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THE EFFECT OF THE 1967 BANK ACT REVISION ON COMPETITION IN CANADIAN BANKING MARKETS

by

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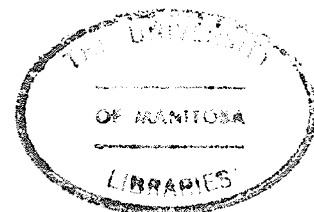
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EARL A. MCARTHUR

A thesis submitted to the Faculty of Graduate Studies of the University of Manitoba in partial fulfillment of the requirements of the degree of

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ABSTRACT

The importance of this study centres about the critical nature of the Bank Act in the historical development of the Canadian economy. Since the original Act was passed in 1871 each successive revision has impacted strongly on the Canadian economic environment. The 1967 revision was no exception. At the time of this legislation a new direction for government policy arose such that the revision was, at least in part, designed to promote competitive banking markets. To assess the degree of success this policy directive had, this study evaluates the hypothesis that the passing of the legislation known as the 1967 Bank Act revision caused an increase in the degree of competition within Canadian banking markets.

The thesis assesses the competitive shifts in banking markets rather than the institution of banking due to the fungible nature of most financial instruments. Financial institutions utilize a variety of assets and liabilities in their daily operations and the chartered banks encounter competition from many sources, with the types of institutions competing depending upon the market concerned. Thus, while changes in competition among the banks themselves are considered, a restriction of the analysis to this aspect alone would result in too limited an approach. The competitive thrusts of other financial intitutions must be taken into consideration as well. This is best done through an evaluation of the competitive changes within the individual markets.

The banking markets examined are those of deposits and loans.

Deposits are disaggregated into transaction (savings and demand) and term varieties while the types of loan markets studied are those of consumer, commercial and mortgage credit. All financial institutions are discussed to the extent that they are involved in the identified markets. In all deposit markets the major competitors of the chartered banks are the trust companies, mortgage loan companies and the cooperative banks. Competition in the credit markets comes from the cooperative banks, sales finance and consumer loan companies and retail dealers in the consumer credit market; sales finance companies and foreign bank subsidiaries in the commercial credit market; and trust companies, mortgage loan companies, cooperative banks, life insurance companies and government institutions in the mortgage credit market.

The study applies the theory of industrial organization as a means of assessing shifts in competition. Banking markets are described in terms of the elements of structure and conduct and this resulting characterization is compared to the market models of price theory from pure competition through to monopoly or, in the case of the loan markets, monopsony since the financial institutions are considered buyers of credit instruments. Changes in structure and conduct are taken as indicative of shifts in market competitiveness and as they are altered the markets are considered to change relative to the specific models of theory.

Competition encompasses both price and non-price aspects. Price competition is self explanatory while non-price competition refers to the activities of firms directed toward technological development and

product innovation. Unfortunately there is no exact relationship between this overall concept and the theoretical models, which were originally formulated after the consideration of the pricing aspect of competition only. For this reason it is possible to have a move toward more price competition concurrently with less non-price competition. However, the hypothesis may be analysed in terms of the shifts in both aspects of competition. The final evaluation of the hypothesis must also take into consideration the fact that five different banking markets are being examined at the same time. It is possible that competition within the various markets may be affected differently. A judgemental weighting of these dissimilar competitive shifts is necessary in order to arrive at an overall assessment of the hypothesis.

Historically the chartered banks have been a tightly-knit oligopolistic group with high entry barriers, few and large sized firms, interdependent pricing and low levels of non-price competitive behaviour. Prior to 1967 these circumstances were tolerated by the Canadian government in the interests of promoting an alternative set of policy objectives. In particular the stability of the financial industry and the existence of an effective monetary policy were pursued.

In the period preceding the 1967 Bank Act revision the progressive attitudes of near banks and rapidly rising interest rates led to a serious erosion of the chartered banks' market power. In compliance with the Bank Act the banks were required to maintain a 6% interest rate ceiling on loans. This requirement became more and more

restrictive as rates rose in the early 1960's. The Porter Commission was appointed in 1961 to review the situation and make recommendations. Their recommendations put forward in 1964 were designed to improve the competitiveness within banking markets and among the banks themselves. While the final content of the legislation did not embody all of the Commission's proposals, it was obvious that the government had accepted the competitive objective. Market entry barriers facing the chartered banks were removed in whole or in part, collusive pricing for most financial instruments was formally prohibited and ownership and boardroom relationships across institutional boundaries were curtailed or reduced.

The effectiveness of the 1967 Bank Act revision on the promotion of the competitive objective was analyzed on a market by market basis. The findings were as follows:

(1) The commercial credit market showed some improvement in competition. Openly collusive pricing was prohibited by the revision, but the banks developed an alternative oligopolistic pricing mechanism which produced similar results. However, the revision's removal of the 6% interest rate ceiling allowed the banks to provide a competitive thrust toward the higher-risk end of the market and there was some additional positive change through general improvements in non-price competition. Further, the removal of the rate ceiling led to increases in the involvement of foreign bank subsidiaries and the greater use of commercial paper as a corporate funding alternative. This resulted in reductions in concentration levels within the market.

(2) In the consumer credit market there were modest increases in competition through the removal of the rate ceiling barrier and greater non-price competition. However, there was a significant rise in overall concentration which was severe enough to suggest that the market was less competitive overall.

(3) In the mortgage credit market there was a definite increase in the degree of competition. The removal of two important market entry barriers facing the chartered banks helped bring down concentration ratios. There was also some increase in non-price competition through improved chartered bank progressiveness and the initial movement of some institutions into the market.

(4) The revision caused the term deposit market to become less competitive. Reductions in the entry barriers facing the chartered banks led to a significant increase in market concentration. The increased strength of the chartered banks led to bouts of excessive price competition and a reduction in entry incentives for the near banks.

(5) The revision made the transaction deposit market more competitive. The reduction of the interest rate ceiling removed a major barrier facing the chartered banks. Non-price competitive improvements also resulted, in particular the chartered banks' development of a non-chequable savings deposit.

The study indicates a range in the apparent effect of the revision on the different banking markets and the hypothesis is not fully supported. However, the evidence indicates that there were increases in the degree of competition in the commercial credit,

mortgage credit and transaction deposit markets. Further, in the two markets where there was considered to be a decline in competition there were still isolated instances of improvement. In conclusion the hypothesis is supported with qualifications.

