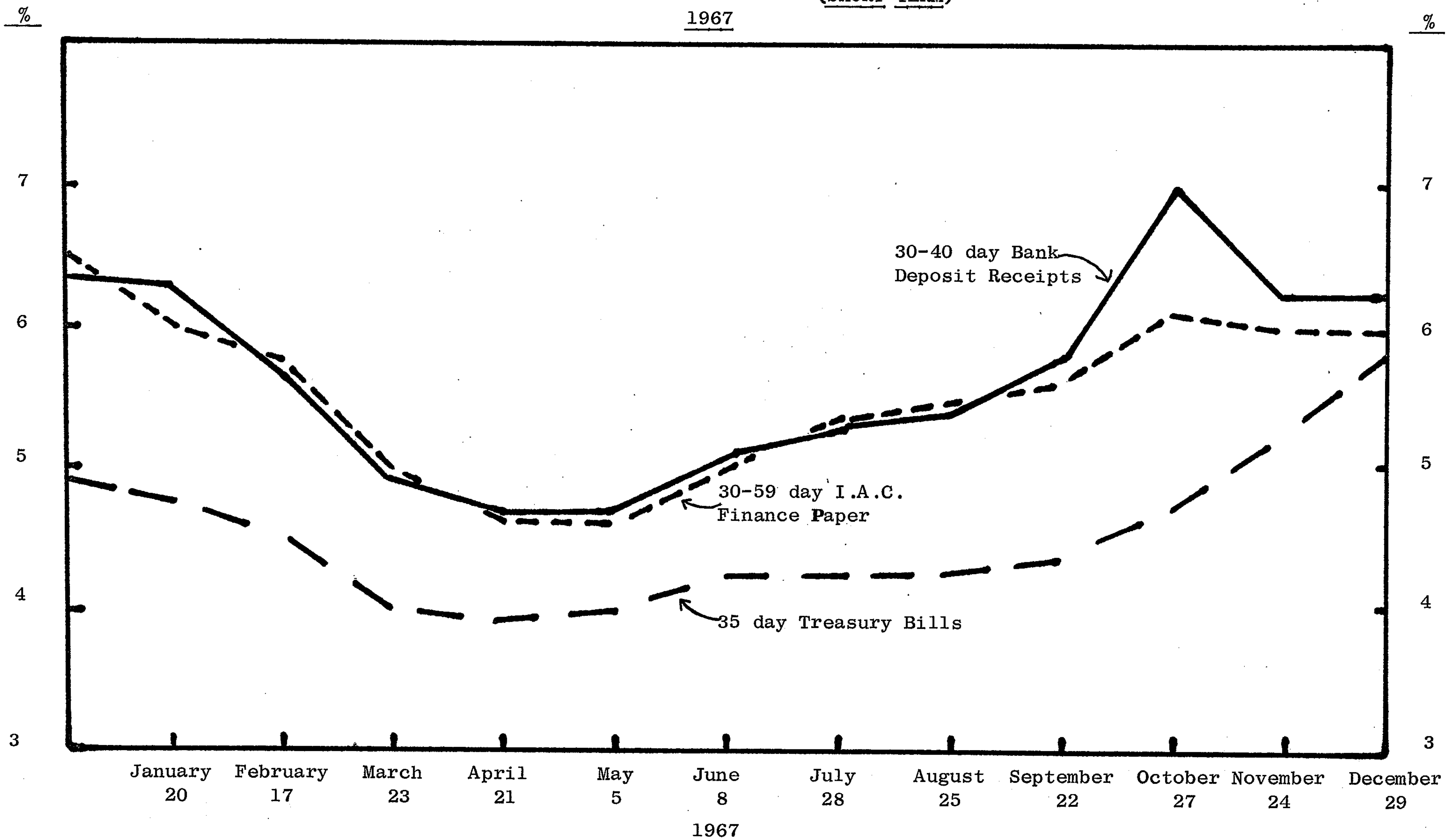
Source: Wood Gundy Securities Limited and
a Canadian Corporation

CHART 1

INTEREST RATES

(SHORT-TERM)

1967



rates of interest shown on the chart moved in unison during the first 9 months of 1967, declining steadily from the beginning of the year until the end of April and then gradually recovering until September.

The commercial banks, during the first 9 months of the year, were attracting considerable term deposits with the rates they were offering at that time. The growth in their term deposits was significant, from $2.6 billion at the end of January 1967 to $3.3 billion at the end of September.[86] However, it was during the last few weeks of September that the commercial banks really began to attract new term deposits from non-financial corporations with surplus funds by outbidding all the competition for these deposits. As a result, the interest rate on deposit receipts with the banks for 30 to 40 day terms rose from 5 3/4 per cent to over 7 per cent within a five week period! This was an increase of over 1 1/4 per cent and was much greater than the increases in other money market rates of interest (see Chart 1).

The Bank of Canada became very concerned with this aggressive behaviour on the part of the commercial banks which was driving up interest rates faster than the Bank of Canada thought necessary.

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[86] Bank of Canada, Statistical Summary, February 1968, p. 97.

TABLE XII

BANK DEPOSIT RECEIPTS
30-40 days

	Date	% Yield
1967	September 19	5.75
	September 21	5.80
	October 11	6.40
	October 12	6.51
	October 19	6.85
	October 24	6.97
	October 26	7.06
	October 27	7.00
	November 6	6.25

Source: A Canadian Corporation

> The central bank's problem in deciding how much monetary expansion to permit in order to restrain the rise in interest rates was complicated by the structural changes which were occurring in the banking system as a result of the Bank Act revision which went into effect in May 1967. The general effect of this revision was to make the financial system more competitive by softening or removing most of the special restrictions under which the banks had been working. The banks naturally took advantage of these changes to compete more aggressively for an enlarged share of the total financial business of the community. Indeed, for a period in the autumn their competition for large blocks of short-term corporate funds was so aggressive that it appeared to be uneconomic, and I felt that it threatened to introduce some instability and distortions into the financial system. I informed the banks of my views and was gratified that a more normal relationship of rates came about soon thereafter.[87]

The more normal interest rate level that the Bank of Canada suggested for 30 day deposits must have been 6 1/4 per cent because all the banks' rates fell to this level by November 1 and remained constant at that level for the rest of the year.

> Canadian chartered banks have sharply lowered the interest rates they offer on short-term deposits, apparently as a result of talks with the Bank of Canada.
>
> Banks had been offering 7 per cent or more on sums deposited for as few as 30 days. The rates were higher than finance companies were offering and higher than most of the banks' lending charges...
>
> It is believed the Bank of Canada expressed its concern about the level of short-term rates and that chartered banks then moved to lower their levels.
>
> The Bank of Montreal dropped its rate on 30-day deposits to 6 1/4 per cent from 6.9 per cent...[88]

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[87]Bank of Canada, Annual Report 1967, p. 9.

[88]"Banks Slice Short-Term Rates", The Globe and Mail, Toronto, November 1, 1967.

The activity of the commercial banks to attract new term deposits by means of offering higher interest rates than anyone else was entirely successful as can be seen from Table XIII. Term deposits rose from $3.3 billion to over $4.1 billion during the fall of 1967. After rates were reduced to 6 1/4 per cent, term deposits fell off to $3.4 billion by year end. However, even the 6 1/4 per cent interest rate was sufficiently high enough to maintain a substantial supply of term deposits during the early months of 1968.

> The chartered banks are more than holding their own against the near-banks in the scramble for new deposits sparked by the revisions in the Bank Act last spring...
>
> The 6 1/4 % rates on term deposits with chartered banks have attracted huge amounts of money from large corporations and government enterprises such as the hydro companies who would normally invest excess cash in the short-term market.
>
> Short-term market dealers say that this does not cut back the amount of money available but it narrows the choice of lenders available when they are arranging a deal. Sometimes the best terms available are at a bank - and that means a smaller commission for the dealer.
>
> The 6 1/4 % rate gives them a big advantage in 30-59 days money, which was going at about 5.90 % last week.[89]

From the above discussion we can see that the commercial banks under the provisions of the new Bank Act have become more competitive within the financial system and have become more aggressive in the Canadian money market, and that they have

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[89]"Chartered Banks Gaining in Competition for Deposits", Financial Times of Canada, Montreal, January 27, 1968.

TABLE XIII

CANADIAN DOLLAR DEPOSITS

($ millions)

1967 Date		Non-Personal Term and Notice Deposits
August	2	3,256
	9	3,280
	16	3,266
	23	3,291
	30	3,370
September	6	3,463
	13	3,548
	20	3,598
	27	3,669
October	4	3,770
	11	3,863
	18	3,919
	25	4,037
November	1	4,119
	8	4,128
	15	4,009
	22	3,976
	29	3,931
December	6	3,828
	13	3,786
	20	3,534
	27	3,458

Source: Bank of Canada Statistical Summary
February 1968, p. 97.

developed their own money market instruments to facilitate this activity and that the commercial banks have now established themselves as major participants in the money market of Canada, both as borrowers and as lenders.

THE FUTURE ROLE OF THE BANKS

The Bank Act revisions of 1967, as we have seen, has enabled the commercial banks to become more active participants in the Canadian money market, particularly as borrowers. Throughout 1968 the banks have continued to attract large term deposits from institutions with temporary surplus cash as can be seen from Table XIV.

This success has been the combined result of a number of factors. Firstly, the commercial banks have offered rates of interest that have been competitive with other money market rates. For example, in early February 1969, according to one dealer, banks have offered 6 3/4 per cent for term deposits with demand call features, compared with an approximate yield of 6 1/4 per cent for 91 day government of Canada treasury bills.

Secondly, the Canadian chartered banks have a very high credit standing among investors and this places them at a distinct advantage over commercial paper borrowers in the money market.

TABLE XIV

MONEY MARKET STATISTICS
1968

($ million)

	Chartered Banks Canadian Dollar Deposits Non-Personal Term and Notice (ave. of Wed.)	Short-term Paper of Sales Finance Cos. (end of month)	Other Commercial Borrowers (end of month)
1967 December	3,652	815	232
1968 January	3,459	921	330
February	3,580	963	335
March	3,642	992	348
April	3,874	989	361
May	3,999	1,054	266
June	4,180	1,165	249
July	4,320	1,156	271
August	4,296	1,123	306
September	4,444	1,148	271
October	4,443	1,106	343
November	4,282	1,214	399
December	4,395	1,135	-

Source: Bank of Canada Statistical Summary January 1969, p. 10 and p. 32.

Finally, the commercial banks of Canada have made their term deposits very convenient for lenders. Term deposits can be arranged virtually anywhere in Canada and they have cut down considerably the amount of administrative work involved on the lenders' part. The continued success of the commercial banks in attracting large term deposits can be attributed then to their competitive rate, prime security and convenience.

We do not believe that the money market borrowing activities of the commercial banks have or will seriously distort the operations of the money market. Table XIV has shown that while bank term deposits have climbed substantially during 1968, there has been no concurrent contraction in other money market securities such as sales finance or commercial short-term paper. In fact, sales finance companies, despite the competition from the banks, increased their short-term borrowings from $815 million at the end of 1967 to $1135 million by the end of 1968 - an increase of nearly 40 per cent!

It would seem, then, from the figures on Table XIV that money market borrowers have been able to obtain funds from the market even though the commercial banks have absorbed a considerable amount of temporary surplus cash. This has been mainly, we believe, because the spread between corporation bank borrowing charges has remained more than about 1/4 per cent above the banks' term deposit rates and the borrowing corporations have offered to prospective lenders a yield higher than that of the banks, thereby attracting funds away from potential term deposits, and at the same time, they have obtained these funds more cheaply than bank funds.

We think that the commercial banks have demonstrated their ability to attract short-term funds and they will continue to do so in the future. However, we also see the continued use of finance and commercial paper as major money market instruments because so long as bank lending charges exceed their borrowing rates by at least 1/4 per cent, some firms (particularly those who do not qualify for the banks' prime lending rates) will continue to find funds from the money market.

BANKERS' ACCEPTANCES

Bankers' acceptances were introduced into the Canadian money market on June 11, 1962. At the time of introduction, Mr. R.D. Mulholland, the President of the Canadian Banker's Association issued the following press statement:

> On June 11, 1962, the chartered banks introduced a new banking instrument, bankers' acceptances.
>
> The establishment of a market in bankers' acceptances should be another constructive step in promoting efficient employment of funds available for short-term investment...

The bankers' acceptance provides a technique whereby a customer wishing to use the facilities of the money market may sell in the market a short-term instrument which a chartered bank has undertaken to pay at maturity. The acceptance itself is a draft drawn by the customer and accepted by a chartered bank after the requisite conditions of the transaction have been met.

Upon acceptance, the accepting bank becomes fully liable for payment of the draft at maturity, the customer, of course, reimbursing the bank. In return for this obligation, the bank will charge the customer a fee. Acceptance will be created only for prime credit risks.

The term of an acceptance will range from 30 to 90 days. Acceptances will be drawn in denominations of $200,000, $300,000, $500,000 and $1,000,000, combinations of amounts being used when required. The underlying commercial transaction giving rise to an acceptance must be of a self-liquidating nature and acceptances will not be issued for capital purposes.[90]

The market in bankers' acceptances did not develop too well at first because of the high acceptance charge made by the banks of 1 1/4 per cent. Most companies wishing to borrow short-term funds could borrow more cheaply by issuing commercial paper. By the end of June, 1965 three years after their introduction, only $15 million of acceptances were outstanding. In July 1965 one of the banks reduced its acceptance fee to 1/2 per cent and this triggered an increase in the volume of acceptances outstanding, until by May 1966 there was $156 million outstanding.[91]

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[90]R.D. Mulholland, "Bankers' Acceptances", <u>The Canadian Banker</u>, Vol. 69, Summer 1962, p. 121.

[91]Harris and Partners Limited, unpublished memorandum on <u>Commercial Paper and Bankers' Acceptances</u>.

A corporation that wanted to make use of this instrument first approached a bank to establish (a) the banks willingness to accept the note, (b) the amount it would accept and (c) the acceptance fee payable (which varied from bank to bank and with the corporation's credit rating). The corporation, after obtaining this information, next approached an investment dealer in order to receive a bid from the dealer on the proposed acceptance. This enabled the corporation to determine its costs precisely and if the costs were satisfactory (that is, low enough), the corporation could utilize the bankers' acceptance as a source of funds.

If the corporation decided to use acceptances as its source of finance, it filled out the form provided by the bank (see sample), had it accepted by the bank, endorsed it to a dealer and had the bank deliver it to the dealer against payment in either Montreal or Toronto.

The following example more clearly explained the procedure.

> The Progressive Screw and Gear Co. has a contract to deliver $200,000 worth of nuts and bolts to Modern Motors in 90 days' time and they need money to finance it. A dealer tells the Company that he will pay 3 3/4 % for a 90-day Bankers' Acceptance. The Company goes to their bank and establishes a Bankers' Acceptance line of credit. The bank agrees to accept the draft and charges the Company at the rate of 1 1/4 % per annum for endorsing it which makes a total cost of (3 3/4 % plus 1 1/4 %) 5% for the 90 days. If the Company were to apply to the bank for an ordinary loan, it would probably be at the prime rate of 5 1/2 % so the Company saves 1/2 of 1% for 90 days which on $200,000 amounts to $246.58. The dealer then takes the

ACCEPTED

(DATE)

PAYABLE AT
CANADIAN IMPERIAL BANK OF COMMERCE
25 KING STREET WEST
TORONTO 1, ONT.

FOR CANADIAN IMPERIAL BANK OF COMMERCE

AUTHORIZED SIGNATURE

AUTHORIZED SIGNATURE

FORM 572T-62

THE DRAWER HEREBY CERTIFIES THAT THIS DRAFT IS DRAWN IN CONNECTION WITH SUCH PRODUCTION OR MARKETING AS IS MENTIONED IN SECTION 18(1)(F) AND/OR (G) OF THE BANK OF CANADA ACT.

DUE ____________________
DO NOT INCLUDE DAYS OF GRACE

BRANCH
NUMBER

____
PLACE DATE

SAMPLE

____________________ AFTER DATE WITHOUT DAYS OF GRACE

PAY TO THE ORDER OF THE UNDERSIGNED DRAWER

____________________ DOLLARS $

VALUE RECEIVED, AND CHARGE TO THE ACCOUNT OF

TO CANADIAN IMPERIAL BANK OF COMMERCE
25 KING STREET WEST
TORONTO 1, ONT.

____

Sample Bankers' Acceptance

> Bankers' Acceptance into position and tries to market it to another client who has short-term funds for investment.[92]

The advantages of bankers' acceptances were mainly on the side of the borrower.