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INTRODUCTION

This study focuses on the competitiveness of Canada's chartered banking community. It will be concentrating on the markets within which the banks operate rather than on the banking industry per se. This approach is chosen because of the fungibility characteristic of financial instruments; that is, that the output of one institutional type is often easily exchangeable for or replaced by that of others. Though they are segregated in legal terms, different institutions can be direct output and input competitors in one or more markets. This makes the analysis of the competitiveness of the financial industry along institutional lines, for example, "banking", an inappropriate application. Instead, similarities of instrument characteristics are used to provide a more realistic classification of the competitive arenas.

The primary banking markets and those upon which this study will focus are those of deposits and loans. Banks solicit funds through the issuing of various forms of deposits, then return these funds to the economy by lending them to various deficit units which need a supply of credit. A major portion of banking profit ensues from the nature of the spread between the rates they charge on loans and the rates they pay to depositors.

Banks are by far the largest type of financial institution in Canada but this is not the only reason they hold center stage. They are also the focal point of the Canadian payments system through their participation in the attraction of the most liquid of financial

instruments (demand deposits) and the operation of a clearing-house system which enables cheques drawn against one institution to be transformed into purchasing power at another. The banks are collectively the primary providers of the facilities needed for the near immediate realization of the financial aspects of economic exchange.

The crucial importance of banking activity led to a natural working liaison with the Canadian Government when the latter body assumed responsibility for the cyclical control of economic activity. The banks are the chief channel by which a government extension, the Bank of Canada, manipulates monetary variables with the eventual purpose of affecting the supply and content of real goods. This policy channel is made operational by legislation applicable to the banks which restricts and directs the scope of their activities.

The primary route the Government of Canada has chosen to take for the changing of banking legislation has been decennial revisions of the Bank Act, first instituted in 1871. One such reform occurred in 1967. The main purpose to which that particular change was directed was the promotion of competitive forces in banking markets. It now seems appropriate to look back and analyze just how successful the 1967 reformulation was in terms of this competitive objective.

For this purpose an industrial organization approach has been utilized whereby elements of structure and conduct are used to evaluate the degree of competitiveness or non-competitiveness existing in a given market. Using this framework then, the hypothesis for the study is established. It is that the 1967 Bank Act revision caused a

movement towards more competitive circumstances within Canadian banking markets.

CHAPTER I

THEORETICAL ASPECTS OF THE STUDY

As stated, the hypothesis to be examined is that a particular piece of legislation (the 1967 Bank Act) made Canadian banking markets more competitive.

To begin, consider what is meant by the term "competition." It can be defined as "the striving of two or more [firms] against one another for the same objective."[1] This definition is multi-faceted with respect to a number of its aspects such as:

(1) the strategies and behavioural patterns involved (i.e. the nature of the striving between firms).

(2) the competitive grouping (i.e., which two or more firms are the competitors).

(3) the objective(s) pursued by the firms.

and (4) the competitive arena (i.e. what product markets are involved).

Competition has both price and non-price aspects. Both embody the striving of firms against one another. The term price competition is self-explanatory. Non-price competition refers to the wide variety of methods used to develop and market new or improved products through product differentiation, improved product quality,

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[1] Kenneth G. Dennis, Competition in the History of Economic Thought (Arno Press, New York, 1977), p. 9.

etc. Any general use of the word "competition" will refer to a combination of both the price and non-price aspects.

Changes in competition will be observed through an application of the industrial organization schema of market structure, conduct (behaviour) and performance. Using this schema, a banking market can be characterized as to the degree of competition by identifying its particular combination of the structure and conduct elements. Altering these elements can result in a change in the market's type to one of more or less competition. This method of analysis will be more fully explained shortly.

The analysis of the structure and conduct of specific markets is crucial to this study. The standard application of the industrial organization approach has concerned itself with the structure and conduct of an industry in which all firms have a great deal of similarity in the types of business pursued. But the fungibility nature of financial instruments allows a great deal of substitution to take place between the outputs of characteristically different financial institutions. Because of this fungibility the examination of Canada's financial system wholly on the basis of firm type (e.g. chartered banks as opposed to trust companies) would be too simplistic. While the structure and conduct of institutional groups is examined, the analysis emphasizes the structure and conduct in the markets for specific financial instruments (e.g. the market for commercial business loans). All of the banking markets to be analyzed are introduced later in this chapter, then discussed in detail in

Chapter II. The competitive groupings (i.e. the firms involved) in each market are discussed in Chapter II as well.

The operations of markets influence a variety of identifiable socially desirable performance objectives. For the purposes of this study these objectives may be divided into three groups as follows:[2]

1. Static Resource Efficiency Criteria; this concept can be further broken down into three sub-groups;[3] "allocative efficiency" or the efficient allocation of resources between different forms of output, "technical efficiency" (also called internal or x-efficiency) or the efficient usage of previously allocated resources in the production process and "distributive efficiency" or, irrespective of what is produced, the efficient distribution of that output among individual economic units.
2. Dynamic Resource Efficiency Criteria; requires that technological change will follow optimal rates and directions.
3. Equity and Other Performance Criteria; the goal of equity requires that the market operates in a way to promote the "fair" distribution of wealth, income and opportunity.

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[2] William G. Shepherd, The Economics of Industrial Organization, (Englewood Cliffs, N.J.; Prentice-Hall Inc., 1979), pp. 31-36.

[3] Douglas Needham, Economic Analysis and Market Structure, (New York; Holt, Rinehart and Winston Inc. 1969).

Other performance criteria are many and include such general goals as freedom, security, job satisfaction, stability, etc.

Economic price theory describes four primary market types or models; pure competition, monopolistic competition, oligopoly and monopoly. As already noted above, definitions of the various market types may be indicated by identifying the mix of the elements of structure and conduct associated with each. For example, the level or situation of those elements most closely associated with the pure competition model may be termed the dimensions of a purely competitive market. Similarly, the other market models may be related to combinations of particular structure and conduct characteristics.

There are many different types of structure and conduct elements which could be identified and this necessarily poses a problem for an analysis of this type. To treat the subject in a comprehensive way would require measuring shifts in all elements. However, many of them are obscure and present difficulties in obtaining and applying data. To simplify the process of data collection and to make the analysis less cumbersome two elements each of structure and conduct were selected. They were chosen partly on the basis of data availability but particularly for their explanatory power in regards to competitive shifts. The two structure elements are (1) the number and size of firms and (2) the existence or non- existence of entry barriers. The two conduct elements are (1) pricing behaviour and (2)

non-pricing behaviour.