> Acceptance borrowing, at this moment, provides an additional source of funds for smaller firms at a cost below the prime rate and, in a tight money period, supplements credit when bank borrowing is restricted. It helps to satisfy a demand for credit without the banks having to liquidate some other asset during periods of heavy credit demand. The prime commercial paper borrowers, however, have not yet found it necessary to avail themselves of the acceptance technique. The market for acceptances has grown largely one sided - the borrower finds it advantageous, but the lender prefers to invest in prime commercial paper without a bank's endorsement. The slightly higher return is apparently enough to compensate him for the added risk.[93]

Acceptances were not a dominant instrument in the money market as their volume during 1967 was fairly constant at about $170 million.

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[92]Mills, Spence and Co. Limited, Bankers' Acceptances (Toronto, June 8, 1962) p. 2.

[93]J.J. Dowsley and Hart Buck, "The Short-Term Money Market and Instruments", The Canadian Banker, Vol. 73, Autumn 1966, pp. 89-90.

TABLE XV

BANKERS' ACCEPTANCES

($ millions)

Average of Wednesdays 1967	Amount Outstanding
January	164
February	166
March	170
April	183
May	183
June	184
July	187
August	177
September	171
October	174
November	169
December	151

Source: Bank of Canada Statistical Summary December 1968, p. 894.

CHAPTER VII

SALES FINANCE COMPANIES

Sales finance companies have been primarily engaged in the business of supplying funds to the buyers of durable goods such as automobiles. They did not generally lend directly to the purchaser of the consumer product, but instead, the initial credit was made available to the buyer by the automobile dealer or other retailer at the time of sale. The dealer then sold the instalment credit contract to the finance company which collected the monthly payments directly from the customer.

The bulk of the instalment credit contracts that finance companies purchased were for terms of three years or less and because of this and because they were subject to the vagaries of consumer buying habits, substantial fluctuation in the size of sales finance company assets often occurred. To meet these possible changes, sales finance companies required a large proportion of their borrowings to be in the form of short-term obligations and so the industry became an active participant in the money market.

In fact, sales finance companies have played an important role in the Canadian money market from its inception.

> The finance companies were the first substantial borrowers other than the federal government in the Canadian short-term market, and their efforts to develop and improve this source of funds have contributed much to its growth. Indeed, they are still the largest single group of borrowers in the money market despite the many others who have entered it, and more than one-half of all outstanding short-term paper is normally issued by twenty sales finance companies who are regular borrowers, a high proportion being issued by a few large companies.[94]

The industry has many firms in it, but the bulk of the business was handled by a few companies (often referred to as the Prime Finance Companies).

> The sales finance industry is highly concentrated: ten companies have about 90% of the business covered by DBS statistics and the four largest companies have some 80%. Most of the other companies are quite small, operating either locally or within one province, with the majority having only one office.[95]

NOTES VERSUS THE COMMERCIAL BANKS

Until the end of the Second World War sales finance companies relied primarily on the banks for the short term accommodation they required to finance the fluctuations in their asset structure.

> ... the most significant feature in the financing of these companies in the post-war period was the rise in the sale of short-term notes to non-bank investors. Whereas there were no such sales in the early post-war

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[94] Report of the Royal Commission on Banking and Finance, (Ottawa: Queen's Printer, 1964) p. 211.

[95] Ibid., p. 202.

years, they became later a most important source of funds for the companies.[96]

As can be seen from Table XVI in 1945 the largest firms had no short-term notes outstanding. However, beginning in 1946 short-term notes became a steadily more important source of financing until by 1951 the short-term notes outstripped bank loans as a source of funds.

When a sales finance company experienced a sharp increase in the volume and size of its assets, the ratio of its short-term liabilities, consisting of bank loans and short-term notes, to its total liabilities increased. This occurred because initially the company had no assurance that the increase in its assets was permanent and in addition, there were unavoidable lags involved in planning and marketing a long term debt issue so that for a period, at least, short-term accommodation was required.[97] If the increase in assets was permanent then the company would finance these contracts by means of long term debt issues.

However, until long term financing was obtained, the largest companies had the problem of deciding whether to obtain short-term accommodation at the banks or whether to obtain short-

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[96]William C. Hood, Financing of Economic Activity in Canada (Ottawa: The Royal Commission on Canada's Economic Prospects, 1959), p. 191.

[97]Bruce MacLaury, The Canadian Money Market (Cambridge: Harvard University, 1961), p. 174.

TABLE XVI

OUTSTANDING BANK LOANS AND SHORT TERM NOTES OF SIX OF THE LARGEST INSTALMENT FINANCE COMPANIES IN CANADA

($ millions)

Year	Demand Bank Loans	Short-term Notes
1945	4.6	-
1946	29.9	3.0
1947	53.9	13.7
1948	49.3	13.6
1949	65.0	20.1
1950	92.3	53.6
1951	47.6	142.2
1952	170.6	187.0
1953	172.3	218.7
1954	92.8	157.9

Source: William C. Hood, Financing of Economic Activity in Canada (Ottawa: The Royal Commission on Canada's Economic Prospects, 1959), p. 158.

term funds in the money market where funds were usually much cheaper, or both. There has been substantial transfers from one type of borrowing to another. As can be seen from Table XVI the immediate post war era saw a great shift from bank borrowing to money market borrowing.

> No single factor serves to explain these fluctuations; rather, they are the combined result of (1) the development of a market for finance company paper; (2) restrictions on bank lending to finance companies; and (3) the differing functional role of bank loans and short-term notes in finance company operations.[98]

Most large firms relied on both banks and short-term notes for their short-term financing because of practical lending patterns,relative interest costs, and because of seasonal lending patterns. The amount of new money that could be raised in the money market was often determined by the size of the firm's outstanding bank loans in relation to its total line of credit at the banks. Unused bank lines of credit provided a measure of security for short-term creditors and so seldom would a major company borrow short-term in excess of its unused lines of bank credit as lenders on their part were reluctant to lend funds to sales finance companies under these circumstances. Thus, the finance company's ability to borrow at the commercial banks usually set a practical limit on the amount of money it could raise by means of its short-term notes.

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[98] Ibid., p. 175.

When interest costs in the money market were substantially lower than the banks' lending rates it was more profitable for sales finance companies, and others, to borrow in the money market. However, when money market rates tended to be either the same as or higher than bank borrowing costs, companies tended to place more reliance upon bank borrowings as a source of short-term finance.

Shifts between bank loans and short-term notes also reflected seasonal fluctuations in the money market. Lenders had a tendency to run off their finance company paper at year end for window dressing purposes to show more cash on their balance sheets.[99] As sales finance company notes declined, the finance companies turned more to the banks for funds and the proportion of bank loans to short-term notes rose at this time. Therefore, the larger finance companies would usually finance both by bank loans and by short-term notes during the course of a year.

ACCEPTANCE PAPER

"Acceptance Paper is the trade name for the promissory notes sold by companies engaged primarily in financing durable

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[99]Bruce MacLaury, The Canadian Money Market (Cambridge: Harvard University, 1961), p. 179.

consumer goods."[100] Often this paper was referred to as Finance Paper or if it was issued by the major firms it was often called Prime Finance Company Paper.

The companies did not all issue the same type of short-term notes in all details but there was a general pattern of standardization. Most notes usually were drawn in the name of the lender and were as such not bearer notes. Negotiations between lender and borrower were usually conducted through a money market dealer although an increasing number of finance companies dealt directly with the lenders. Dealers received commissions varying between 2 and 3 1/2 cents per $100 per month of term or .25 to .42 of one per cent per annum on the paper of the Prime Finance Companies.[101] Delivery of the notes was often on the following day although same day delivery could be usually arranged in Toronto or Montreal.

The notes were either issued at par or at a discount (see sample) and the denominations varied from firm to firm with the usual minimum amount being from $25,000 to $50,000.[102] The yields were in line with market rates and were changed from time to time to maintain this relationship although this was not always the case since sales finance company rates were affected

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[100] Wood, Gundy and Company Limited, Discount Paper in Canada (Toronto: October 1958), p. 7.

[101] Douglas H. Fullerton, The Bond Market in Canada (Toronto: The Carswell Company Limited, 1962), p. 180.

[102] Bruce MacLaury, The Canadian Money Market (Cambridge: Harvard University, 1961), p. 181.

TOTAL PRINCIPAL AND INTEREST AYABLE AT MATURITY

pf

INTEREST BEARING NOTE

PACIFIC FINANCE CORPORATION OF CANADA LTD. B 0851

Toronto, Ontario, ____________

____________ for value received, the undersigned promises to pay

order of ____________

rincipal

plus $ ____________ interest

PACIFIC FINANCE CORPORATION OF CANADA LTD.

____________ VICE PRESIDENT

____________ ASSISTANT SECRETARY

CANADA (4-66)

pf

DISCOUNT NOTE

PACIFIC FINANCE CORPORATION OF CANADA LTD. № 2951

Toronto, Ontario, ____________

____________ for value received, the undersigned promises to pay

order of ____________

____________ dollar

PACIFIC FINANCE CORPORATION OF CANADA LTD.

____________ VICE PRESIDENT

____________ ASSISTANT SECRETARY

ANADA (4-66)

by outside influences such as the demand for instalment credit and by the relative availability of bank accommodation. When the notes matured most companies were willing to roll over its notes at the new rate even if they did not need the money so as to keep the good will of their customers.

Acceptance paper has relatively no secondary market although this was compensated for by issuing notes of the exact term that the creditor desired. This tailor making of the term reduced the chances of the lender having to trade these notes before maturity. If unforeseen circumstances did compel a creditor to sell his notes the finance companies often repurchased them themselves before maturity although they were not required to do so. During periods of tight money,notes were often issued with call provisions in order to attract funds and to cater to the liquidity needs of the lender.[103]

The notes were usually secured by receivables deposited with a trustee of at least 112 per cent and often up to 133 per cent of the notes outstanding. In a number of cases, mainly firms that were subsidiaries of U.S. firms such as General Motors Acceptance Corporation, the only security was the general credit of the corporation although in most of these cases the notes were guaranteed by the U.S. parent company.

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[103]Bruce MacLaury, The Canadian Money Market (Cambridge: Harvard University, 1961), p. 183.

Finance company paper has become a major factor in the money market as can be seen from Table XVII. The short-term notes of sales finance companies more than doubled themselves between 1961 and 1964. However, in 1965, with the collapse of Atlantic Acceptance in June of that year and with the subsequent default of its paper, there has been a leveling off of the amount of short-term notes outstanding as lenders became more wary of the credit standing of finance companies. The last few years has been a period of consolidation and retrenchment by the sales finance companies as they have attempted to improve their credit position and we can expect that the growth in their short-term notes will resume in the near future.

Even in the post June 1965 period when lenders were reluctant to trust sales finance companies with their surplus cash the sales finance companies were still able to obtain substantial sums of money - mainly from the commercial banks. Normally, however, sales finance companies have been able to obtain a major portion of their financing requirements from the money market.

> Because the market now includes a large number of Canadian and American investors who are accustomed to using finance company paper as a short-term investment, the finance companies find it a reliable source of short-term funds. They may at times have to pay high rates and do a more strenuous selling job to attract lenders, but

only in rare instances has the market "dried up" for a particular company and even then not for more than a few days.[104]

[104]Report of the Royal Commission on Banking and Finance, (Ottawa: Queen's Printer, 1964), p. 213.

TABLE XVII

SHORT-TERM PAPER OUTSTANDING
SALES FINANCE AND CONSUMER LOAN
COMPANIES

($ millions)

End of	Total
1961	491
1962	635
1963	801
1964	1060
1965	842
1966	927
1967	912

Source: Bank of Canada Statistical Summary December 1967, p. 889 and October 1968, p. 748.

CHAPTER VIII

NON-FINANCIAL CORPORATIONS

Non-financial corporations (mainly industrial firms) have made use of the money market both as borrowers and as lenders.

> The rise in the cost of money since the end of World War II has put pressure upon corporate treasurers to reduce their cash requirements to a minimum. At the same time, it has offered new possibilities to earn an attractive return on excess cash.[105]

This short-term borrowing and lending activity on the part of many corporations has led to the development, in Canada, of commercial paper and of the Commercial Paper Market.

Commercial paper can be defined generally as the short-term promissory notes of non-financial corporations sold primarily to other non-financial corporations and the commercial paper market can be defined as the market dealing primarily in these instruments. An example of the mechanics of the market follows.

> White Co. advises its investment dealer that it has a temporary cash surplus of $1 million available for three weeks starting tomorrow. This money is needed to meet end of month accounts payable.

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[105] George Garvy, Deposit Velocity and its Significance (New York: Federal Reserve Bank of New York, 1959), p. 61.

The investment dealer looks into the situation. He then reports that three week Treasury Bills would yield 1.70%. None of the finance companies are willing to accept money for less than six months. However, Black Co., a prime industrial credit risk, is known to be looking for $1 million for three weeks and will offer a promissory note at 1.75%. The investment dealer recommends negotiating for the note. White Co. knowing Black Co.'s excellent credit standing, agrees, subject to Black providing it with "proof of legality" but suggests to the investment dealer that 2% should be the rate. The investment dealer contacts Black Co.

Black Co. advises that proof of legality can be provided. However, it says 2% is too high. The investment dealer suggests a compromise of 1.875% and gets Black's approval to offer these terms to White. He does and the offer is accepted.

As White Co. is a Vancouver firm and Black is a Montreal firm, delivery the next day is arranged by the investment dealer with branches in both cities. This involves making certain that Black's promissory note is not delivered to White until White's cheque has been collected by the investment dealer's branch in Vancouver.

Conversely, White Co. agrees to deliver the cheque to the investment dealer in Vancouver on the understanding that it won't be delivered to Black Co. until the promissory note is received by the investment dealer in his branch in Montreal.

Delivery is much easier when the two companies are in the same city. The dealer then collects the note from the borrower, delivers it directly to the lender who gives in exchange his cheque in favor of the borrower which is immediately sent back to the borrower.

Redemption of the note is handled in the same way.

The investment dealer, acting as a negotiating and delivering agent in the transaction, earns a fee of about 1/8 of 1% per annum, calculated to the period of the note, always paid in total by the borrower. This works out to roughly $100 per million per month. If the borrower's credit is marginal, or if he is new in the field, this fee could be higher until such a time as the borrower's credit standing is established.[105A]

THE COMMERCIAL PAPER MARKET

"The commercial paper market is one of the oldest of the short-term money markets in Canada."[106] Unfortunately, a general lack of statistics about the early history of the commercial paper market in Canada has hampered the analysis of its development. Sarpkaya[107] mentioned that two industrial firms began using the money market as a source of funds in the early 1940's while MacLaury said that, "...at least one Canadian firm began borrowing on its own unsecured notes as early as 1948."[108] At any rate, the commercial paper market began modestly during the 1940's and has expanded considerably since that time until by 1965 there were over 200 industrial firms issuing

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[105A]John P.S. Mackenzie, "Commercial Paper Market Grows But Not Without Some Pains," Canadian Business, Vol. 35, October 1962, p. 123.

[106]S. Sarpkaya, "The Commercial Paper Market in Canada," The Canadian Banker, Vol. 70, Winter 1963, p. 109.

[107]*Ibid.*, p. 109.

[108]Bruce MacLaury, The Canadian Money Market (Cambridge: Harvard University, 1961), p. 251.

commercial paper.[109] The number of industrial firms that have lent money on the commercial paper market must have been substantial, although there have been no precise figures or even estimates given to indicate the number. An examination of the records of one Winnipeg based company indicated that over 75 individual firms had lent money to the company at one time or another.

Statistics as to the size of the commercial paper market were lacking for the early years of its development as well. Statistics have been reported since the early 1960's by the Bank of Canada as can be seen from Table XVIII. However, the year end figures of commercial paper outstanding should not be taken as a reliable indication of the size of the money market in commercial paper as there has been a definite seasonal borrowing pattern as the figures for 1967 have indicated. The spring time was usually the time of year when commercial paper outstanding reached a peak, while the year end marked the low point as far as commercial paper outstanding was concerned. This fluctuation was mainly due to the combined effect of many lending companies

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[109] J.J. Dowsley and Hart Buck, "The Short-Term Money Market and Instruments," _The Canadian Banker_, Vol. 73, Autumn 1966, p. 84.

TABLE XVIII

SHORT-TERM PAPER OUTSTANDING
COMMERCIAL BORROWERS

($ millions)

End of		Amount
1961	December	231
1962	December	290
1963	December	241
1964	December	287
1965	December	166
1966	December	197
1967	January	239
	February	274
	March	344
	April	398
	May	352
	June	315
	July	338
	August	319
	September	302
	October	293
	November	290
	December	247

Source: Bank of Canada Statistical Summary
April 1968, p. 269 and
December 1967, p. 889.

liquidating their holdings of commercial paper shortly before their year end so as to show higher cash balances in their annual reports.[110] Thus, the amount of commercial paper has fluctuated widely and at least one estimate has said that commercial paper has reached as high as $550 million.[111] Whatever the actual figures have been, there can be no doubt that the commercial paper market has grown considerably since World War II.

> Whatever growth the commercial paper market has enjoyed can be explained simply - it has been profitable for both borrower and lender. Corporate borrowers which have gained access to the short-term market have found it possible to pare borrowing costs by an average of two percentage points in recent years. Lenders have been able to put funds to work at more attractive rates than those offered on treasury bills.[112]

We shall concentrate to some extent on corporations both as lenders and as borrowers in the commercial paper market,as one of the major characteristics of the money market in Manitoba was that most of the institutions participating in the money market did so primarily as either commercial paper borrowers or lenders.

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[110] S. Sarpkaya, "The Commercial Paper Market in Canada," The Canadian Banker, Vol. 70, Winter 1963, p. 110.

[111] Ibid., p. 110.

[112] John P.S. Mackenzie, "Commercial Paper Market Grows But Not Without Some Pains," Canadian Business, Vol. 35, October 1962, p. 122.

CORPORATE CASH FLOWS

The basis of whether a corporation was a commercial paper issuer or purchaser or both depended upon its cash flows and the policies relating thereto.

> While financial executives as a group feel it is impossible to formulate a set of financial management policies of universal applicability, one policy that seems to be unanimously accepted is that cash must be conserved. It is agreed that few businesses, even the wealthiest, have sufficient cash to do all the things they wish to do. Hence it is necessary to be constantly on the lookout for ways to reduce cash requirements and to economize in its use.[113]

The cash budget was generally regarded as the basic financial tool for managing the cash of a company. An intensive use of cash budgets assisted a manager in determining his corporation's minimum operating requirements and greatly assisted him in the management of surplus funds. The cash budget may have spanned a week, month, quarter or a year in time and a number of cash budgets covering different time periods may have been used simultaneously to achieve a greater degree of accuracy in the determination of the company's cash position. The budget outlined the dates on which expected major cash receipts and cash payments would occur. Since cash receipts and cash payments were seldom synchronized, the manager of the company's cash

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[113]Nesbitt, Thomson and Company Limited, Commercial Paper, (Toronto, November 28, 1963), p. 1.

could determine by means of a cash budget, approximately what funds his company needed for its operations and when the company would need them or, conversely, what temporarily excess funds the company had for investment and how long they would exist.

A company's cash flow was influenced by many factors.[114] Funds may be needed for inventory purchases, dividend payments or debt repayments. Some companies have preferred to have a healthy liquid position for contingency purposes, while other firms with seasonal cash flows sometimes have had to borrow or conversely invest in the money market.

Even the business cycle influenced a company's cash position substantially.

> In periods of expanding activity, business firms require additional working capital. Conversely, in periods of declining activity, business as a whole tends to experience excess liquidity and to accumulate cash balances in excess of current needs.[115]

There were many ways whereby a company could forecast and later influence its cash flow but this topic was beyond the scope of this paper so no further comment will be made. It is

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[114] See George Garvy, Deposit Velocity and its Significance (New York: Federal Reserve Bank of New York, 1959), p. 67 for a more detailed outline of corporate cash flows.

[115] Ibid., pp. 67-68.

important, though, to realize that it was often on the basis of the results as shown by a cash budget that a corporation determined its position as either an issuer of corporate paper or a lender of funds to other corporations or both. We have examined in more detail in the following sections non-financial corporations as borrowers in the commercial paper market and non-financial corporations as lenders in the commercial paper market.

NON-FINANCIAL CORPORATIONS AS BORROWERS

Commercial paper was the name given to the unsecured promissory notes issued by non-financial corporations.

> There is a basic difference between finance companies and industrial issuers of commercial paper. By the nature of their business of borrowing and lending money, finance companies usually have paper outstanding at all times and roll-over their notes at maturity. In this sense, commercial paper is a "permanent" source of finance. Industrial issuers, on the other hand, generally use the commercial-paper market to meet seasonal-borrowing needs ... In fact, the existence of such seasonal demands for funds is a common denominator among virtually all industrial issuers. Only those industrial firms whose seasonal borrowing needs are predictable enough for them to sacrifice the added flexibility of bank loans, and are large enough to make the savings over bank loans worthwhile, find it practical to resort to the open market.[116]

As mentioned previously, there were more than 200 companies issuing commercial paper in Canada,

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[116]Nevins D. Baxter, The Commercial Paper Market (Boston: The Bankers Publishing Company, 1966) pp. 32-33.

> ... including department and chain stores, grain companies, oil companies, brewing and distilling companies, textile companies - in short, any company of status whose cash requirements are affected by seasonal changes in accounts receivable, inventories, or cash movement generally.[117]

These firms have been attracted to the commercial paper market for a number of reasons. The main reason for issuing commercial paper was that it was a cheaper means of financing than bank borrowing. This has certainly been the case in Canada for since 1954 commercial paper rates have usually been below the banks' prime lending rates.[118] Secondly, and,

> closely allied to the cost advantage is the fact that open-market borrowing improves the competitive position of a business firm in the credit market. In bargaining with banks on rates and other loan terms, the firm can point out a convenient alternative. Moreover, the prestige that goes with open-market borrowing increases competition among banks for the borrower's account.[119]

A third advantage in using the commercial paper market as a source of funds was the fact that regular exposure to money market dealers and to institutional investors could open the door to the capital market in the future for the sale of equity and long-term debt issues. Money market dealers were often

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[117]J.J. Dowsley and Hart Buck, "The Short-Term Money Market and Instruments", The Canadian Banker, Vol. 73, Autumn 1966, p. 84.

[118]S. Sarpkaya, "The Commercial Paper Market in Canada", The Canadian Banker, Vol. 70, Winter 1963, p. 110.

[119]G. Walter Woodworth, The Money Market and Monetary Management (New York: Harper and Row, Inc., 1965), p. 110.

underwriters as well, so becoming well known to these dealers could often facilitate the future distribution of the corporation's long term securities.[120]

A fourth advantage expressed both in publications[121] and from personal interviews with corporation money market managers was that commercial paper borrowing was recognized as a desireable supplement to direct bank borrowing. When credit conditions were tight a corporation's bank, in order to reduce the demand on it for loan accommodation, has on occasion requested a firm to borrow via the commercial paper market. Thus the use of the commercial paper market often strengthened a corporation's borrowing position particularly, during periods of credit restraint.

OFFERING MEMORANDUM (See Appendix "A")

A company that wished to issue commercial paper often submitted what was known as an offering memorandum to all its prospective lenders. This document was prepared by the corporation usually with assistance from its money market dealer advisors who in turn distributed it to potential customers. Corporations usually relied on the money market dealers to market their short-

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[120] S. Sarpkaya, "The Commercial Paper Market in Canada", The Canadian Banker, Vol. 70, Winter 1963, p. 112.

[121] G. Walter Woodworth, The Money Market and Monetary Management (New York: Harper and Row, Inc., 1965), p. 111.

term notes because it reflected the fact that most companies were only borrowing in the market on a seasonal basis and it would be very difficult for a corporation itself to maintain constant contact with potential lenders. Dealers, on the other hand, were constantly placing short-term paper with lenders and they were thus in contact with the market at all times. For their services, dealers usually charged commissions of 1/8 of 1 per cent on the good quality paper which was payable by the borrowing corporation at the time of the sale of the note.[122] There were relatively few dealers in Canada who actively market commercial paper, "...of the 10 dealers active in the commercial paper market, three do the bulk of the business."[123]

The offering memorandum usually contained information concerning the company and the characteristics of its notes. Commercial paper could be issued in either the form of interest bearing notes, discount notes, or demand notes and they were usually issued in maturities of up to 365 days. The practical minimum amount of the notes was usually $100,000 but they have been issued in amounts as low as $10,000.[124]

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[122]Douglas H. Fullerton, The Bond Market in Canada (Toronto: The Carswell Company Limited, 1962), p. 181.

[123]S. Sarpkaya, "The Commercial Paper Market in Canada", The Canadian Banker, Vol. 70, Winter 1963, p. 111.

[124]Ibid., p. 109.

Often reference would be given in the offering memorandum about the fact that the company had a ceiling on the amount that it could borrow at any given time. This amount was usually the amount of unused bank lines of credit that the corporation had. This, as has been previously mentioned, provided a measure of security for the lender.

> Because the notes are in the main unsecured by specific assets, the growth of the commercial paper market has been largely on the basis that an adequate line of bank credit is available to the issuer. Many borrowers (undoubtedly at the insistence of the lenders) undertake to restrict their total borrowing to the limit of their lines of credit.[125]

The offering memorandum often contained a number of legal documents as well, confirming the fact that the company could legally issue short-term notes. Typical documents might have been: a copy of the company's borrowing resolution issued by the board of directors; a copy of an independent legal opinion confirming the fact that the company was a legal entity and that the notes were lawful obligations of the company; a copy of the signatures of the authorized signing officers of the company. These documents were useful to the lender for giving him a considerable amount of information about the legal status of the

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[125] J.J. Dowsley and Hart Buck, "The Short-Term Money Market and Instruments", The Canadian Banker, Vol. 73, Autumn 1966, p. 85.

company as well as providing him with a standardized form of information disclosure on the short-term notes of the many different borrowing corporations. The final opinion about the financial strength of the company, of course, would have to be made by the lender on the basis of the information contained in the offering memorandum as well as from data obtained from annual reports and credit agencies.

NON-FINANCIAL CORPORATIONS AS LENDERS

Many non-financial firms have considerable amounts of surplus funds which were invested in the money market so as to yield a return to the company and not remain idle. Although there was no set pattern, short-term investment portfolios usually contained a variety of money market securities including commercial paper.

> The decision to invest funds in commercial paper is affected by the characteristics of various substitute assets. Yield, default risk, marketability, and availability of the alternative instruments are compared with the corresponding aspects of commercial paper. The choice among these assets by an individual investor will depend on his willingness to sacrifice some liquidity and perhaps assume greater risk in exchange for a higher return.[126]

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[126] Nevins D. Baxter, The Commercial Paper Market (Boston: The Bankers Publishing Company, 1966) pp. 41-42.

INVESTMENT CHARACTERISTICS OF SECURITIES

The most important feature in considering a short-term investment was the security of the investor's principal.[127] Although the likelihood of default in the money market was very slim, we do recall the collapse of Atlantic Acceptance in 1965 so the safety factor cannot be entirely ignored. Most companies that have surplus funds have need for these funds at some time for their operating requirements. For this reason, the manager of a short-term portfolio had to keep in mind that his invested funds would one day be used in the company's operations and that he must, therefore, keep in mind that he cannot risk these funds unduly.

Every investment contained some degree of financial risk that is contained in the overall credit worthiness of the borrowing institution and the legality of its obligations. For practical purposes Government of Canada securities were entirely void of financial risk and all other securities were graded accordingly. Risk of commercial failure in the money market was very small but each investment was usually analyzed carefully by the lender.

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[127] Nesbitt, Thomson and Company Limited, Commercial Paper, (Toronto, November 28, 1963), p. 4.

Many companies regularly conducted an analysis of their short-term investments and prepared a written policy statement for use by the portfolio manager outlining what investments could be purchased, and for what amounts and for how long. Appendix "B" contains an example of such a policy statement as well as a list of approved short-term investments.

A second investment consideration was the liquidity of the investment.[128] Many firms required a need for marketability in their short-term portfolios arising from the possibility of requiring their funds unexpectedly.

> Some companies report a policy of formally defining surplus cash in terms of the different purposes for which forecasts indicate it is to be used and then select appropriate securities for each category.[129]

A primary reserve would provide funds for unforeseen payments on short notice and for unexpected variations in operating cash requirements. Securities in this classification would include investments possessing very high liquidity and marketability such as treasury bills and demand commercial paper.

A secondary reserve would include funds for which specific near-term cash needs were known such as dividend or debt payments.

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[128] Nesbitt, Thomson and Company Limited, Commercial Paper, (Toronto, November 28, 1963), p. 4.

[129] Ibid., p. 4.

In addition to the securities contained in the primary reserve, other investments coinciding with the forecast cash needs and offering higher yields could be used such as Provincial and Municipal notes as well as bank, finance company and commercial paper of fixed term.

A general reserve may be maintained consisting of cash surpluses kept for flexibility in the event that an attractive acquisition opportunity developed or for possible future capital expansion. The securities in this category would be less marketable but of good quality with longer maturities and more favourable yields such as longer term bonds of governments and corporations.

The usual portfolio, then was diversified to the extent that it was composed of different types of securities of differing maturities - that is, it was a "balanced portfolio."

From Table XIX can be seen the proportional composition of one company's short-term investment portfolio during 1966 and 1967. During 1966 the portfolio was fairly well balance with about 18 per cent of the portfolio in Government of Canada securities and about 30 per cent of the portfolio in Provincial and Municipal short-term securities. The remaining 52 per cent of the portfolio was composed of investments in commercial paper, bank paper and finance company paper. Over the year 1966,

TABLE XIX

SHORT-TERM INVESTMENT PORTFOLIO

(per cent)

End of		Government of Canada	Provincial and Municipal	Bank Paper	Commercial Paper	Prime Finance Paper
1966	January	24	23	8	32	13
	February	17	26	14	34	9
	March	17	33	25	21	4
	April	16	48	15	15	6
	May	13	28	12	44	3
	June	15	36	18	30	1
	July	14	45	6	35	-
	August	9	38	26	27	-
	September	11	32	22	30	5
	October	13	29	38	20	-
	November	20	24	28	24	4
	December	17	25	44	14	-
1967	January	18	32	31	19	-
	February	13	30	27	30	-
	March	9	36	33	22	-
	April	9	36	25	30	-
	May	9	36	33	22	-
	June	18	24	33	25	-
	July	18	21	19	42	-
	August	18	18	38	26	-
	September	24	22	42	12	-
	October	1	12	84	3	-
	November	1	7	89	3	-
	December	6	5	74	15	-

Source: A Canadian Corporation

commercial paper declined at the expense of bank paper. By year end no investments were made in Prime Finance Company paper.

During the first 9 months of 1967 the portfolio distribution was generally stable, with about 10 per cent in Government of Canada treasury bills and the remainder split evenly among Provincial, Bank and Corporation securities. However, in October coinciding with the commercial banks' aggressive push for more deposits by offering relatively high interest rates (see Chapter VI) the portfolio shifted markedly into bank paper with the proportion reaching as high as 89 per cent in November 1967. This was also the behaviour pattern of a great number of other non-financial corporations at that time and even since then, bank paper has played a major role in the portfolios of these companies.

A third consideration that a manager of a short-term portfolio often had to take into account upon making particular investments was yield.

> The degree of risk a corporation should take in searching for higher returns on its portfolio funds is really the major question facing the manager of a short-term investment portfolio. Concerned as he is with obtaining a satisfactory yield, he is engaged in a constant balancing of risk and return. His decisions must be guided by careful judgment as to the necessary mix of quality, liquidity, and safety.[130]

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[130] Morgan Guaranty Trust Company of New York, Money Market Investments, April 1964, p. 7.

As stated yields varied with the degree of risk involved and a delicate "balancing act" was required to obtain high yields but with a fair degree of safety. From Table XX one can see the yields that were obtained on the portfolio referred to in Table XIX during 1967.

The yield fluctuated between a low of 5.27 per cent in June to a high of 6.21 per cent in December. Comparison of Table XX with Chart 1 will indicate that the portfolio returned a yield approximately the same as that given on Prime Finance paper and bank deposit receipts. This, of course, was also born out by the fact that the composition of the portfolio during 1967 was increasingly in bank paper which was yielding such high rates during the later part of 1967.

The importance of this short-term portfolio cannot be overlooked as the interest income on this portfolio was in excess of $1,000,000 during both 1966 and 1967. A short-term portfolio, therefore, skillfully managed, can be of great assistance to the earnings position of a non-financial corporation during periods when the firm has surplus cash resources. It was for this reason that many cash flush corporations now maintain short-term investment portfolios.

TABLE XX

YIELD ON SHORT-TERM INVESTMENT
PORTFOLIO 1967

(per cent)

Month	Yield
January	6.17
February	6.01
March	5.53
April	5.66
May	5.36
June	5.27
July	5.42
August	5.44
September	5.57
October	5.96
November	6.19
December	6.21

Source: A Canadian Corporation

SECTION III

THE MONEY MARKET IN MANITOBA

CHAPTER IX

THE BACKGROUND

Manitoba, the central province of Canada, entered confederation in 1870, and by 1912 covered an area of 251,000 square miles the bulk of which consisted of timber lands and extensive mineralized rock formations with only 30,000 square miles of land in the Southern part of the province under cultivation.[131]

The province's economy has been primarily based upon agriculture and its related industries, although in recent years with the development of hydro-electric power, the mining and manufacturing industries have become of increasing importance.