The numbers and size of firms can be quantified by calculating concentration ratios for both markets and institutions. The market percentage share of the various institutional types also provides evidence of this structural element. Changes in entry barriers can be observed directly when legislation is involved, or by implication if it is caused by a structural shift. Pricing behaviour can be analyzed through data on changing prices by individual firms (e.g. the prime lending rate of the Bank of Montreal versus the Royal Bank) or institutional type (e.g. all chartered banks' mortgage rates versus those of trust companies). Non-pricing behaviour is more difficult to determine. Some evidence is available regarding the introduction of new financial instruments or complementary financial services. Further, the development of new institutional types to meet specific financial requirements implies a more diversified product base in that the choice available to a customer has been improved.

It will not be necessary here to go into a detailed discussion of the four primary market models. It will suffice to describe these models in terms of the four structure and conduct elements chosen above:

1. Number and size of firms; pure competition and monopolistic competition are characterized by many small-sized firms. Oligopoly generally has a few large-sized firms while monopoly has, by definition, only one.

2. Entry barriers; no entry barriers exist in pure competition while in monopolistic competition there are product differentiation barriers only. Barriers are generally high for both oligopoly and, in particular, monopoly.

3. Non-pricing Behaviour; the non-pricing behavioural element is the main means of differentiating between pure competition and monopolistic competition. A purely competitive market is one in which the product is homogeneous for all firms. In monopolistic competition this homogeneity condition is relaxed. Each firm's output is slightly different from the others' although they remain close substitutes. An oligopoly may produce a homogeneous or differentiated product, though the latter is more likely given constraints placed on an oligopolists' pricing competitiveness. A monopoly produces one homogeneous product.

The technological development of new and improved products is an important part of a firm's non-pricing behaviour. Structurally there is nothing to prevent any of the four market types from having a progressive nature. As Scherer has noted, there is "...no simple one-to-one relationship between market structure and technological progressiveness...".[4]

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[4] F.M. Scherer, Industrial Market Structure and Economic Performance, Chicago; Rand McNally and Company, 1970), p. 7.

The existence of a progressive nature may not be sufficient evidence for differentiating between market types or vice-versa, however, the subject has been one of much debate and some well-substantiated observations can be made. It has been shown that a purely competitive market will innovate more quickly and keep less of the benefits to itself. Consumers will get the innovation sooner at a lower price. However, many innovations will prove too costly and risky for the small purely competitive firm. In monopoly, cost and risk are not major factors but a monopolist will tend to apply a restrictive policy to inventions and seek them less judiciously. Progressiveness is best promoted somewhere between these two extremes. There is some strong argument that "loose oligopoly" is most effective in terms of a progressive performance. In such a market firms are large enough to undertake the more costly and risky innovations but are also small enough to feel great incentives to innovate. As Shepherd states, "... loose oligopoly is the first approximation to optimal setting for innovation."[5]

4. <u>Pricing Behaviour</u>; in pure competition firms are unaware of their competitors and choose their price in response to market stimuli only. In monopolistic competition each firm is able to affect the market price through changes in

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[5] Shepherd, <u>Economics of Industrial Organization</u>, p. 395.

production, meaning monopolistic competitors do have some degree of market power. Oligopolists tend to set prices interdependently though the exact nature of the pricing method may vary greatly (e.g. price leadership, open collusion, etc.). In a loose oligopoly pricing behaviour may approximate that of pure or monopolistic competition while in a tight oligopoly it will be more similar to a monopoly where prices are set unilaterally.

In order to identify the degree of price competition, the market models may be assumed to form a spectrum or continuum from pure competition through monopolistic competition to oligopoly to monopoly. Any movement resulting in a shift towards more and smaller firms, removal of entry barriers and reductions in interdependent pricing can be thought of as a move along the spectrum towards a more price competitive market. It should be noted that this application does not necessarily ignore the theory of second best. A contradiction may arise if, for example, a market with reduced entry barriers results in a more collusive pricing nature due to the entry of a firm that is more capable of organizing the other firms.

Empirically, shifts in non-price competition are identified through measurement of the conduct element non-pricing behaviour. It is an important type of competition and changes must be examined in order to properly test the hypothesis put forward here. Unfortunately, non-price competition is not as strongly related to the market spectrum as is price competition. As already discussed,

the point of optimum non-price competition is in the middle part of the spectrum (at loose oligopoly) rather than at an end position. For this reason it will be possible to have contradicting shifts in the two types of competition. For example, if a market moved from a position of loose oligopoly to one of pure competition it would likely result in greater price competition and lesser non-price competition.

An evaluation of the degree of support for the hypothesis depends upon a judgement of the weight of evidence in terms of both types of competition. An additional complication arises because more than one market is to be examined. Chartered banks utilize a number of different financial instruments. In particular they solicit transaction and term deposits and issue consumer, commercial and mortgage credit. These five market areas will be discussed in the next chapter. For now it will suffice to introduce them in name only. Testing the hypothesis must also include weighting competitive shifts in these different markets. The combination of two types of competition and five banking markets necessarily results in a value judgement as to whether the banking markets, in total, have become more or less competitive. The imprecise nature of this testing method is recognized here. However, the approach utilized is designed to provide for a systematic evaluation of the evidence.

At this time it will be useful to return to performance and public interest implications. The degree of competition has some relationship with the triad of performance objectives outlined on

page 6. If the relationship were direct then implications regarding performance and public interest could be implied from the observed shifts in competition. However, the relationship is not direct and little can be said regarding changes in the overall public interest.

First, with respect to static efficiency (performance objective no. 1), a purely competitive market gives a highly efficient result in equilibrium and has the mechanism available to move toward that equilibrium. The other markets all have a degree of market power and fail, in various ways, to promote the conditions of static efficiency. The monopolistic competitor charges a higher than efficient price with the difference equal to the costs of the "unique" aspect of its product. In all oligopolistic or monopolistic markets there is some tendency for the selling price to rise above average cost. Hence, it may be stated that a general superiority of pure competition holds for realizing the conditions of static resource efficiency. This provides a correlation between pure competition and optimum price competition.

The relationship between dynamic efficiency (performance objective no. 2) and the various market models is more ambiguous. Dynamic efficiency implies that non-price competition is at its optimum and as mentioned earlier, a loose oligopoly approximates that result. Since the attainment of optimum levels of price and non-price competitions are not necessarily consistent with one another, the implications for static and dynamic efficiencies are that they may also prove to be inconsistent. However, the value judgement to

be made in testing the hypothesis regarding combined shifts in pricing and non-pricing competitiveness may be interpreted as having direct implications for the combination of static plus dynamic efficiency performance objectives. If it is judged that overall banking markets have become more competitive, it is implied that they have also become more efficient.