The estimated population of Manitoba at April 1, 1968 was 969,000 of whom over 510,000 lived within the Metropolitan Winnipeg area.[132] Metropolitan Winnipeg's central geographic position within the province has been one factor accounting for the concentration of over 80 per cent of the province's manufacturing industry within the city's boundaries, as well as having developed the city into an important wholesale, distribution and financial center for the entire Prairie Region. An indication of

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[131]Province of Manitoba, Prospectus (New York: Drexel Harriman Ripley Incorporated, October 3, 1968) p. 4.

[132]Province of Manitoba, Prospectus (New York: Drexel Harriman Ripley Incorporated, October 3, 1968) p. 4.

Winnipeg's place as an active commercial and financial center can be seen from the fact that "in recent years cheque clearings through Winnipeg banks have ranked either third or fourth in volume among Canadian Cities."[133] This was largely due to the activities of the grain trade which was centralized in Winnipeg as well as the fact that Winnipeg was the headquarters for one of the largest mutual funds in Canada, one of the largest Canadian investment dealers as well as the headquarters for a number of large insurance companies. It was not surprising, then, that we found the facilities of the money market used by the major commercial and financial institutions located in Manitoba.

To obtain information regarding the money market operations of major Manitoba institutions, a number of questionnaires were prepared and sent to each of the major operators in the money market. Two different questionnaires were used, one *Commercial Paper as a Source of Funds* was sent to those companies that were primarily short-term borrowers; one entitled *Investing in the Money Market* was sent to those firms who were primarily engaged in lending temporary surplus funds. The questionnaires were based to a large extent on the questionnaires prepared by Nevins D. Baxter for compiling the data for his book *The Commercial Paper Market*.

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[133] *Ibid.*, p. 8.

TABLE XXI

MANITOBA VALUE OF PRODUCTION
PRINCIPAL SECTORS OF THE ECONOMY

($ millions)

	1963	1964	1965	est 1966	est 1967
Agriculture	379	430	465	491	479
Construction	403	421	415	485	577
Manufacturing	335	357	380	400	409
Mining	170	174	183	179	187
Electric Power	47	50	52	57	61
Forestry	20	23	25	25	24
Fisheries	7	6	7	7	5
Furs	5	5	7	5	5
Total	1367	1466	1534	1647	1746

Source: Province of Manitoba, Prospectus, p. 6.

Note - The total may not add due to rounding

Copies of the two questionnaires can be seen in Appendix "C". These questionnaires were followed up by one or more personal interviews with the various officers responsible for the money market activities of each firm. As a result of the questionnaires and interviews, information concerning the money market were obtained from eight major borrowing institutions and three lending institutions.

Although replies were not obtained from all the major money market participants (Federal Grain being the notable non-respondent), supplementary sources of public information were consulted to round out the completeness of the survey. As a result, the results gathered represented, by far, the majority of the money market activities carried on within the Province of Manitoba. Among the responding companies there were a number of requests for anonymity and we have, therefore, tabulated our results in such a way as to respect the wishes of the companies involved.

THE GRAIN COMPANIES

Of the large number of grain companies, both public and private, with their financial operations concentrated within Manitoba, only four of the larger companies have made any extensive use of the money market as a source of funds. These companies are:

United Grain Growers
McCabe Grain (now National Grain)[134]
Pioneer Grain[135]
Federal Grain[136]

The grain companies have concentrated their activities in the business of operating country and terminal grain elevators as intermediaries in the handling of grain between the producer and The Canadian Wheat Board. For example, United Grain Growers on July 31, 1967 owned and operated 767 grain elevators in the four western provinces with a total capacity of 59.7 million bushels as well as terminal elevators in both Vancouver and Port Arthur with an additional capacity of 9.75 million bushels.[137] As an agent of The Canadian Wheat Board, the company purchased wheat, oats and barley from the producers which grain was carried by the company at fixed commission rates until final delivery was made to the Board at the terminal elevators.[138]

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[134]McCabe Grain and National Grain merged in September 1968.

[135]Pioneer Grain was a private company owned by James Richardson and Sons Limited. The other companies have widespread public ownership.

[136]Federal Grain when approached was reluctant to participate in our survey.

[137]United Grain Growers Limited, Annual Report, July 31, 1967, p. 12.

[138]According to United Grain Growers the handling margin per bushel during 1967 was 4 1/2 cents for wheat and barley and 3 1/2 cents for oats, the storage allowance was 1/30 of 1 cent per bushel per day plus interest at the current bank rate at the average per bushel cost of such grain from time of purchase until delivery to the Board.

TABLE XXII

MANITOBA'S RESPONDING MONEY MARKET PARTICIPANTS

Borrowers	Lenders
United Grain Growers	Investors Group
Pioneer Grain	Monarch Life
National Grain	Great West Life
Manitoba Hydro	
Manitoba Telephones	
Beaver Lumber	
Metropolitan Corporation of Greater Winnipeg	
Province of Manitoba*	

* The Province of Manitoba also lends money on occasion

It was during the time period that elapsed between purchase and final delivery that the grain companies needed large amounts of short-term working capital. The grain companies were required to pay the producer upon delivery of the grain at the country elevator and they also had to pay for the handling and storage charges until the grain was finally delivered to The Canadian Wheat Board at the terminal elevators. The Board did not reimburse the grain companies until delivery of the grain was made. Therefore, although ultimately the grain companies were reimbursed, they had to finance the movement of grain to the terminal elevators themselves. This required large amounts of working capital which could be obtained from the banking system or from the money market.

The smaller grain companies have generally made use of bank accommodation exclusively for working capital requirements because they were not well known enough to have a satisfactory market established for short-term notes. On the other hand, the larger grain companies have been able to rely on both the commercial banks and the money market for their short-term finance requirements. Statistics published by the Bank of Canada indicated that bank loans to grain dealers have been very substantial, particularly during 1968, however, statistics as to the amount of "grain paper"[139] outstanding were lacking so we have had to make

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[139]The short-term notes of the grain companies were commonly referred to in the money market as grain paper.

our own estimates of the extent to which grain companies and others have made use of the facilities of the money market to raise short-term capital. These estimates have been tabulated in the concluding chapter of this paper.

OTHER INDUSTRIAL BORROWERS

Two of Manitoba's crown corporations, namely the Manitoba Telephone System and the Manitoba Hydro-Electric Board (referred to hereafter as Manitoba Hydro) have made fairly extensive use of the money market as a source of short-term funds.

The Manitoba Telephone System began its operations over 60 years ago in 1908 and since that time it has grown and developed into a large company with assets of over $206 million[140] offering a complete range of communication services.

Manitoba Hydro has been the major supplier of electric power in the province. The company had total assets of over $590 million[141] in 1968 and provided service to over 226,000 consumers.[142] These customers used over 5 billion kilowatts of power.[143]

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[140] Manitoba Telephone System, Annual Report 1967-68, March 31, 1968, p. 8.

[141] The Manitoba Hydro-Electric Board, Annual Report, March 31, 1968, p. 12.

[142] Ibid., p. 4.

[143] Ibid., p. 4.

TABLE XXIII

CHARTERED BANKS-LOANS TO
GRAIN DEALERS

($ millions)

Average of Wednesdays	1966	1967	1968
January	261	325	575
February	248	531	596
March	326	571	596
April	416	549	785
May	406	492	869
June	374	423	833
July	369	440	824
August	346	461	816
September	333	481	801
October	348	549	789
November	329	581	812
December	279	551	823

Source: Bank of Canada Statistical Summary
April 1968, p. 245. and
January 1969, p. 8.

Both of these companies have experienced seasonal fluctuations in their operating cash flows, and because temporary shortfalls of cash have been encountered from time to time, these companies have borrowed short-term funds from the money market. If they had excess cash they were required to lend this money to the government of Manitoba or to its various crown corporations and agencies.

The Beaver Lumber Company with head office in Winnipeg has been an active borrower in the money market although currently its activities have been minimal. The company which was originally formed in 1906 operated in 1967 a retail lumber and supply business throughout Western Canada and Ontario. The company had assets of over $32 million at December 31, 1967 and a net income of over $2 million for the year 1967.[144]

The Metropolitan Corporation of Greater Winnipeg (referred to hereafter as Metro) was an administrative organization to administer various facilities (such as the transit system) within the Greater Winnipeg area. It has experienced a regular seasonal cash flow pattern and as such has made use of the money market to meet part of its operating cash requirements. Although Metro was really a municipal organization, we have included the tabulation of its money market operations along with those of the other commercial paper borrowers because many of its activities were similar.

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[144] Financial Post Corporation Service, Beaver Lumber, pp. 1 and 4.

CHAPTER X

MONEY MARKET BORROWING OPERATIONS

There were a variety of reasons given by the major money market borrowers in Manitoba for their use of the money market as a source of funds. However, two main reasons predominated in their replies and these were that commercial paper was used as a lower costing substitute for bank borrowing and that commercial paper, when used, was used mainly to meet well defined seasonal demands for funds.

All of the responding companies indicated that commercial paper was used by their firms on a seasonal basis as can be seen from Table XXIV. It was interesting to note that the spring time was the relatively low borrowing period for all the firms. Table XVIII in Chapter VIII indicated that for Canada as a whole, commercial paper outstanding reached a peak in the spring time and declined during summer, fall and early winter. Manitoba, on the other hand, had its peak borrowing periods occurring during the summer, fall and early winter which was directly opposite to the national trend. Of interest was also the fact that neither of the three responding grain companies had similar cash flow patterns. United Grain Growers' peak commercial paper borrowing period (and, therefore, the period of its lowest operating cash inflows) was in winter. National Grain's peak

TABLE XXIV

THE SEASON WHEN COMMERCIAL PAPER OUTSTANDING WAS AT A PEAK

Company	Spring	Summer	Fall	Winter
Metro[145]		x	x	
Manitoba Hydro		x	x	
Manitoba Telephones			x	x
United Grain Growers				x
National Grain			x	
Pioneer Grain		x		
Beaver Lumber		x	x	

Source: Money Market Questionnaire, Commercial Paper as a Source of Funds, Question 7.

[145]Metro's questionnaire indicated that they did not necessarily have their short-term money market borrowings peak during the summer and fall, but this was normal. To quote:

"This may vary due to progress of Capital Programs. Notes to finance current operating costs usually peak during summer and fall, since our first income from Municipal levies is not received until June 30, at which time 50 per cent is received; 25 per cent by September 30 and 25 per cent by December 21. Capital financing generally peaks in fall or early winter following construction in the spring and summer months and is usually funded in fall and winter."

borrowing period was in the fall and Pioneer Grain's was during the summer. We found this differing pattern of seasonal borrowing behaviour to be unusual particularly in an industry that was seasonally affected by fall harvests. We found no reasonable explanation for this behaviour other than to say that some cash flow distortions may have arisen from the grain companies activities in areas outside the grain shipping and storage business. United Grain Growers, for example, had substantial interests in the fertilizer, feed and printing industries and these may have been significant enough to alter the overall cash flow patterns of the company's grain operations.[146]

Of the various commercial paper notes issued by the major money market borrowing firms in Manitoba, we found that the grain companies sold only interest bearing notes while the other commercial paper issuers sold either interest bearing or discount notes depending upon the wishes of the lender. All of the responding companies have sold their notes through a number of the money market dealers while only Metro and Manitoba Hydro have on occasion placed their paper directly with the lender.

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[146] United Grain Growers owned the "Canwest Brand" of fertilizer as well as a number of subsidiary companies including United Livestock Feeds Limited (a B.C. feed company) and the Public Press Limited, publisher of the *Country Guide*.

The dealers have usually charged commissions of 1/4 of 1 per cent for selling the paper of the smaller grain companies due to the relative difficulty in finding lenders, while only charging 1/8 of 1 per cent for marketing the commercial paper of the larger grain and industrial firms.[147]

The responding companies indicated that generally speaking they were very alert when shopping for short-term funds by watching interest rates and other market trends and almost all of the responding companies reviewed the performance of their money market dealers in obtaining funds for them at reasonable cost and some of the respondents indicated that they would shift from dealer to dealer quite readily if they felt that the dealers were not on their toes and competitive.

Each of the responding companies indicated that they were limited as to the extent to which they could use commercial paper as a source of funds. In the case of the Crown Corporations and Metro the maximum limit on commercial paper borrowing was set by statute. For the remaining commercial paper borrowers, the maximum borrowing limits were established by the respective corporation's by-laws and these by-laws were usually related to the corporation's bank lines of credit. Table XXVI has summarized these borrowing limits for 1968.

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[147] S. Sarpkaya, "The Commercial Paper Market in Canada", The Canadian Banker, Vol. 70, Winter 1963, p. 111.

TABLE XXV

CHARACTERISTICS OF THE
SHORT-TERM NOTES

Company	Interest Bearing	Discounted	Sold By Dealers	Sold Directly
Metro	x	x	x	x
Manitoba Hydro	x	x	x	x
Manitoba Telephones	x	x	x	
United Grain Growers	x		x	
National Grain	x		x	
Pioneer Grain	x		x	
Beaver Lumber	x	x	x	

Source: Money Market Questionnaire, *Commercial Paper as a Source of Funds*, Questions 3 and 4.

TABLE XXVI

LIMITS ON COMMERCIAL PAPER BORROWING 1968

Company	Limits
Metro	$10 million for operating expenses $15 million for capital expenditures
Manitoba Hydro	$50 million
Manitoba Telephones	$10 million
United Grain Growers	$15 million for 183 days
National Grain	Related to an unstated per cent of its unused bank lines of credit
Pioneer Grain	100 per cent of its unused bank lines of credit
Beaver Lumber	50 per cent of its unused bank lines of credit

Source: Money Market Questionnaire, Commercial Paper as a Source of Funds, Question 8.
By-Law No. 1263 of Metro.
The Manitoba Telephone Act, Section 19.
The Manitoba Hydro Act, Section 31.

All of the responding companies indicated that behind their commercial paper borrowings they maintained in practice, ample unused bank lines of credit. The majority of the companies maintained unused bank lines of credit equal to 100 per cent or more of their outstanding short-term notes as can be seen from Table XXVII.

The reasons given for the extensive use of unused bank lines of credit relative to commercial paper outstanding have been tabulated on Table XXVIII. All the firms indicated that the money market was an unreliable source of funds and that having bank credit available covered the eventuality of not being able to borrow from the money market all the funds that they needed. It was interesting to note that two firms kept substantial bank lines of credit in order to maintain favourable relationships with their banks. Banks, of course, wanted the loan business of their large customers, and even though unused bank lines of credit represented a contingent liability they also meant potential business for the banks. The banks would rather have some business than none at all from their large customers so they have often preferred to extend to their potential large borrowing customers lines of credit which often go unused for considerable lengths of time.

Most of the responding companies revealed that during periods of monetary restraint their commercial paper borrowings fell relative to bank loans. In other words, when credit conditions became

TABLE XXVII

UNUSED BANK LINES OF CREDIT
TO COMMERCIAL PAPER OUTSTANDING

Company	100 per cent or more
Metro	x
Manitoba Hydro	x
Manitoba Telephones	no reply
United Grain Growers	x
National Grain	x
Pioneer Grain	x
Beaver Lumber	x

Source: Money Market Questionnaire, Commercial Paper as a Source of Funds, Question 14.

TABLE XXVIII

REASONS FOR DETERMINING
THE EXTENT OF UNUSED BANK LINES
OF CREDIT RELATIVE TO COMMERCIAL
PAPER OUTSTANDING

Company	To maintain favourable bank relations	Commercial paper is an unreliable source of funds
Metro		x
Manitoba Hydro		x
Manitoba Telephones	x	x
United Grain Growers		x
National Grain		x
Pioneer Grain		x
Beaver Lumber	x	x

Source: Money Market Questionnaire, Commercial Paper as a Source of Funds, Question 15.

restricted the banks became more important as sources of needed financing and less reliance was placed upon borrowings in the money market. The reasons given for this increased reliance on bank loans varied as can be seen from Table XXIX.

During the periods of monetary restraint most of the firms indicated that they could not obtain all the funds they needed from money market sources. Only Manitoba Hydro said that they were able to obtain all the funds that they might need from the money market during periods of monetary restraint. However, although they were able to borrow the required funds, they did not necessarily borrow exclusively from the money market during periods of credit restraint, as their statement in Table XXIX indicated. This fact that the money market dried up as a source of funds for most companies reinforced their belief that the money market was an unreliable source of funds, necessitating having ample bank credit available at all times.

On the other hand, all of the responding firms said that they could obtain all the funds they needed from the commercial banks during periods of monetary restraint. It was of interest, though, to find that at least two firms were requested by their banks to borrow via the money market during periods of monetary restraint no doubt to ease the demand for short-term funds on the banks so as to enable the banks to satisfy more of the demands of their valued customers that did not have access to the money market.

TABLE XXIX

REASONS FOR LESSENED USE OF
MONEY MARKET BORROWINGS DURING
MONETARY RESTRAINT

Company	Higher money market borrowings would strain our bank relations	The demand for our paper is not strong enough	Other
Metro			1
Manitoba Hydro			2
Manitoba Telephone	no reply		
United Grain Growers	x		
National Grain		x	
Pioneer Grain	x		
Beaver Lumber	x		

1 - "Frequently the Street Supply is insufficient and we resort to banks at the higher cost. We have had up to 100 per cent on the Street, but this is unusual."

2 - "Since we have a prime bank rate, it is usually advantageous to borrow from the bank at times of monetary restraint."

Source: Money Market Questionnaire, Commercial Paper as a Source of Funds, Question 11.

TABLE XXX

ARE FIRMS ABLE TO OBTAIN ALL THEIR REQUIREMENTS FROM THE BANKS DURING PERIODS OF CREDIT RESTRAINT?

Company	Yes	Yes, but only to our open credit lines	Yes, but asked to borrow first in the money market
Metro	x	x	
Manitoba Hydro		x	x
Manitoba Telephones		x	
United Grain Growers			x
National Grain	x		
Pioneer Grain		x	
Beaver Lumber	x		

Source: Money Market Questionnaire, Commercial Paper as a Source of Funds, Question 16.

INTEREST RATES

We found that in Manitoba there was a distinct structure of relative interest rates between the various money market borrowers. The differing interest rates that the various companies had to pay indicated the relative credit worthiness of the companies in the eyes of the lending institutions. Metro and Manitoba Hydro had interest costs generally below the grain companies and the other commercial paper issuers in Manitoba. Most of the grain companies as well as Beaver Lumber paid the same interest rate on their money market borrowings and these rates roughly corresponded to the rates paid by Prime Sales Finance Companies for short-term funds. We were surprised, however, to find that the Manitoba Telephone System sometimes had to pay higher interest rates than most of the other borrowing companies. The fact that Manitoba Telephones have only borrowed in the money market since 1966 (and then only intermittantly) may mean that as yet no substantial market has been developed for its notes, and until the company has become more familiar with investors, they can be expected to have to pay a premium rate of interest in order to have their notes sold. We would expect, therefore, that in the future that Manitoba Telephones' interest costs can be expected to fall relative to the interest costs experienced by other Manitoba money market borrowers.

Pioneer Grain, we found, generally paid the highest costs for its short-term borrowings of all the major borrowers in the province. This was probably due to the fact that it was a private company and as such did not make public much information about its financial position. Investors have, then, been somewhat wary of the company and in order to compensate for this attitude, Pioneer Grain has had to offer relatively higher interest rates for its short-term notes in order to attract sufficient funds for its operations.

The spread between the company's borrowing rates from the commercial banks and the money market borrowing rates had a great deal to do in determining the extent to which the various companies borrowed via commercial paper.

When the cost of bank borrowing and money market borrowings (including brokerage) were about the same, only two of the responding companies indicated that they would still continue to issue commercial paper. These companies indicated that a supplementary source of finance to bank loans was desirable and they, therefore, needed to keep a nationwide set of lending contacts at all times. In order not to lose these sources of funds, they would market commercial paper to them (at a reduced level of course) even when bank accommodation was available at the same cost. The majority of the responding firms indicated, though, that when money market and bank costs were the same they preferred to suspend their money market operations and rely on more flexible bank loans for their short-term financing requirements.

However, when the rates on commercial paper fell relative to the banks lending rates, six out of the seven responding companies indicated that they would increase their money market borrowings relative to bank borrowings. Only Manitoba Telephones indicated that its money market borrowings were not sensitive to the interest spread between bank loans and commercial paper.

The pattern of relative interest costs between the money market and the banks as experienced by Metro during the 1965-1967 period have been graphed on Chart 2. The main characteristic of this chart was that it indicated that the spread between the two interest rates has tended to narrow in recent years. As a result there have been occasions when Metro has not borrowed in the money market at all (December, 1967 and the early months of 1968). Metro was able to borrow usually at rates 1/2 of 1 per cent lower on the street but when the spread narrowed to less than that, Metro turned to bank accommodation for more of their funds, although they did from time to time in early 1968 issue commercial paper to maintain a market for it even though bank borrowing was not more expensive.

TABLE XXXI

RELATIVE INTEREST COSTS
MANITOBA MONEY MARKET BORROWERS

Company	Interest rate costs in relation to the rates paid by Prime Finance companies for short-term funds.
Pioneer Grain	Above
Manitoba Telephones	Same as or above
National Grain	Same as
United Grain Growers	Same as
Federal Grain	Same as
Beaver Lumber	Same as
Manitoba Hydro	Same as or below
Metro	Below

Source: Money Market Questionnaire, Commercial Paper as a Source of Funds, Question 6, and Wood Gundy Securities Limited.

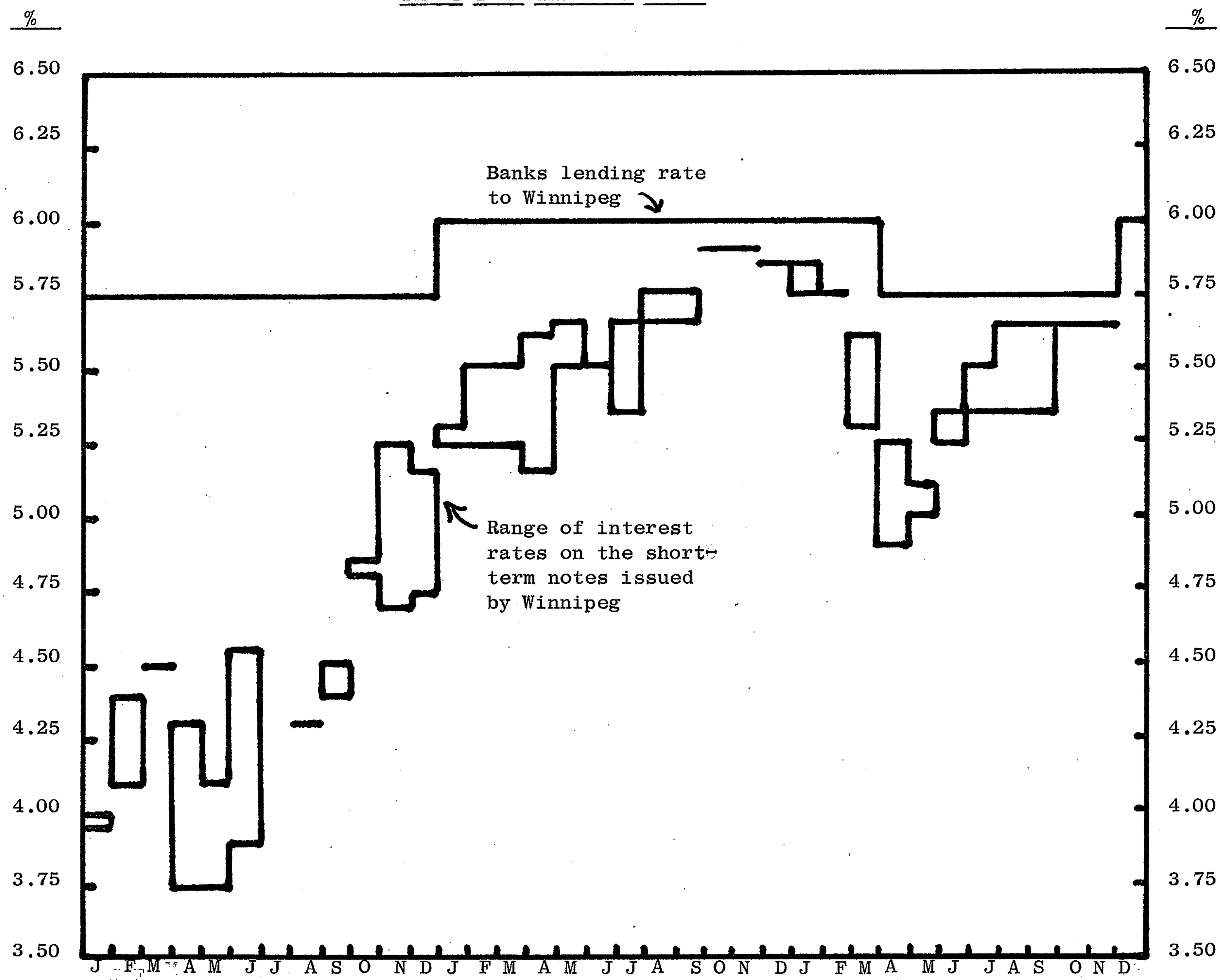
TABLE XXXII

IF BANK AND MONEY MARKET COSTS WERE THE SAME WOULD YOU STILL ISSUE COMMERCIAL PAPER?

Company	Yes	No
Metro	x	
Manitoba Hydro		x
Manitoba Telephones		x
United Grain Growers	x	
National Grain		x
Pioneer Grain		x
Beaver Lumber		x

Source: Money Market Questionnaire, _Commercial Paper as a Source of Funds_, Question 13.

METROPOLITAN CORPORATION OF WINNIPEG
SHORT-TERM INTEREST RATES



Beaver Lumber indicated that they no longer made regular or extensive use of the money market as a source of funds because the cost of bank accommodation for them has been about the same as their money market borrowing costs. They said that if the spread between rates narrowed to 1/8 of 1 per cent (their dealers commission rate) then they would borrow exclusively from the commercial banks. Other companies reported that they had experienced a similar narrowing of the spread between their money market borrowing costs and their banks' lending rates and the net result has been that in recent years (at least since 1966) less and less use of the money market has been made by many firms in Manitoba. This trend can be seen from the amounts of commercial paper that has been outstanding since 1958 by a number of Manitoba's money market borrowing firms as shown in Table XXXIII.

These have been the main characteristics of Manitoba's commercial paper borrowers. We turn now to the provincial government.

THE PROVINCE OF MANITOBA

> Large volume provincial short-term borrowing started in Canada in 1957, a time when interest rates appeared extremely high after a period of relatively stable low rates and when the supply of credit in the chartered banks was strained more than it had been for many years.[148]

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[148] Alex Kenner, "Short-Term Provincial Borrowing," The Canadian Banker, Vol. 69, Winter 1962, p. 59.

TABLE XXXIII

COMMERCIAL PAPER OUTSTANDING

($ thousands)

Year	Federal Grain	National Grain	United Grain Growers	Beaver Lumber	Manitoba Hydro
1958			12,000	1,300	
1959			15,000	200	
1960	8,700		13,000	1,600	
1961	14,500		12,000	1,100	
1962	8,750	305	13,138	--	
1963	14,675	2,055	14,500	--	
1964	13,900	3,305	11,800	--	9,000
1965	11,740	2,340	12,000	--	2,500
1966	2,420	300	5,500	--	9,100
1967	2,900	1,506	2,500	450	--

Source: Money Market Questionnaire, Commercial Paper as a Source of Funds, Questions 18 and 19, and the Financial Post Corporation Service.

Note: The dates of the data are as follows :

Federal Grain - July 31
National Grain - July 31
United Grain Growers - a representative month
Beaver Lumber - December 31
Manitoba Hydro - March 31

Between 1957 and 1962 all of the provinces of Canada except Ontario and Newfoundland raised approximately $264 million by means of short-term bond issues with maturities of from one to three years. As can be seen from Table XXXIV Manitoba was a fairly active borrower at that time, having raised $37 million from the money market.

There were a number of short-term provincial issues prior to 1957 but it was not until 1957 that extensive use was made of the money market as a source of funds.[149] The aim of the provinces in borrowing short-term funds at that time was to postpone long-term financing since interest rates looked too high and thus they would save on interest costs. However, the experience of the various provinces in saving interest costs by short-term financing was varied. Manitoba was quite successful in saving interest on its funding operations while Quebec was unsuccessful.

> It appears that almost no province borrowed with the idea that it would repay the loan at its maturity but expected either to borrow short-term again, or to do long-term financing. The first heavy maturities were in 1959 when Quebec had $43 million come due. At that time long-term yields had risen to 5.75 per cent from five per cent in 1957 and 1958. Quebec's initial experience in using the short-term market as a postponing action was, therefore, poor and it induced the province to do most of its re-financing in 1959 in the long-term market.

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[149]Manitoba created some small special short-term issues in 1955 according to Alex Kenner, "Short-Term Provincial Borrowing," The Canadian Banker, Vol. 69, Winter 1962, p. 62.

TABLE XXXIV

PROVINCIAL SHORT-TERM BORROWING
1957 - 1962

($ million)

Province	'57	'58	'59	'60	'61	'62	Total	Average size of each issue
Alberta				10	10	10	30	10.0
British Columbia	3		2	10		10	25	6.2
Manitoba	2		11	24			37	1.7
New Brunswick			7	6			8	4.0
Nova Scotia		5	22	9			40	2.2
Prince Edward Island			2	2			4	2.0
Quebec	15	55		10			80	9.0
Saskatchewan	15			16	9		40	2.0
Total	35	60	44	97	19	20	264	

Source: Alex Kenner, "Short-Term Provincial Borrowing," The Canadian Banker, Vol. 69, Winter 1962, Pp. 59 and 61.

Note: Totals may not add due to refunding of some issues.

Other provinces, which were not faced with such heavy refundings at a period of high rates, took a longer view and borrowed long if rates were lower on maturity when the issue was originally sold, or if rates were higher, borrowed short again. By astuteness and by some measure of providence, Manitoba managed to save about two million dollars in interest by borrowing short and waiting for long-term rates to fall.[150]

As Table XXXIV indicated provincial short-term borrowings tended to rise until 1960 and then borrowings fell off sharply. The reason for this decline in short-term borrowing was the federal government's budget of December 20, 1960 which made bond issues of non-tax paying bodies (such as the provincial governments) taxable if the discount offered on the bonds was more than one-third of the coupon (that is, a three per cent coupon bond could not be sold to yield more than four per cent to the investor). As it appeared in Hansard:

> ... that where the contractual rate of interest on any bond, debenture, or similar evidence of indebtedness, issued by a tax-exempt borrower, is less than 5 per cent, and where the bond or debenture is issued at a discount which provides an effective yield to maturity or to the earliest call date that exceeds the contractual rate by more than one-third, the whole discount shall be deemed to be income in the hand of the first Canadian resident taxable holder of the instrument.[151]

Kenner commented that:

> Prior to this change, a province could offer a two per cent bond to yield four per cent and the after-tax yield

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[150] Ibid., Pp. 60-61.

[151] Canada, House of Commons Debates, Vol. 1, 1960-61, (Ottawa: The Queen's Printer, 1961) December 20, 1960, p. 1011.

would be three per cent, equivalent to a six per cent bond at par. The low coupon big discount bonds afforded the corporate investor (the principal purchaser of short-term provincial bonds) an investment unmatched in after-tax yield by anything else in the market and also kept the provinces' short-term borrowing costs at the same, or at a lower level than those of the government of Canada. The Receiver General was the only loser and on December 20, 1960 the loophole was closed. Henceforth, with the increased cost of short new borrowing and with the existence of many outstanding low coupon Canada bonds selling at relatively high equivalent yields (after-tax yields converted to an equivalent yield of a bond selling at par), the provinces could not show the same large savings in borrowing short.[152]

As mentioned, due to the rule changes, since 1960 provincial short-term bond borrowings have declined to relatively small amounts and they now play a minor role in provincial financing. In addition to the budget rule changes which increased the relative costs of provincial short-term bond borrowings the high volume of federal government short-term borrowings has kept short-term rates high in comparison with long-term rates and this has reduced the profitability of short-term borrowings *vis-a-vis* long-term borrowing.[153]

With the decline of short-term bonds as a source of funds both Manitoba and Saskatchewan since 1962, through issues of provincial treasury bills,have continued to make use of the cheaper borrowings in the money market as a steady source of funds.

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[152]Alex Kenner, "Short-Term Provincial Borrowing," *The Canadian Banker*, Vol. 69, Winter 1962, Pp. 62-63.

[153]*Ibid.*, p. 64.

Since 1962 the province of Manitoba has had outstanding \$14 million in 91 day treasury bills which have been constantly rolled over and have thus become a permanent source of finance for the province. One million dollars worth of treasury bills were issued every week for 12 weeks and on the 13th week two million dollars worth were issued, for a total of \$14 million.

Manitoba's treasury bills were first offered to the public through a fiscal agent. Two money market dealers alternated as fiscal agent every four weeks. This practice ended about the middle of 1967 when the treasury bills were offered by public tender, through money market dealers only, with the successful bidder obtaining the whole issue. The fiscal agents did, however, develop a good market for the province's treasury bills and the province has experienced little trouble in marketing its bills - in fact, from time to time, there has been an excess of demand.

Under the public tender system the money market dealers submitted their bids by telephone to the government by 11 A.M. each Monday and the bills were issued and delivered each Wednesday in 25, 100, 500, or 1000 thousand dollar lots to the successful dealer at the main branches of the Royal Bank in any major city across Canada as requested by the dealer. If the demand for the treasury bills was temporarily weak, the provincial government would reject all bids and would purchase its own treasury bills to sell them at a later date to the public when demand improved.