In order for greater efficiency to have a beneficial effect on the public interest, it would be necessary for more competition to necessarily result in an overall improvement in performance. However, there is a third category of performance objectives identified earlier as "Equity and Other Performance Criteria." Essentially this is a residual objective encompassing numerous unique and singular objectives. Few have any strong relationships with the specific market models or the degree of price and non-price competition. Some examples would be; (1) social impact effects (externalities) such as air pollution, which occur as a result of the production process and may create either positive or negative social benefits in conjunction with more competition of either type; (2) an inequitable distribution of wealth, income and opportunity which is consistent with the existence of static efficiency; (3) more persuasive and non-beneficial advertising which may occur at the same time as more non-price competition.

The above paragraph gives three examples from what would be an extremely long list of qualifications to the assumption that more competition is in the public interest. The combinations and

permutations resulting from the effects of changes in price and non-price competition on "other" performance criteria are numerous. This makes any overall judgement regarding the effect of competitive shifts on the public interest a difficult task indeed. At any rate, this task is not undertaken. Performance aspects of the theoretical approach used here are discussed only to provide an overall perspective. The analysis of the hypothesis will be considered complete once the competitive implications of the legislative change have been identified.

CHAPTER II

FOUNDATIONS OF THE STUDY

The object of this study is to analyze an alteration in legislation (the 1967 revision of the Bank Act), with respect to its effect on the competitive circumstances (structure and conduct) of banking markets. This chapter will lay part of the groundwork toward this objective. First, the analytical framework of the thesis will be presented. This framework encompasses all of the relevant features of both the area being studied and the methods of study. Section 1 will briefly and generally follow the thread of the analysis through this framework. In Section 2, the salient features of the various banking markets will be discussed and the major market participants identified.

It should be noted here that the period analyzed is 1966-74. The choice of 1966 as the beginning year follows from obvious reasons. Since the Bank Act revision became effective in 1967, 1966 is the last year in which the legislation had no influence. The choice of 1974 as the final year was arbitrary and based on shifts in basic economic conditions which are not related to the legislation but are constantly affecting the same variables that the Bank Act revision could be expected to alter. The more years of data used, the larger and more complex is the combined impact of these shifts and the more difficult it becomes to observe the effect of the legislative change in isolation. For this reason it is beneficial,

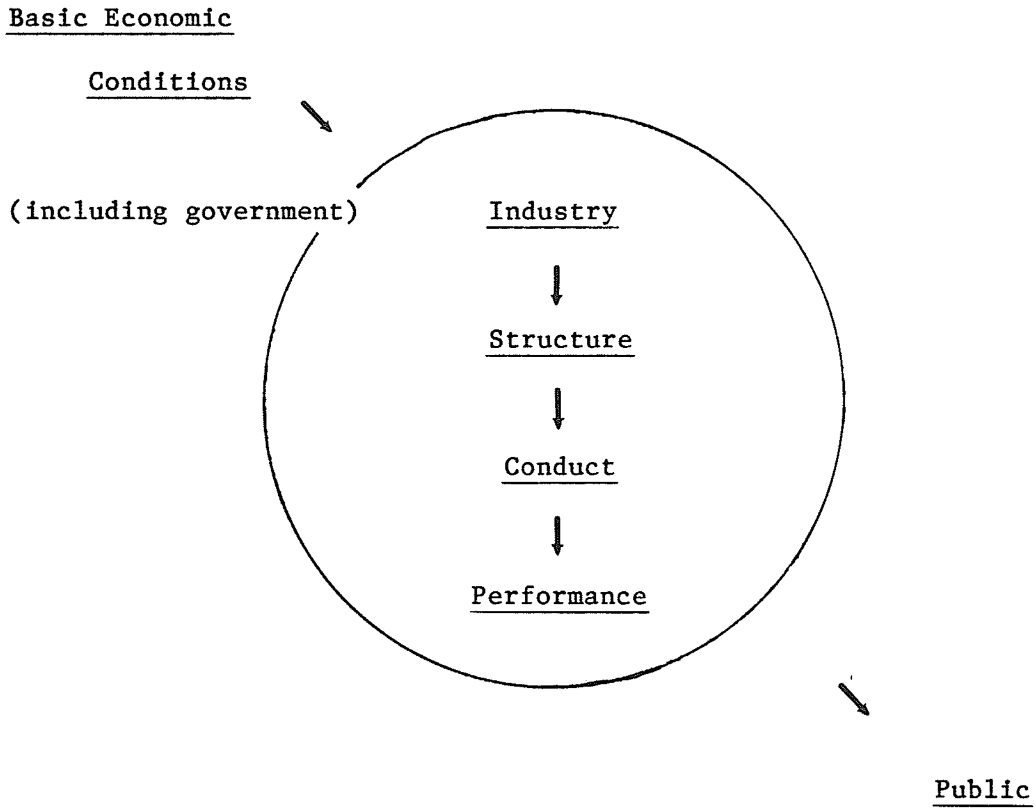
in terms of the analysis, to terminate data collection after a reasonable number of years.

Section 1. The Analytical Framework

The analytical framework of an industrial organization study can be presented in terms of a "flowchart of causation," where linkages run between elements portraying the effects or implications one has for another. This method may be likened to the use of the microscope in scientific studies. First, the framework may be viewed as a single object with no characteristic features. Then, under the "microscope," it may be observed in finer and finer detail, first distinguishing the major primary segments together, then enlarging these individually or in combinations and groups to examine them in a more fragmented manner.

The basic flowchart of a general industrial organization study of this type is shown in Figure 1. The area of concern is the circle, which represents an industry. Within the circle, and abstracting from various feedback effects, there is a flow from structure through conduct to performance. Outside the circle there is a group of basic economic conditions which are relevant to the industry. The Government may be viewed as being one of these basic economic conditions. Through the use of legislation and policy directives, they can directly or indirectly influence operation within the industry. Shifts in the economic conditions and government regulatory methods alter the structure and/or conduct of the

Figure 1



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industry, and subsequently affect the performance. Industry performance has an impact on the public, and it is this impact which the government is trying to control through their policy programs.

Figure 1 is a simplification. It applies to a simple industry, where though there may be many competitors, there is one basic firm type and the sphere of business operations is confined to a homogeneous market. Figure 2 is a more detailed diagramatic presentation of the scope of this analysis.

The financial industry has two special characteristics relative to this framework. First, there are a variety of institutional subsets. Besides the chartered banks, there are other deposit-taking institutions such as trust companies and cooperative banks and there are a variety of non-deposit taking institutions such as sales finance and consumer loan companies. For each type we may speak of their structure, conduct and performance in relation to their activities as institutions.

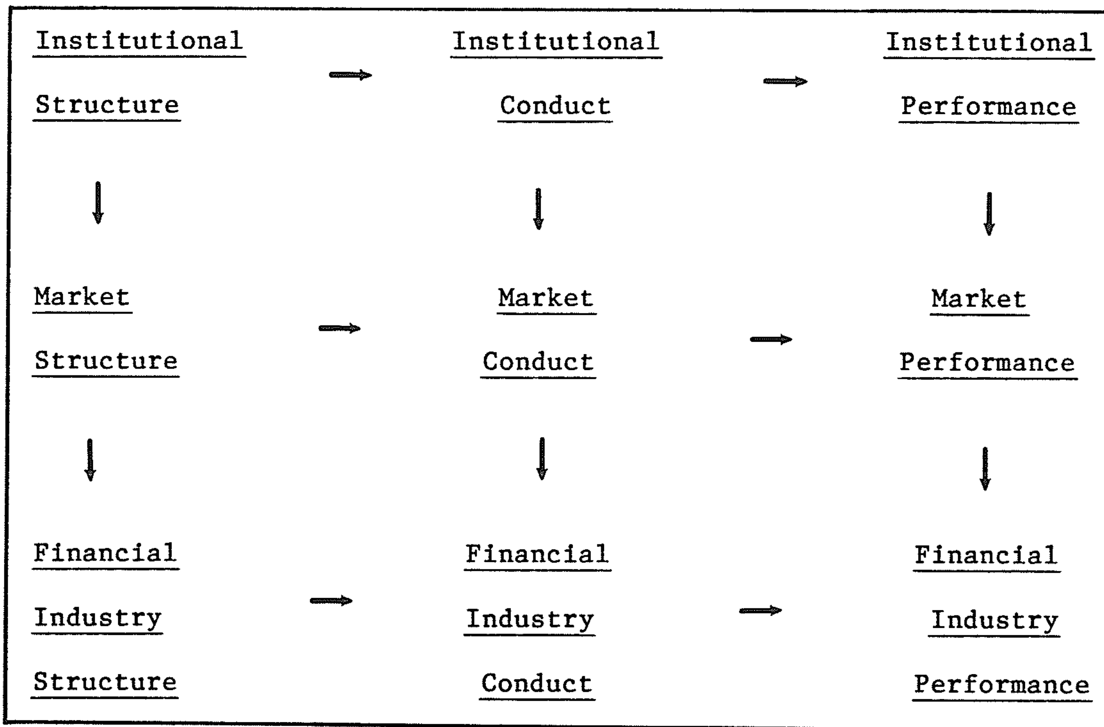
The second important characteristic is that each intermediary operates in a variety of asset and liability markets and there is a considerable overlap in the types of financial instruments utilized by each. When it comes to defining the banking markets suitable for analysis, it must be remembered that competition comes to the banks, not only from other banks but from various other financial institutions as well. To have a comprehensive picture of the competition, it is necessary to consider all participants in a given market.

The combined composition of business activity of the various

Figure 2

Federal Government → Bank of Canada

(Legislation) (Monetary Policy)



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institutional types gives rise to structure, conduct and performance within each individual market. In turn, we may speak of the structure and conduct of the financial industry as a whole which is a combination of the institutional and market characteristics in aggregation. Industry performance, in turn, flows from institutional and market performances, or alternatively from industry structure and conduct. Figure 2 also embodies the regulatory framework. The Federal Government has two basic modes of influencing the financial industry. First, it can pass legislation and second, it can operate a monetary policy through its central bank, the Bank of Canada.

The hypothesis may now be described using Figure 2. The Canadian Government revised the Bank Act in 1967. This altered the existing regulatory framework and influenced changes in the structure and conduct of various institutional types and within specific markets for financial instruments. The hypothesis states that the revision altered the elements of structure and conduct in such a way that in aggregate, these markets became more competitive.

The flow of the analysis could be carried further to examine the impact of the legislation on institutional and market performance and the implications this might have on the overall public interest. However, as described in Chapter 1, this would not have any direct effect on the analysis of the hypothesis as stated.

Section 2. The Markets and Participants

A market can be described as a collection of products that are considered close substitutes from the viewpoint of either the buyer or the seller. Price theory is based on an examination of defined market areas.

Financial instruments are not normally thought of as definable market products, however, with some mental manipulation the same approach can be applied. The primary banking markets are those of loans and deposits. In the deposit markets the financial institution offers for a cost, a stream of repayment which includes the deposit principal plus an additional interest payment and/or various services such as chequing privileges. The deposit markets then, are like most other product markets, in that the firm being analyzed (the financial institution) is the product seller while individuals and other businesses are the buyers.

The loan markets are of a different character. In these markets it is the individuals who offer the product for sale. Loans may be viewed as a stream of repayments for which the financial institution pays an initial lump sum and possibly some additional financial services (e.g. monthly statements of unpaid balances). The important point to note for this study is that the chartered banks and other financial institutions are purchasers of the loans. Thus, when applying price theory to banking markets and measuring market structure and conduct, one must look for degrees of monopoly versus competitive selling in deposit markets and monopsony versus

competitive buying in loan markets. Fortunately the theory adapts well and in practice the differentiation becomes a matter of semantics only.

The deposit market has been subdivided into two submarkets: transaction deposits and term deposits (see Figure 3). The transaction deposit market includes all of those deposits which are utilized in some way for transaction purposes. Obviously this would include demand and chequable savings deposits. Non-chequable savings deposits are also included as they are considered to be a secondary transaction balance. It would have been useful to examine both primary and secondary transaction deposit markets separately, however, the existence of the chequable savings deposit made the calculation of separate market shares and concentration ratios difficult, since this latter deposit type has some of the characteristics of both.[6]

Demand deposits are the most liquid of all financial instruments. No interest is paid on them and they are transferable by cheque, often subject to a service charge. They are available in any denomination for firms and individuals, though the fact they bear no return will encourage their utilization only to that degree necessary to facilitate immediate transactions. Chartered banks are the sole providers of the strict demand deposit. The primary type of deposit in this category is the current account, a non-interest