In addition to the $14 million of 91 day treasury bills, the province has issued, from time to time, special treasury bills of varying size and maturity to meet its well defined seasonal demands for operating capital. This short-term paper was issued largely in the fall and winter (particularly in November). Although, these borrowings have been very substantial, the amounts raised by this means have not been tabulated or published by any official source. This has been largely due to confusion over the term treasury bill. Every month the provincial government has furnished the Dominion Bureau of Statistics with the figures for the total amount of treasury bills issued for that month. However, these figures have not given an accurate indication of the amount of money raised by the provincial government from the public because the government has continually bought a substantial amount of its own treasury bills, and these bills were then not sources of new short-term capital for the government.

For example, the Prospectus, issued in October 1968, reported that there were $98,218,000 in treasury bills outstanding as of March 31, 1968.[154] However, the same Prospectus in another section reported that of this amount, $37,207,000 was held by the province on its own account.[155] Thus, there was really only $61,011,000 of short-term money raised from public sources at that time, not $98 million, the figure reported to the Dominion Bureau of Statistics.

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[154]Province of Manitoba, Prospectus (New York: Drexel Harriman Ripley Incorporated, October 3, 1968) p. 9.

[155]*Ibid*., p. 10.

Unfortunately, no one has tabulated just what the amount of treasury bills sold to the public has been over the years (and a spokesman for the provincial government said that it would be a difficult and time consuming task) so it has been virtually impossible to gather any concrete ideas as to what extent the province of Manitoba has raised short-term funds by special issues of treasury bills. If the figures that appeared in the Prospectus were typical, one could say that the provincial government has made rather fairly extensive use of treasury bills as a source of finance to meet seasonal fluctuations in its cash flow.

The interest costs on Manitoba's 91 day treasury bills have been tabulated on Table XXXV.

Manitoba's treasury bills have varied from .44 of one per cent to 1.68 per cent above government of Canada treasury bills during 1966 and 1967. The yield spread has tended to widen over the last two years but this may have been due to the relative insensitivity of Manitoba's treasury bills to changes in money market rates of interest. While the government of Canada's 91 day treasury bills reflected very closely changes in the level of short-term interest rates, a close examination of Table XXXIV shows that very often there was little or no change in Manitoba's 91 day treasury bill yield from month to month. Over a longer period of time, however, Manitoba's treasury bill yield has moved in sympathy with government of Canada treasury bill yields.

As has already been indicated, Manitoba's interest savings from short-term borrowings have been substantial enough to warrant the time and effort involved in operating regularly in Canada's money market. In fact, in the future, the province has indicated that its interest savings will be even more substantial when changes to existing legislation will offer the provincial government greater flexibility in its money market dealings.

TABLE XXXV

TREASURY BILL YIELDS

(per cent)

Date	Province of Manitoba 91 day bills	Government of Canada 91 day bills	Yield Spread	Day-to-Day Loans Closing Rates
1965				
December 31	5.50	4.54	.96	3.00
1966				
January 28	5.40	4.64	.76	3.50
February 25	5.40	4.70	.70	3.75
April 1	5.68	5.11	.57	5.25
April 29	5.68	5.09	.59	4.50
May 27	5.56	5.12	.44	5.125
June 30	5.56	5.01	.55	4.50
July 29	5.68	5.02	.66	4.75
September 2	5.80	5.05	.75	4.75
September 30	5.83	5.04	.79	4.75
October 28	6.40	5.20	1.20	5.125
December 1	6.40	5.15	1.25	5.00
December 30	6.40	4.98	1.42	5.00
1967				
January 27	6.10	4.65	1.45	4.625
February 24	5.85	4.59	1.26	4.25
March 31	5.20	4.13	1.07	4.00
April 28	4.95	4.03	.92	4.00
June 1	5.20	4.25	.95	4.25
June 29	5.35	4.31	1.04	3.625
July 28	5.55	4.35	1.20	4.00
September 1	5.70	4.35	1.35	4.00
September 29	5.70	4.73	.97	4.375
October 27	6.65	4.97	1.68	5.00
December 1	6.65	5.49	1.16	5.25
December 29	6.60	5.98	.62	5.875

Source: Wood Gundy Securities Limited

CHAPTER XI

SHORT-TERM LENDERS

Manitoba also had a number of substantial investors in the money market. These investors were, of course, mainly the large financial institutions with head offices in Winnipeg. Questionnaire replies were received from three of these financial institutions but in compliance with a request for anonymity, these companies have been referred to as Company #1, Company #2, and Company #3, in this chapter.

The main reason generally given by these companies for their use of the money market for the temporary investment of their funds was that they wanted to keep their assets earning a maximum return while at the same time, they wanted to keep their bank balances (which did not earn income) at a minimum. Other comments were as follows :

> "It is the best profitable means of employing our cash reserves while retaining liquidity and eliminating risk to capital."

> "We are basically long term investors, however, from time to time, our cash flow temporarily exceeds our pay-outs and such funds are invested in the short-term market as part of our overall policy to keep our funds employed effectively."

> "We use the short-term market very infrequently ... as an offset to mortgage and other large commitments."

The bulk of the investors' short-term portfolios were composed of bank, finance and corporate paper. None of the firms as a general rule purchased government of Canada treasury bills and only one invested in provincial treasury bills. The main reason for this seemingly aversion towards treasury bills was the fact that each of the three major investors had operations that frequently required the immediate use of large amounts of cash resources (such as to meet mortgage commitment payments as well as to take advantage of favourable investment periods in the stock and bond markets). In order to maintain this high degree of liquidity, the bulk of the investors' portfolios was in the form of demand paper (one firm quoted the figure of 95 per cent) thus excluding treasury bills as an investment medium.

Two of the responding firms' portfolios were affected by seasonal patterns of cash flow. One firm's short-term investments were largest in the fall and winter and smallest during the summer. The other firm had its portfolio reach its maximum size during the spring and it was smallest in the winter. The third major investor said that its short-term portfolio was not affected by seasonal cash flows, but rather the firm's position regarding the state of the stock market had more influence on whether the company had a large short-term portfolio or not. Thus, in general, there was no seasonal short-term investment pattern by Manitoba's major money market investors when taken as a whole.

TABLE XXXVI

THE APPROXIMATE PORTFOLIO DISTRIBUTION OF MANITOBA'S MONEY MARKET INVESTORS DURING 1968

(per cent)

Investment	Company #1	Company #2	Company #3
Government of Canada Treasury Bills	-	-	-
Provincial Treasury Bills	-	10	-
Bank Paper	50	5	50
Prime Finance Paper	16	30	-
Commercial Paper	23	30	50
Municipal Paper	6	25	-
Grain Paper	5	*	*
Total	100	100	100

* included in Commercial Paper

Source: Money Market Questionnaire: Investing in the Money Market, Question 3.

Note: In all three responding companies their holdings of bank paper increased significantly during 1967 and 1968 as a result of the aggressive behaviour of the banks described in Chapter VI and because the banks were considered to be prime credit risks. As one company said, "Our total short-term position has been very large and we did not want to get too heavily committed in corporate paper."

During periods of monetary restraint two out of the three responding companies reported that their holdings of corporate and finance company paper generally increased. One company reported that they "were not affected much. If anything, it increases as we become more cautious about investing long-term in a falling bond market." Another said, "In such a period, the stock market would be less attractive and we would tend to increase our reserves."

Each of the responding investing companies said that they relied on the various money market dealers to supply them with the required securities. They seldom purchased directly placed paper because, according to one company, "directly placed paper is not readily available at all times, particularly in the Winnipeg market."

We found that the short-term portfolios of each of the responding investing companies was reviewed from time to time as circumstances warranted, but that there was no systematic analysis of their short-term credits. Basically, the short-term investments were made in companies in which the investing institutions already held long-term securities. The philosophy expressed was that if a company was willing to hold long-term debt or equity positions in a borrowing firm, they would also be willing to lend it short-term capital.

This policy has worked quite satisfactorily for these companies up until now but in the years ahead when high interest rates might strain the resources of a number of borrowing firms, we think that more attention should be given to the analysis of short-term credit risks. The Investment Dealers' Association of Canada have also expressed a desire that more analysis be carried out by money market lending institutions.

> As the money market grows, there are an increasing number of corporations of many kinds borrowing in the short-term market, and it becomes more difficult for the purchaser of the paper to be selective and have time to examine the credit standing of each name. It is important that, if the paper market is to grow in a responsible manner, the buyers be fully aware of the credits they are purchasing. This is especially true as a large volume of paper is sold on a "demand" basis and perhaps not enough attention is paid to the name of the borrower.[156]

All the companies maintained diversified portfolios (see Table XXXVI) and they did not, generally speaking, overcommit themselves in any one company and to ensure this diversity, informal practical lending limits have been set by the lending companies on the various borrowing firms to help minimize their exposure to possible financial loss. These informal limits usually were effectively established and maintained by the various money market managers who had day to day contact with money market dealers and borrowers. They thus cannot be said to be wholly

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[156] Investment Dealers' Association of Canada, Submission to the Royal Commission on Banking and Finance, June 1962, Appendix G, p. 440.

objective in their policy decisions as personal relationships have played an important part in the operations of the various financial markets in Canada, including the money market. We would suggest that each of the investing companies could have protected their short-term funds better, by having the company's money market operations objectively analyzed by someone not directly connected with the day to day money market trading operations of the firm. This has been the practice of a number of large investing firms in Eastern Canada since the collapse of Atlantic Acceptance in June 1965.

Basically, however, the short-term lending operations of the major Manitoba firms can be regarded as merely an adjunct to their long-term investment operations and because of this, relatively little attention has been given by Manitoba's financial institutions to maximizing the use of the money market as an investment vehicle.

THE PROVINCE OF MANITOBA

On occasion the province of Manitoba has been a substantial lender of short-term funds. Surplus funds have arisen from time to time as a result of such things as the receipt of bulk tax or other payments from the Federal government and the receipt of the proceeds of long-term debenture issues. When the provincial government has found itself with excess cash on hand it has invested these funds in the money market for its own account and on behalf of its crown corporations and agencies.

The province has acted as the agent for its crown corporations (such as Manitoba Telephones and Manitoba Hydro) and for its crown agencies (such as the Manitoba Development Fund) and when these institutions have surplus cash (such as immediately following the receipt of the proceeds from long-term debenture issues) the province has invested these funds for them. If within the provincial government itself or among its crown corporations or agencies there was a need for short-term funds, the satisfying of these needs received first priority. Funds so invested were lent at the going rate of interest and without any brokerage charges. In other words, the province has attempted to shift short-term funds between its own organizations in order to more efficiently use its cash resources. Only after internal needs have been satisfied did the province look to external alternative forms of investment.

The province has practised the policy of investing its surplus funds externally mainly in bank paper, trust company deposit receipts and in commercial paper of guaranteed organizations such as Ontario Hydro. Rarely has the province purchased government of Canada treasury bills. The money market securities purchased have been purchased on a demand basis or for fixed periods of time depending upon the circumstances.

The lending activity of the province of Manitoba has not been on a regular basis as the province has usually found itself with surplus cash at irregular intervals. Therefore, the characteristics and policies of its lending behaviour have been shaped more by circumstance than by design. As such, it has been difficult to accurately outline in detail the province's lending activities in the money market. However, we can say that this short-term lending activity has been substantial enough to warrant the use of the government as a central agency for its own crown corporations and agencies in an attempt to maximize the use of its total cash resources and to minimize its total borrowing costs.

CHAPTER XII

SUMMARY AND CONCLUSION

The first use of the money market by Manitoba institutions occurred in the early 1950's when the major financial institutions began investing small sums of money in money market instruments (Monarch Life began investing in the money market as early as 1951). The first major money market borrower from the province of Manitoba was the Beaver Lumber Company which began using commercial paper about 1954. The Province of Manitoba issued a few short-term bonds in 1955. These initial attempts to make use of the money market as both a source of funds and as a vehicle for investment roughly coincided with the broadening of the money market carried out under the auspicies of the Bank of Canada after 1954. However, the growth and development of the money market in Canada subsequent to its formal establishment occurred mainly outside of Manitoba. The few firms that had tried using the money market did not make very extensive use of the market in the years immediately following 1954 because they were mainly intermittent users of the market.

It was not until 1958 that institutions in Manitoba entered the Canadian money market on a substantial and permanent basis.

1958 was the year that the Western grain companies began issuing grain paper. The United Grain Growers was the first of the major grain companies to borrow via the money market and it was closely followed by such companies as Pioneer Grain and Federal Grain in 1960 and National Grain in 1961. The Province of Manitoba made substantial short-term borrowings beginning in 1959. The lending institutions, too, began substantial short-term lending during the late 1950's.

The 1960's saw the use of the money market widen to include Province of Manitoba treasury bills in 1962, Metro short-term notes in 1962, and Manitoba Hydro and Manitoba Telephones commercial paper issues in 1963 and 1966 respectively. These institutions have been regular borrowers since they entered the money market.

However, indications as to the relative size of Manitoba's money market operations in relation to the total Canadian money market, both borrowing and lending, have been hampered by a general lack of statistics on commercial paper. Statistics have been regularly published regarding government of Canada treasury bills, bank paper, and sales finance company short-term borrowings, but only relatively recently, have statistics been gathered regarding the role of commercial paper in Canada's money market.

The bulk of Manitoba's borrowing and lending activities have been concentrated in the commercial paper market and so the published statistics, although informative, have not been all that revealing in respect to Manitoba's money market operations.

We have, therefore, resorted to our own estimates of the magnitude of Manitoba's money market activites, based on the replies to our questionnaires. We have only tabulated Manitoba's commercial paper borrowings, as provincial treasury bill statistics in the hands of the public over a given period of time were unavailable even to the provincial government, and the lending institutions did not all report the extent of their lending activities to us, as in some cases the information had been destroyed or where it was still in existence, extracting the information from accounting records was very difficult.

From Table XXXVII one can see that our estimated commercial paper borrowings from Manitoba have been about 5 to 10 per cent of the Canadian total. Since nearly all of Manitoba's commercial paper has originated from firms headquartered in the city of Winnipeg, borrowings of this magnitude have indicated that while Winnipeg was not a major Canadian money market center, it has been an important one. In this way, the money market has contributed to making Winnipeg one of the larger financial centers in Canada.

TABLE XXXVII

ESTIMATED COMMERCIAL PAPER BORROWINGS
AT YEAR END FOR MANITOBA

($ millions)

Year	Manitoba Estimate	Canada Dec. 31
1961	20-30	231
1962	15-25	290
1963	30-40	241
1964	30-40	287
1965	30-40	166
1966	20-30	197
1967	10-20	247

Source: Author's estimate and Table XVIII

Note: While year end commercial paper borrowings for Canada generally represented a seasonal low point in the year's operations, for Manitoba, the spring was generally the seasonal low borrowing period and, therefore, the data given above has tended to overstate Manitoba's borrowings relative to Canada's. Over the course of a year, then, Manitoba's commercial paper borrowings only represented about 5 to 10 per cent of the total borrowings for Canada.

Table XXXVII also indicated that the money market borrowings of Manitoba institutions have fallen off in recent years. This has been primarily due to the narrowing trend of the spread in interest rates between commercial paper and bank loans as we saw from Chart 2. From the information gathered from the major money market borrowers in Manitoba, we have been able to obtain an idea as to the pattern of demand for short-term market funds by Manitoba's commercial paper issuers which has been shown graphically on Figure 1.