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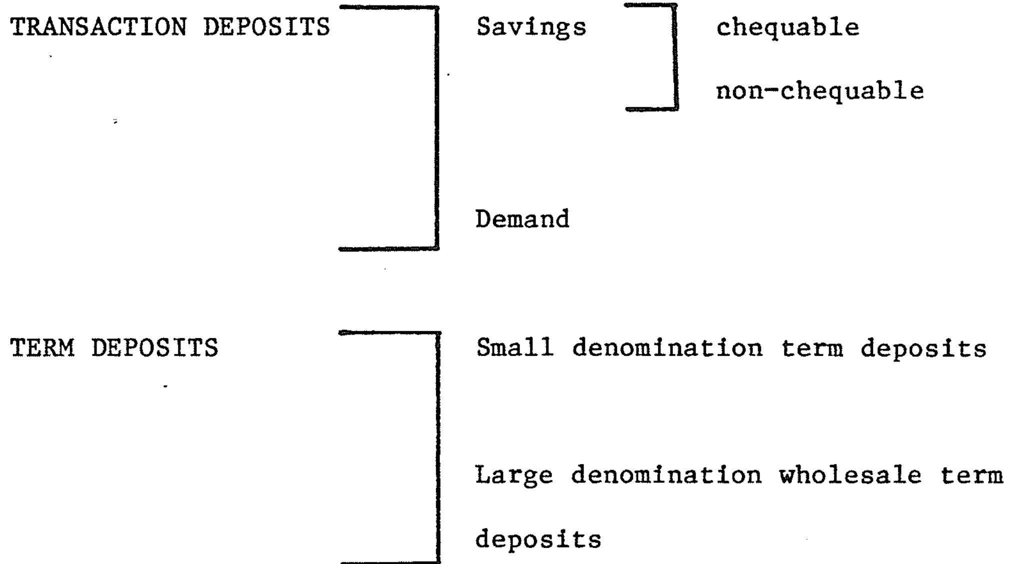
[6]Though demand and savings deposits are aggregated into one single market, called transaction deposits, the analysis will differentiate between the two where possible.

FIGURE 3

DEPOSIT MARKETS



bearing financial vehicle used to operate a business firm's working capital. In 1957 the banks introduced personal chequing accounts for individuals. The chartered banks also offer both chequable and (since 1967) non-chequable savings deposits.

Other insitutions which offer deposits for transaction purposes are called near banks. Trust companies, mortgage loan companies, cooperative banks and Quebec savings banks are all of this type. They do not solicit strict demand accounts concentrating instead on chequable and non-chequable savings deposits. Other financial instruments included in the transaction deposit market include non-chequable savings deposits of Government savings institutions and Canada Savings Bonds. Canada Savings Bonds have some similarity to term deposits in that bonuses have traditionally been offered to anyone keeping the bond to maturity and liquidating them necessitates the acceptance of an interest reduction, but the loss is not as great as in a normal term deposit and a prime selling point of the Canada Savings Bonds appears to be their high degree of liquidity.

The second liability market is that of term deposits. The distinguishing characteristic of this liability instrument is that the deposits are illiquid for a specified period of time, or require prior notice of withdrawal with actual liquidation being subject to interest rate penalties. The existence of secondary markets for large-denomination wholesale deposits improves their liquidity considerably. However, the redemption period still exists whether for the original or secondary purchaser.

Competition in this market comes from a variety of sources including Quebec Savings Banks, Government savings institutions, cooperative banks, and trust and mortgage loan companies. For the cooperative banks not only are their term deposits a part of the market, but share capital as well.[7] Trust companies also issue guaranteed investment certificates while mortgage loan companies offer debentures, both instruments which conform well to the characteristics of the term deposit market. Other financial instruments which also bear the essential characteristics of a term deposit and which have been included in this market are the Canadian dollar short term paper issued both by sales finance companies (finance paper) and commercial companies (commercial paper), bankers' acceptances, Federal treasury bills held by the general public and provincial and municipal treasury bills. Further, it should be noted that this market is defined to include only Canadian dollar term deposits. Foreign-currency deposits and Eurodollar deposits do provide considerable competition for Canadian dollar wholesale term deposits, but an attempt to gather relevant data was not undertaken.

The term deposit market could be further disaggregated because of the very diverse nature of the liabilities included. It was

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[7] The turnover rate of cooperative banks' (credit unions and caisses populaires) share capital varies over a very illiquid time frame of once every 2.5 to 15 years. See David E. Bond and Ronald A. Shearer, The Economics of the Canadian Financial System: Theory, Policy and Institutions (Scarborough, Ontario: Prentice-Hall of Canada Ltd., 1972), p. 212.

decided to give the market a more comprehensive definition and accept this limitation, rather than concentrate on more detailed market areas, where the data are not appropriate,[8] and the danger exists that a considerable degree of competition would not be identified.

There is one important point which deserves emphasis. The analytical method chosen requires the segregation of deposits into specific markets. This study has chosen that form of segregation which both utilizes the available data to best advantage while still being indicative of the extent of competition within an extremely heterogeneous product market. The choice is open to question, and other studies have opted for various alternatives. For instance, Brian Griffiths[9] chose to include chartered bank term deposits and all cooperative bank deposits, including chequable savings, in a savings deposit market. James Dean and Richard Schwindt[10] did not examine the term deposit market at all. The Economic Council's study on banking efficiency used a deposit breakdown which was

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[8] Data disaggregating bank term deposit totals by term to maturity is not reported.

[9] Brian Griffiths, "Competition and Regulations in Oligopoly Banking: The Canadian Experience with the 1967 Bank Act," in mimeo, presented to the Queen's University Conference on Canadian Monetary Issues, August, 1975.

[10] James W. Dean and Richard Schwindt, "Bank Act Revision in Canada: Past and Potential Effects on Market Structure and Competition," in mimeo, presented to the Queen's University Conference on Canadian Monetary Issues, August, 1975.

composed of chequable deposits, non-chequable household deposits and non-chequable corporate deposits. The latter conform most closely with the term deposit market of this study, but include a number of corporate and institutional savings deposits and do not include personal term deposits.[11] An important point to keep in mind is that the fungible nature of the various markets makes any disaggregation lack total validity as some substitutions will still be evident across groupings.

The loan market is divided first into two sub-markets; security loans and mortgage loans. The security loan market is further disaggregated into the consumer and commercial loan markets, a division based primarily on the type of issuer. Mortgages can also be subdivided by issuer into residential mortgages (including both conventional and NHA approved) and non-residential. (see Figure 4) However, the data required to give an accurate breakdown of the mortgage credit market by type of issuer was not available. Thus, three credit market areas are examined, the consumer and commercial credit markets are submarkets of the larger security loan market, while the mortgage credit market is an aggregated presentation.

Commercial loans are highly tailored to the needs of the individual enterprise, hence they are extremely differentiable and lumping them all together abstracts from this point. Moreover, many

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11 Canada, Economic Council of Canada, Efficiency and Regulations, a Study of Deposit Institutions, (Minister of Supply and Services, Canada, 1976), pp. 31-34.

Figure 4

Loan Markets

Security Loans

Consumer Loans

Commercial Loans

Mortgage Loans

Residential

Conventional

N.H.A. Approved

Non-Residential

broad categories of borrowers may be distinguished such as high risk credit seekers, low-risk credit seekers, small community endeavours, large corporations, foreign subsidiaries etc. Banks pervade the entire market, while other smaller institutions have had to focus on more specific clientele. The banks' prime source of competition for the small business loan comes from the sales finance companies who concentrate on the higher risk end of the market and charge considerably higher interest rates.[12] Cooperative banks, in keeping with their traditional philosophy, have concentrated on mortgages and personal loans, and while they do participate in the commercial market it is primarily at a low-key local level. The Industrial Development Bank, a wholly owned subsidiary of the Bank of Canada, also operates in this market, however it normally assumes the role of lender of last resort. Only those individuals unable to obtain credit elsewhere on reasonable terms may apply. In the 1970's foreign wholesale banks have become significant participants in the commercial credit market.

Many corporations have access to various alternative forms of financing and they have less dependency upon bank loans and other types of commercial credit. Besides the use of internal funds, a firm may issue commercial paper if their needs are short term, or

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[12] In the data reported, sales finance companies are aggregated with consumer loan companies. This is not because of the lack of differentiable characteristics between the two, however, and where it is useful and possible to do so, they will be discussed separately.

appeal to public sources through equity and bond financing if their needs are for a longer duration. The commercial paper totals are considered here as part of the commercial credit market.[13]

The banks have not always participated in the market for consumer credit. Until 1954 they were legally restricted from utilizing this form of asset, and most of their activities in this regard date only from then. In recent years however, they have surpassed all other intermediaries in the market share they control.

Like the business loan, the consumer loan is a highly differentiable asset, with the precise design dependent upon a number of factors such as the credit worthiness of the borrower or size of loan. Terms will differ with regard to size, interest payments, specified repayment periods, etc. Again the banks pervade the entire market while other institutions concentrate on specific areas. Prime competition comes from cooperative banks who lend to members in small amounts. On the liability side they emphasize the saving aspect and consumer loans are complementary to that type of activity. Sales finance and consumer loan companies and particularly the latter are a significant source of funds for those individuals who cannot obtain funding elsewhere because of the high risk nature of their credit

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[13] The longer term bond and equity instruments as well as leasing contracts have not been included as part of the measured commercial credit market as the banks do not participate readily in the long end of the market. They have emphasized short and medium term self-liquidating loans because of the nature of their liabilities.

position, but the costs of such loans are considerably more. Retail dealers have taken advantage of the convenience of credit cards in the process of exchange and provide a large volume of credit in the form of their accounts receivable. The price of such credit is high to compensate for high degrees of risk. Life insurance companies enter the consumer credit market by issuing loans secured by customer policies and while not a major competitor they are evident. Further competition comes from Quebec Savings Banks, but their involvement is minimal.

The number of institutions involved in the mortgage market is greater and distribution more equal than in the other credit markets. Mortgages are a longer term, high interest bearing and relatively non-liquid asset. For this reason, they appeal to those institutions which require lower levels of liquidity. However, the fact that they are repaid on a monthly basis and that, in the case of residential mortgages are set for a maximum 5 year term, creates a constant flow of repayment funds, which mitigates the liquidity problem to a large degree.

Chartered bank entry in the mortgage market began in 1954 when the Bank Act revision of that year allowed them to issue NHA guaranteed mortgage loans. Since that date they have increased their share of the market considerably.

Trust companies, mortgage loan companies, mutual and closed-end funds, life insurance companies, trusteed pension funds and recently mortgage investment trust corporations have been involved in the

mortgage market for the purposes of matching their assets to the specific characteristics of their liabilities. Cooperative banks and Quebec Savings Banks are involved, largely in response to the needs inherent with the clientele they solicit. Consumer loan and sales finance companies also participate, but once again, they are more liable to attract the needs of those with poorer credit ratings and unable to obtain mortgage financing at cheaper rates elsewhere. The Federal Government is also a prime entrant in this market, mainly through the mortgage holdings of the Central Mortgage and Housing Corporation. Small amounts are also held by general insurance companies, fraternal benefit societies, provincial government institutions and various non-financial economic units.

CHAPTER III

THE 1967 BANK ACT REVISION

Chapter I discussed the theoretical aspects of this study. Chapter II outlined the financial area under examination and provided information on the participants involved. Chapter III completes the basic framework for the study. The chapter provides a concise description of the economic and legislative conditions leading up to and influencing the 1967 Bank Act revision and closes with an itemized list of the main points in the revision.

Section I. The Pre-1967 Environment

Consider the chartered banks as an institutional group and two aspects are immediately apparent. First, they are few in number and second, they are large in size. Table 1 shows that in 1960 there were 9 chartered banks in Canada with an average of 561.2 branches per bank. Only five of these could be considered nation-wide retail banking institutions and they were in control of over 90% of all chartered bank assets prior to 1967 (see Table 4).

Entry into banking in the pre-1967 period was minimal with only two new chartered banks being formed between 1925 and 1960 and the four mergers that took place over that period actually reduced the number of chartered banks by two. A number of entry barriers were in effect during this period and these were instrumental in restricting the establishment of new banking entities. Barriers were of two main

TABLE 1

ENTRY INTO CHARTERED BANKING 1867-1973

Year	Number of Banks	New Banks	Mergers	Failures	Number of Branches/Banks
1867	35				3.5
1900	35	26	7	19	20.2
1925	11	11	26	9	349.1
1950	10	1	2	0	367.9
1960	9	1	2	0	561.2
1968	10	2	1	0	658.0
1973	10	1	1	0	670.1

Sources: Bond and Shearer, Financial System, p. 321.
Statistics Canada, Credit Unions, catalogue number 61-004.

types; legal and structural. The main legal barriers were an incorporation barrier, which refers to the lengthy and complicated procedure required to procure a bank charter and a financial barrier which refers to the financial requirements new bank prospects had to meet. Structural barriers arose from the large size of existing banks which, in general, placed new banks at cost and service disadvantages.