When the costs of borrowing from the money market have been the same as or greater than bank borrowing costs, a number of Manitoba firms (United Grain Growers and Metro) have continued to issue limited amounts of commercial paper in order to maintain a market for their paper (point A). However, as the spread between commercial paper rates, plus brokerage, widened relative to the firms' bank borrowing rates the demand for money market funds increased rapidly as more firms began issuing commercial paper (point B). In other words, when commercial paper became a cheaper source of finance more use was made of the money market as a source of funds and less reliance was placed on bank borrowings. All the firms borrowing in Manitoba had maximum borrowing limits either in terms of absolute commercial paper borrowings (United Grain Growers - $15 million) or in terms of bank lines of credit (the maximum borrowing limit ranged from 50 to 100 per cent of

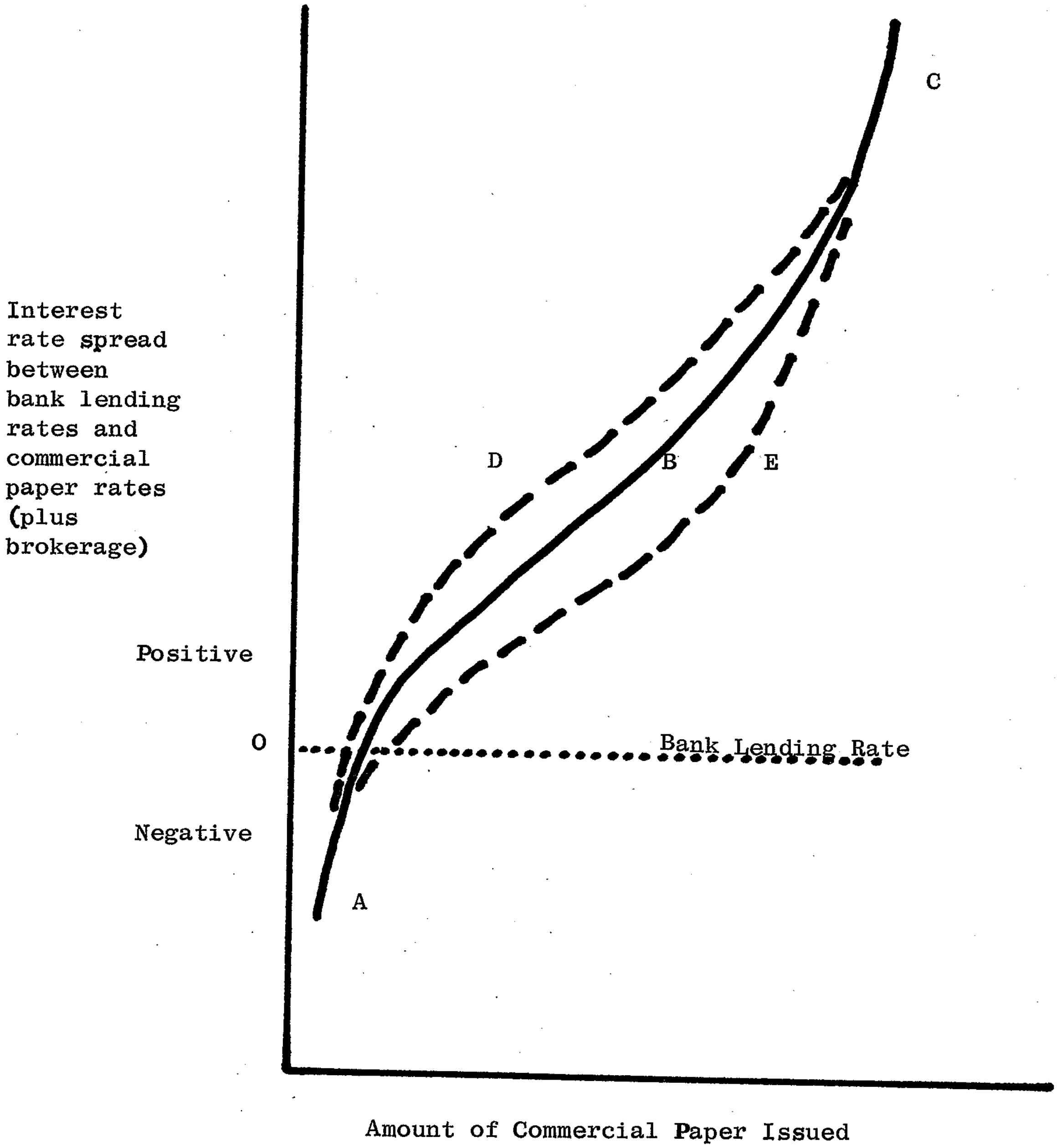

Figure 1

DEMAND CURVE FOR MONEY MARKET FUNDS FROM MANITOBA'S COMMERCIAL PAPER BORROWERS total unused bank lines of credit). This effectively meant that at some point (as firms reached their maximum commercial paper borrowing limits) the demand for money market funds leveled out and became relatively inelastic (point C). This then gave the demand curve an S shape (ABC).

The demand curve ABC fluctuated within a range around point B depending upon the state of monetary ease within Canada and upon seasonal cash flow patterns. During periods of monetary ease the demand curve tended to shift to the right towards AEC as the market for commercial paper improved. During periods of tight money the demand curve tended to shift to the left along ADC as Manitoba's corporations borrowed relatively more heavily from the banks in order to maintain the good will of their banks or as the market for their commercial paper declined. Demand was also relatively less during the spring when high seasonal cash inflows reduced the requirements for short-term finance. However, during the summer, fall and winter Manitoba's commercial paper demand curve tended to shift towards AEC as more substantial cash short-falls were encountered which were covered with short-term borrowings.

The Province of Manitoba has been a fairly heavy short-term money market borrower. They have been involved in the money market in one way or another practically since the money market was established in 1954. The province's money managers have shown a good deal of sophistication: by their innovation of treasury bills in 1962; by their continued use of the money market since then; and from the fact that they have utilized the money market very successfully to minimize their long-term borrowing charges. A lack of statistics has hampered our analysis of their operations, but from information received from the government they have indicated that as time goes on the role of the money market in the province's operations will become more important as they gain more flexibility and expertise in the money market.

The major lending institutions of Manitoba have, from time to time, made extensive use of the money market as a source of investment opportunities (one firm indicated that they had over $100 million invested on occasion). Statistics in this area again have hampered our analysis of these companies. However, the money market was not the prime interest of these investors who were, rather, interested in long-term investments. As such the money market has not been utilized to its fullest extent by these firms, and in a number of instances their policies and attitudes towards the money market have been a bit haphazard which could be dangerous. We would like to see these companies make greater use of the potential of the money market as a vehicle for profitable short-term investment.

In conclusion, we may say that the money market has been a factor in the financial development of the province and of its industries. While in relation to Canada as a whole, it has not been a major participant in dollar terms the province has, nevertheless, in its own way contributed to the growth and development of the Canadian money market through the introduction and steady use of grain paper and provincial treasury bills.

The introduction and use of these two types of instruments has indicated that Manitoba has the financial soundness and expertise necessary to create and implement new techniques in the financial scene in Canada. In addition, Manitoba's use of and contributions to the Canadian money market has helped make the money market national in scope rather than regional in outlook. We think that these have been beneficial developments in the growth of the Canadian economy and of its financial system.

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APPENDIX "A"

OFFERING MEMORANDUM

This Memorandum of Information is not, and under no circumstances is to be construed as, a public offering of these Short Term Notes for sale in the United States of America or in the territories or possessions thereof.

OFFERING MEMORANDUM

Unsecured Short Term Notes

CANADIAN GENERAL ELECTRIC COMPANY LIMITED
214 King Street West
Toronto 1, Ontario
Telephone 366-7311 Area Code 416

CANADIAN GENERAL ELECTRIC COMPANY LIMITED

SHORT TERM NOTES

The Company:	Canadian General Electric Company Limited, with head office in Toronto, Ontario, was incorporated under the laws of Canada on July 15, 1892 and is a subsidiary of General Electric Company, 570 Lexington Avenue, New York. The Company manufactures a wide range of electrical apparatus, appliances and supplies as more fully described in the annual report accompanying this Memorandum of Information.
Term:	In maturities ranging up to 365 days from the date of issue of each note.
Principal Amount:	Issuable as and when required in an aggregate principal amount not now determined, but not exceeding $50,000,000 principal amount at any time outstanding.
Payment:	Payable in lawful money of Canada at the principal office in Toronto or Montreal of the Company's bankers specified therein.
Denominations:	Short Term Notes to be issued on a discount basis, interest bearing or demand in such denominations as determined by the Company from time to time, subject to a minimum amount of $50,000. Short Term Notes will not be subject to prepayment by the Company without the consent of the holder.
Rates:	On application.
Delivery:	Against payment by certified cheque to the purchaser or his agent.
Legality:	In the opinion of Counsel, these Short Term Notes are investments in which the Canadian and British Insurance Companies Act states that companies registered under Part III thereof may, without availing themselves for that purpose of the provisions of subsection (4) of section 63 of the said Act, invest their funds; are securities in which trust companies registered under the Trust Companies Act of Canada may invest their own funds and, if the investment in such security is also authorized by the instrument creating the trust, both unguaranteed and guaranteed moneys; are securities in which trust companies registered under the Loan and Trust Corporation Act of Ontario may invest their funds as well as money received for guaranteed investments or as deposits.
Purpose of Issue:	The net proceeds to be received by the Company from the issue of Short Term Notes will be used for general corporate purposes.

August 1, 1967

CANADIAN GENERAL ELECTRIC COMPANY LIMITED

214 KING STREET WEST, TORONTO 1, ONTARIO - TEL: (AREA 416) 366-7311

"Be it enacted as a by-law of Canadian General Electric Company, Limited (hereinafter called 'the Company') that:

1. The directors may and they are hereby authorized from time to time to

   (a) Borrow money upon the credit of the Company:

   (b) Limit or increase the amount to be borrowed:

   (c) Issue bonds, debentures, debenture stock or other securities of the Company:

   (d) Pledge or sell such bonds, debentures, debenture stock or other securities for such sums and at such prices as may be deemed expedient:

   (e) Mortgage, hypothecate, charge or pledge all or any of the real and personal property, undertaking and rights of the Company, to secure any such bonds, debentures, debenture stock or other securities or any money borrowed or any other liability of the Company.

2. The directors may from time to time by resolution delegate to any two officers of the Company (including the President, or the Vice-President–Finance, or the Secretary), all or any of the powers conferred on the directors by paragraph 1 of this by-law to the full extent thereof or such lesser extent as the directors may in any such resolution provide.

3. The powers hereby conferred shall be deemed to be in supplement of and not in substitution for any powers to borrow money for the purposes of the Company possessed by its directors or officers independently of a borrowing by-law."

****

I hereby certify that the foregoing is a true and correct copy of By-Law No. 76 of CANADIAN GENERAL ELECTRIC COMPANY LIMITED enacted December 10, 1952, as amended July 20, 1961.

Dated at Toronto this 1st day of August, 1967.

Secretary

CANADIAN GENERAL ELECTRIC COMPANY LIMITED

214 KING STREET WEST, TORONTO 1, ONTARIO - TEL: (AREA 416) 366-7311

"*RESOLVED:*

THAT any two of the following officers of the Company, namely, the President, the Vice President - Finance, and the Secretary, or any one of them together with the Treasurer or a Vice President of the Company, be and they are hereby authorized and empowered to borrow money from time to time upon the credit of the Company as and when required in connection with its business, upon such terms and conditions as they may deem advisable, and by way of, but not limited to, bank loans, interest bearing notes, discount notes and banker's acceptances, and to execute on behalf of the Company promissory notes and other documents covering any sum or sums so borrowed. Provided, however, that the total amount of outstanding indebtedness of the Company incurred under this resolution shall not at any time exceed a maximum of Fifty Million Dollars ($50,000,000.00) in Canadian currency or the equivalent thereof in any other currency, and provided further that no monies shall at any time be borrowed for a period exceeding two years.

THAT any and all promissory notes and other documents executed on behalf of the Company shall constitute a valid and enforceable obligation of the Company in accordance with the terms thereof.

AND THAT the resolution set out in Minute No. 738 of the Minutes of the meeting of the Board of Directors held on 28 July 1966, be and it is hereby cancelled and rescinded."

****

I hereby certify the above to be a true and correct copy of a resolution passed by the Board of Directors of Canadian General Electric Company Limited at their meeting held on 13 July, 1967.

Dated at Toronto this 1st day of August, 1967.

Secretary

MARTIN, TRITES, McKEOWN & ANCUTA
BARRISTERS & SOLICITORS

CHARLES S. MARTIN
WILLIAM P. McKEOWN
ALAN G. TRITES
WALTER N. ANCUTA

TELEPHONE 366

214 KING STREET WEST
TORONT
C

August 1, 1967.

Canadian General Electric Company Limited,
214 King Street West,
Toronto 1, Ontario.

Dear Sirs:

re: Canadian General Electric Company Limited
—Short Term Promissory Notes

We understand that Canadian General Electric Company Limited (the "Company") proposes to issue and sell from time to time Short Term Promissory Notes (the "Notes") in maturities up to 365 days from the respective dates of issue thereof.

In connection with the issuance and sale of such Notes we have examined the Letters Patent and Supplementary Letters Patent of the Company, the borrowing by-laws of the Company, resolutions of the board of directors of the Company and such other documents as we consider relevant for the purposes of this opinion.

Based upon and subject to the foregoing, we are of the opinion that:

1. The Company is duly incorporated and validly existing under the laws of Canada with power to issue the Notes.

2. All necessary corporate action has been taken by the Company and the directors thereof to authorize the obtaining of loans by the Company, the execution of Notes for such loans, and the issuance and sale of Notes.

3. The Specimen Notes, copies of which are included in the Company's Offering Memorandum, are satisfactory as to form and, when duly executed by any two of the following officers of the Company, namely, the President, the Vice President - Finance, and the Secretary, or any one of them together with the Treasurer or a Vice President of the Company, Notes in such form will constitute valid and binding obligations of the Company in accordance with their terms.

4. Based on information contained in the Financial Statements and Annual Reports of the Company for its fiscal years ending December 31st, 1962 to 1966 inclusive, the said Notes, at the date hereof,

   (a) are securities in which companies registered under the Canadian and British Insurance Companies Act may invest their funds;

   (b) are securities in which trust companies registered under the Trust Companies Act of Canada may invest their own funds and, if the investment in such security is also authorized by the instrument creating the trust, both unguaranteed and guaranteed moneys;

   (c) are securities in which trust companies registered under the Loan and Trust Corporations Act of Ontario may invest their funds as well as money received for guaranteed investments or as deposits.

5. No filing or registration is necessary in order for the Company to offer the Notes to the public in the Province of Quebec.

6. No filing or registration is necessary in order for the Company to offer the Notes to the public in the Provinces of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario and Nova Scotia, except:

(a) in the case of British Columbia, Saskatchewan, Manitoba and Nova Scotia, if the offer is to an "individual";

(b) in the case of Ontario, if the offer is to an "individual" and the Note is in a principal amount or denomination less than $50,000;

(c) in the case of Alberta, if the offer is

(i) to a natural person acting in his individual capacity and not as a trustee or in any representative capacity, or

(ii) two or more natural persons acting jointly in their individual capacities and not as trustees or in any representative capacity or as a partnership, unincorporated association, unincorporated organization or syndicate.

Yours very truly,

AGTrites:PE

SPECIMEN
INTEREST BEAR[illegible]
NOTE
No. 000

CANADIAN GENERAL ELECTRIC COMPANY LIMITED

TORONTO, ONTARIO

Date ____________________

CANADIAN GENERAL ELECTRIC COMPANY LIMITED, for value received, hereby promises to pay to or to the order of ____________________
____
on the ______ day of ____________________, 19____, at the office of Canadian Imperial Bank of Commerce, ____________________,
the sum of ____________________
____________________ dollars ($____________________)
in lawful money of ____________________,
with interest thereon at the rate of ____________________
percent (______%), per annum, from the date hereof to the date of maturity, upon due presentation and surrender of this promissory note.

CANADIAN GENERAL ELECTRIC COMPANY LIMITED

NOT VALID ....
....

SPECIMEN
DISCOUNT N

ADIAN GENERAL ELECTRIC COMPANY LIMITED

No. 00

TORONTO, ONTARIO

Date ________________________

CANADIAN GENERAL ELECTRIC COMPANY LIMITED, for value received, hereby promises to pay to or to the order of ________________________

____

on the ______ day of ____________________, 19____, at the office of Canadian Imperial Bank of Commerce, ____________________,

the sum of ____

____dollars ($________________)

in lawful money of ____

upon due presentation and surrender of this promissory note.

CANADIAN GENERAL ELECTRIC COMPANY LIMITED

NOT VALID

SPECIME
DEMAND N

CANADIAN GENERAL ELECTRIC COMPANY LIMITED

No. 000

TORONTO, ONTARIO

Date________________________

CANADIAN GENERAL ELECTRIC COMPANY LIMITED, for value received, hereby promises to pay to or to the order of ____________________

____

on demand, at the office of Canadian Imperial Bank of Commerce __________

____,

the sum of ____________________________________

______________________________dollars ($____________)

in lawful money of __________________________________,

with interest thereon at the rate of __________________________

percent (______%), per annum, from the date hereof to the date of maturity, upon due presentation and surrender of this promissory note.

CANADIAN GENERAL ELECTRIC COMPANY LIMITED

NOT VALID

BOARD OF DIRECTORS

J. A. BÉLAND	—*President* The Empire Shirt Mfg. Co. Ltd. Louiseville, Quebec
J. A. BREEN	—*Chairman of the Board* Canada Cement Company Limited Montreal, Quebec
R. V. CORNING	—*General Manager, Lamp Division* General Electric Company Cleveland, Ohio
SENATOR P. DESRUISSEAU, Q.C.	—*Chairman of the Board* La Tribune Ltee. Sherbrooke, Quebec
O. L. DUNN	—*Vice President* General Electric Company New York, N.Y.
J. H. GOSS	—*Vice President* General Electric Company New York, N.Y.
W. C. HARRIS	—*Chairman of the Board* Harris & Partners Ltd. Toronto, Ontario
C. E. HIPP	—*Vice President -Finance* Canadian General Electric Company Limited Toronto, Ontario
R. H. JONES	—*Vice President and Group Executive* General Electric Company New York, N.Y.
W. F. McLEAN	—*President* Canada Packers Ltd. Toronto, Ontario
M. McMURRAY	—*President and Chief Executive Officer* Dominion Bridge Company Limited Lachine, Quebec
COL. M. C. G. MEIGHEN, O.B.E.	—*President* Canadian General Investments Limited Toronto, Ontario
H. B. MILLER	—*Vice President* General Electric Company New York, N.Y.
R. E. PFENNING	—*Comptroller* General Electric Company New York, N.Y.
J. H. SMITH	—*President and Chief Executive Officer* Canadian General Electric Company Limited Toronto, Ontario

August 1, 1967

OFFICERS

J. H. SMITH	—	*President and Chief Executive Officer*
L. R. DOUGLAS	—	*Vice President*
R. N. FOURNIER	—	*Vice President*
C. E. HIPP	—	*Vice President*
C. A. MORRISON	—	*Vice President*
R. M. ROBINSON	—	*Vice President*
ROBERT STORY	—	*Vice President*
W. F. WANSBROUGH	—	*Vice President*
A. G. TRITES	—	*Secretary*
W. R. C. BLUNDELL	—	*Treasurer*
H. HUGHES	—	*Assistant Secretary*
I. H. ASHBURY	—	*Assistant Secretary*
G. P. THOMPSON	—	*Assistant Secretary*

August 1, 1967

CANADIAN GENERAL ELECTRIC COMPANY LIMITED

214 KING STREET WEST, TORONTO 1, ONTARIO - TEL: (AREA 416) 366-7311

J. H. Smith	*President*
R. N. Fournier	*Vice President*
C. E. Hipp	*Vice President*
R. M. Robinson	*Vice President*
W. F. Wansbrough	*Vice President*
C. E. Hipp	*Vice President—Finance*
A. G. Trites	*Secretary*
W. R. C. Blundell	*Treasurer*
H. Hughes	*Assistant Secretary*

CERTIFIED under the corporate seal of the Company this 1st day of August, 1967, that the persons hereinabove named have been appointed to the offices in Canadian General Electric Company Limited set opposite their respective names, and that such persons, respectively, are now holding such offices and acting as such officers and that the signatures set opposite their names are true specimens of their signatures.

Secretary

APPENDIX "B"

INVESTMENT POLICY STATEMENT

POLICY ON SHORT TERM INVESTMENT OF SURPLUS FUNDS

Surplus funds of the Company will be invested in accordance with the following criteria, listed in order of priority:

Security of principal

Liquidity of portfolio

Yield

The portfolio should be reasonably diversified, with no continuing disproportionate investment of large amounts in individual securities. Securities of the Government of Canada, of the Provinces and of the approved chartered banks will comprise a minimum of 25% of the total portfolio.

Individual investments must conform with the approved list shown below.

The financial standing of the borrowers will be reviewed on a continuing basis and any significant changes in their credit worthiness will be taken into account when making investment decisions.

All bearer securities including collateral securing day loans and call loans will be placed in safekeeping with a bank or trust company and in addition shall be insured against loss of documents for an amount sufficient to cover their face value.

LIST OF APPROVED SECURITIES

Security	Maximum Term	Maximum Amount
A. Government Securities		
Government of Canada	5 years	No limit
Provincial Governments:		
Newfoundland	3 years	$ 1 million
Prince Edward Island	"	$ 1 million
Nova Scotia	"	$ 5 million
New Brunswick	"	$ 5 million
Quebec	"	$10 million
Ontario	"	$25 million
Manitoba	"	$ 5 million
Saskatchewan	"	$ 5 million
Alberta	"	$ 7 million
British Columbia	"	$ 7 million
Municipal Governments:		
Short Term Notes of the following municipalities:		
Metropolitan Toronto -	1 year	$ 5 million
London -	6 months	$ 1 million
Vancouver -	6 months	$ 2 million
Money Market Dealers - Day Loans secured by collateral of Government of Canada securities	Day-to-Day	No limit

Security	Maximum Term	Maximum Amount
B. Chartered banks, Trust Companies, Life Insurance Companies:		
Canadian Chartered Banks - Short Term Notes and Bankers Acceptances issued by:		
Bank of Montreal Canadian Imperial Bank of Commerce The Royal Bank of Canada The Bank of Nova Scotia The Toronto-Dominion Bank	1 year	$25 million each
Export Finance Corporation of Canada, Limited - Short Term Notes	1 year	$10 million
The Royal Trust Company - Guaranteed Investment Certificates or Receipts	6 months	$ 3 million
The Montreal Trust Company - Guaranteed Investment Certificates or Receipts	6 months	$ 3 million
Canada Life Assurance Company - Short Term Notes	1 year	$ 4 million
The Manufacturers Life Insurance Company - Short Term Notes	1 year	$ 4 million

Security	Maximum Term	Maximum Amount
C. Industrial Corporations		
Canadian General Electric Company Limited	1 year	$ 3 million
Canadian Pacific Securities Limited - Short Term Promissory Notes, unconditionally guaranteed by Canadian Pacific Investments Limited	1 year	$ 5 million
Canadian Pacific Railways - Unsecured Promissory Notes	1 year	$ 5 million
Dupont of Canada Limited - Unsecured Promissory Notes	1 year	$ 3 million
Canada Safeway Limited	3 months	$ 2 million
Simpsons Limited - Unsecured Short Term Notes	6 months	$ 2 million
Simpson-Sears Limited Unsecured Short Term Notes	6 months	$ 4 million (jointly with Simpson-Sears Acceptance Co. Ltd.)
D. Acceptance Companies, wholly owned by Industrial Corporations		
General Motors Acceptance Corporation of Canada, Limited - Unsecured Short Term Notes (guaranteed by General Motors Acceptance Corporation of New York)	1 year	$ 6 million
Ford Motor Credit Company of Canada, Limited - Short Term Notes unconditionally guaranteed by Ford Motor Company	1 year	$ 6 million

Security	Maximum Term	Maximum Amount
D. Acceptance Companies, wholly owned by Industrial Corporations (contd.)		
Simpson-Sears Acceptance Company Limited - Short Term Notes, unconditionally guaranteed by Simpson-Sears Limited	6 months	$ 4 million (jointly with Simpson-Sears Limited)
Simpson's Acceptance Company Limited - Secured Short Term Notes (pledge of Series "A" Debentures of the company) (not guaranteed by parent organization)	2 months	$ 1 million
T. Eaton Acceptance Company Limited - Short Term Notes, unconditionally guaranteed by the T. Eaton Company Limited	6 months	$ 2 million
F. Investment Dealers - Secured Call Loans		
Investment Dealers - Call Loans, secured by Government collateral as described in A or collateral of bonds that are eligible under the Canadian and British Insurance Companies Act, Part III, for investment by insurance companies, or by any bearer securities which themselves are on this approved list:	90 days	
Dealers:		
Greenshields Incorporated		$ 4 million
McLeod, Young, Weir & Co. Ltd.		$ 4 million
Wood, Gundy & Company Limited		$ 4 million
Harris and Partners Limited		$ 2 million
A.E. Ames & Company Limited		$ 2 million
Dominion Securities Corp. Ltd.		$ 2 million
Nesbitt, Thomson & Company Ltd.		$ 2 million
Richardson's Securities of Canada		$ 1 million

APPENDIX "C"

QUESTIONNAIRES

INVESTING IN THE MONEY MARKET

Instructions: Questions are to be answered by checking as many choices as are appropriate. In the event that any elaboration would seem desirable, you are invited to do so.

1. Why do you invest your funds in the short-term money market?
   _____ we like to keep our bank balances at a minimum
   _____ we wish to have our assets earning the maximum return
   _____ we have a well defined cyclical cash flow
   _____ other, please specify

2. Which of the following money market investments do you purchase?
   _____ government of Canada treasury bills
   _____ government of Canada short-term bonds
   _____ prime finance company paper
   _____ bank paper
   _____ corporate paper
   _____ provincial treasury bills
   _____ municipal short term notes
   _____ U.S. or U.K. treasury bills
   _____ other, please specify

3. What percentage of your short-term portfolio, on the average, consists of
   treasury bills _____ per cent
   bank paper _____ per cent
   prime finance company paper _____ per cent
   corporate paper _____ per cent
   other _____ per cent

4. Do these percentages vary widely from month to month?
   _____ yes
   _____ no

5. What percentage, on average, of the short-term paper you buy, is initially
   _____ under 30 days maturity
   _____ 31 to 90 days
   _____ 91 days or over

6. During what season is your portfolio the largest?
   _____ spring
   _____ summer
   _____ fall
   _____ winter

7. During what season is your portfolio the smallest?
   _____ spring
   _____ summer
   _____ fall
   _____ winter

8. In a period of monetary restraint, do your holdings of corporate and finance company paper generally
   _____ increase
   _____ decrease
   _____ remain the same

9. When looking for maturity dates for your short-term portfolio, which of the following payment factors do you take into consideration?
   _____ dividend payments
   _____ tax payments
   _____ long term security purchases
   _____ long term bond purchases
   _____ mortgage purchases
   _____ capital expenditure commitments
   _____ payrolls
   _____ debt maturity repayments, including sinking funds
   _____ purchase of materials and supplies
   _____ other, please specify

10. In the past year have you tended to invest relatively more short-term funds with the commercial banks?
   _____ no
   _____ yes, because the yield is more attractive than on many other investments
   _____ yes, because the banks are prime credit risks
   _____ yes, because we wish to maintain a satisfactory relationship with our banks
   _____ yes, because bank paper can be obtained in the exact amount and maturity that we require
   _____ other, please specify

11. Which of the following factors are important in influencing your choice between purchasing directly-placed finance company paper and corporate paper issued through dealers?

DIRECTLY-PLACED paper is preferred because

_____ directly-placed paper can be more easily "tailormade" with respect to maturity and amount
_____ direct placers will generally repurchase paper if requested to do so, whereas dealer paper is harder to liquidate
_____ direct paper is available in very short maturities
_____ the direct placers are large well-known companies
_____ direct paper of any specific issuer is always in ample supply

DEALER paper is preferred because

_____ it generally offers a higher yield
_____ paper of many different issuers can be obtained by one contact

12. Check the yield differential necessary to induce you, as of today, to substitute each of the following 90-day assets for treasury bills of the same maturity.

	Percent per annum						
	1/8	1/4	3/8	1/2	5/8	3/4	over 3/4
Prime Finance Paper							
Certificates of Deposit							
Prime Corporate Paper							
Municipal Notes							

13. Do you feel reluctant to hold finance company paper and/or corporate paper over the year end?

_____ yes
_____ no

14. Is your short-term investment policy

_____ formalized in that you have a written policy memorandum on short-term investments
_____ reviewed at least once a year
_____ reviewed less than once a year
_____ reviewed from time to time as the circumstances warrant

15. Do you analyze the credit position of your investments?

_____ no

_____ no, the Canadian government has the best credit rating in Canada so we invest mainly in treasury bills

_____ yes, we review the credit standing of all our investments _____ once a year
_____ more than once a year
_____ less than once a year

_____ yes, and the analysis is conducted by someone other than the person or persons who actually make the investment

_____ other, please specify

16. Is the composition or size of your short-term investment portfolio restricted in any way?

_____ no

_____ yes, by limits on the maximum amount and maximum term that can be invested in any single organization

_____ yes, by limits on the maximum term and the maximum amount that can be invested in any group of investments such as bank paper or prime finance company paper

_____ yes, by legislative restrictions on the types of investments available to us.

_____ yes, by a policy requiring us to maintain a diversified portfolio

_____ yes, by a policy requiring us to obtain a minimum yield

_____ other, please specify

17. When did you first begin lending in the money market?
19_____

18. How much have you had invested in your short-term portfolio at your year end since 1946? Your year end is _______.

Year	Treasury Bills	Total	Year	Treasury Bills	Total
1946-			1953-		
1947-			1954-		
1948-			1955-		
1949-			1956-		
1950-			1957-		
1951-			1958-		
1952-			1959-		

Year	Treasury Bills	Total	Year	Treasury Bills	Total
1960-			1964-		
1961-			1965-		
1962-			1966-		
1963-			1967-		
			1968-		

COMMERCIAL PAPER AS A SOURCE OF FUNDS

Instructions: Questions are to be answered by checking as many choices as are appropriate. In the event that any elaboration would seem desirable, you are invited to do so.

1. Which of the following best describes the position of commercial paper in your over-all debt picture?
   _____ commercial paper outstanding is continually rolled over and is a permanent source of finance
   _____ commercial paper is an instrument to meet well defined seasonal demands for funds
   _____ commercial paper is an almost perfect substitute for virtually all our borrowing from commercial banks
   _____ other, please specify

2. Which of the following documents do you make available to prospective buyers of your commercial paper? Please attach a sample of each.
   _____ annual report
   _____ prospectus
   _____ sample note
   _____ list of authorized signing officers
   _____ legal opinion
   _____ borrowing resolution
   _____ other, please specify

3. Is your commercial paper
   _____ interest bearing
   _____ sold at a discount
   _____ a floating charge on the company's assets
   _____ secured with a specific charge on a company asset
   _____ guaranteed by any other organization

4. Do you sell your commercial paper
   _____ directly to a lender
   _____ through a dealer who has the exclusive right to market your commercial paper
   _____ through a number of dealers

5. If you sell your commercial paper through dealers
   _____ do you periodically review their performance
   _____ do you change dealers from time to time if their performance is not satisfactory
   _____ use their advice as a guide in establishing your interest rate cost

6. Is the rate of interest you pay on your commercial paper
   _____ generally the same as the rates quoted for Prime Finance Company paper
   _____ slightly above Prime Finance Company rates
   _____ below Prime Finance Company rates
   _____ other, please specify

7. In which season does your commercial paper outstanding reach a peak?
   _____ spring
   _____ summer
   _____ fall
   _____ winter

8. Is your borrowing power through commercial paper limited?
   _____ no
   _____ yes, by a limit on the aggregate principal amount that can be borrowed of __________ dollars
   _____ yes, by a limit on commercial paper outstanding of ________ per cent of total debt
   _____ yes, by a ratio between bank lines of credit and maximum commercial borrowings of ________ per cent
   _____ other, please specify.

9. Roughly, what percentage, on the average, is commercial paper of your
   short-term debt _____ per cent
   total debt _____ per cent

10. How do these percentages vary in times of monetary restraint?
    _____ percentages generally increase
    _____ percentages generally decrease
    _____ percentages generally remain the same

11. What factors explain why these percentages are not higher?
    _____ higher commercial paper borrowings would strain our bank relations
    _____ demand for our paper is not sufficiently strong to increase our outstandings at the going interest rate
    _____ we do not desire to increase our outstandings. Please specify reasons.

12. Does the ratio of commercial paper to short-term debt rise when the cost of commercial paper funds falls relative to that of bank loans?
    _____ yes, the proportion of commercial paper is responsive to changes in cost
    _____ yes, but we are constrained by a maximum ratio of commercial paper to short-term debt
    _____ no, fluctuations in relative costs are not generally important

13. If the costs of borrowing directly from banks and of obtaining funds in the commercial paper market were the same, would you sell any commercial paper?
    _____ yes, we would want to keep a supplementary source of finance available
    _____ yes, a nationwide distribution of our paper is desirable
    _____ no, borrowing on commercial paper in these circumstances would strain our bank relations
    _____ no, we would prefer bank loans because of their greater flexibility
    _____ other, please specify

14. For what percentage of your commercial paper outstanding do you maintain unused lines of credit at your banks?
    _____ 100 per cent or greater
    _____ greater than 75 per cent but under 100 per cent
    _____ greater than 50 per cent but under 75 per cent
    _____ 50 per cent or under

15. What considerations are most important in determining the extent of your unused credit lines relative to your commercial paper outstanding?
    _____ our dealers insist that we have these lines before they are willing to sell our paper
    _____ we keep these lines to maintain favourable bank relations
    _____ we feel we genuinely need these lines because commercial paper is an unreliable source of funds
    _____ other, please specify

16. In times of monetary restraint, can you obtain all the funds you need from your banks, at the going interest rate?
    _____ yes
    _____ yes, up to our open credit lines
    _____ yes, but we are encouraged to obtain funds in the commercial paper market, if possible
    _____ no, we are rationed

17. In times of monetary restraint, can you obtain all the funds you need from the commercial paper market, at the going interest rate?
    _____ yes
    _____ no, the supply of funds in the open market seems to dry up in such periods

18. When did you begin issuing commercial paper?
    19_____

19. How much commercial paper have you had outstanding at your year end since 1946? Your year end is __________.

1946-	1958-
1947-	1959-
1948-	1960-
1949-	1961-
1950-	1962-
1951-	1963-
1952-	1964-
1953-	1965-
1954-	1966-
1955-	1967-
1956-	1968-
1957-	