In pre-1967 banking markets there were no stipulations in the Bank Act preventing the banks from utilizing collusive pricing tactics. The banks on the whole had identical prime rates on business loans, deposit rates on savings accounts, service charges etc. The banks were also slow in recognizing the near banks as competitive threats. This enabled some trust and mortgage loan companies to gain ground in various markets through innovations designed to fulfill the needs of the customer, while banks geared their products to what would better utilize existing expertise, rather than investing in new technology.

These characteristics indicate that prior to the 1967 Bank Act revision the chartered banks were a tightly-knit oligopolistic group with high entry barriers, few and large sized firms, interdependent pricing and low levels of non-price competitive behaviour. This situation was tolerated, or even supported, by government policy makers in the interests of promoting policy objectives which transcended competitive considerations in banking markets. For example, the government has, at times, been more concerned with the stability of the financial industry, maintaining Canadian control of the financial industry and the promotion of an effective monetary policy.

At the time of Confederation the foremost financial policy objective in the minds of political leaders was the need for stability in financial dealings.[14] This objective can be traced back to the early bank charters wherein it was often felt necessary to protect depositors through limitations imposed on the amount of allowable debts, controlling entry by requiring legislative approval of bank charters and legally specifying the types of assets the banks could pursue in compliance with the commercial loan theory of banking. The Bank Act of 1871 reinforced these principles, then early revisions set out specific capital requirements and temporarily condoned merger activity upon request in attempts to lessen the degree of risk in banking made apparent by a number of failures during the years immediately following confederation.

In the 1913 revision, mergers were felt to be concentrating economic power and the unrestricted right to combine firms was rescinded and subsequently required the consent of the Minister of Finance. However, stability was still uppermost in the government's mind and to further ensure that, bank inspection by external audit became mandatory. Then, during the first World War, the Department of Finance became the lender of last resort for financially troubled banks. In this respect they were a forerunner of the Bank of Canada, though the purpose of the enabling legislation, known as the Finance Act, had no pretension toward activating a government monetary

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[14] The description of the pre-1967 legal environment facing the banks has largely been taken from Bond and Shearer, <u>Financial System</u>, see especially Chapter 12, "The Development of the Canadian Financial System," pp. 248-280.

policy.

A spectacular bank failure in Canada occurred in 1923 when the Home Bank closed its doors and investigation by a Royal Commission uncovered several examples of misconduct on the part of firm officials. As a result the government undertook personal inspection of the banks on an annual basis. Since that date, Canada has never again been troubled by bank failures. This can be partly attributed to the sufficiency of the existing legislation and partly to the increased size of the banks which were extremely large even in the 1920's. In any event, the stability problem was eventually relegated to the background as an issue of policy. One further piece of legislation did result in the setting up of a 5% reserve requirement during the mid-1930's. It was designed as a safety device to ensure the matching of bank liabilities to bank assets, though in the 1950's and 1960's this purpose became blurred as the reserve requirement came into use for monetary management.

Monetary control did not become a central issue until the depressionary period of the 1930's when the contractionary activity of the chartered banks in the face of falling prosperity pointed out the deficiencies of the Finance Act. That act gave a government bureau partial control over bank reserves but it was the banks themselves who initiated any borrowing activity, so while the government had their finger in the pie so to speak, they as yet had no control.

A major change came in 1935 when the Bank of Canada began operations. Its immediate impact was minimal. It replaced the

Department of Finance as the lender of last resort and regulated the 5% legal reserve requirement. This latter legality offered little control leverage as the banks chose to operate with actual reserves far in excess of the limit, partly due to past experiences and partly due to the lack of an efficient money market to enhance their liquidity position. The central bank in turn busied itself serving the government's increased needs for funds and debt financing primarily through the maintenance of a low bond rate. This effectively removed all possibilities of manipulating the monetary aggregate.

The Bank Act revision of 1954, in conjunction with certain institutional changes, opened the door for an operative monetary policy in the sense that it is known today. The important part of the legislation was an increase in the reserve requirement from 5% to 8% with the Bank of Canada being given the authority to alter it at the rate of 1% per month, up to a 12% maximum. At the same time, the auctioning of treasury bills was increased in volume and frequency and though not legally required to do so, the chartered banks agreed to invest an additional 7% of their assets in cash, day to day loans or treasury bills (a secondary reserve requirement). These institutional changes sharply increased the demand for short-term government securities and facilitated the establishment of a more active money market. The banks removed their cushion of excess reserves and the central bank was given the potential to assume control over chartered bank reserves.

The competitive aspects of chartered banking were not given a high policy priority in the years before 1967. In fact, it is difficult to distinguish any legislation formulated for the promotion of competitiveness in the financial industry.[15] The absence or lack of competition among the chartered banks had been, on occasion, a concern of the Canadian government, but that problem was not as basic as its search for ways of preventing the insolvency of financial institutions. The main thrust of policy appears to have been to provide stability in Canada's financial system and thereby, to contribute to the stabilization of the Canadian economy as a whole.

The parts of the legislation designed to promote industry soundness did tend to have an indirect effect on banking competitiveness. For example, the cash reserve requirements facing the chartered banks were originally designed to ensure that they would match their assets with their liabilities, particularly in terms of risk and liquidity. The competitive effect of the reserve requirements was to result in a strict stipulation for a set percentage of chartered bank assets being held in low interest bearing financial instruments. This handicapped the earning potential of the chartered banks. Further, the banks were not made subject to anti-combines legislation.

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15 Only the 1913 action which put an end to wholesale merger activity can be so interpreted, but the government did not choose to exercise their power over banking concentration and merger approval was little more than a formality.

Merger and price setting activities were condoned by the government primarily because that tended to result in larger more stable institutions and minimized the possibilities of bank failures. As a result price competition between the chartered banks was practically non-existent.

The chartered banks did receive significant competitive pressure from other financial intermediaries, and a number of the regulations imposed upon them prevented effective retaliation. Particularly prohibitive were the severe restrictions on the types of asset and liability markets they could participate in. The original Bank Act had designated the banks to be commercial lenders only, in compliance with the commercial loan theory of banking. The impact of this restriction only became apparent well into this century as the increasingly diverse needs for funds led to the development of new and different types of loan activity from which the banks were excluded.

The erosion of the commercial loan principle began as early as the 1913 revision of the Bank Act when the banks were permitted to make loans against the grain holdings of farmers. In 1937 they were allowed to make unsecured home improvement loans. In 1944 the Farm Improvement Loans Act gave them the right to provide funds secured by farming and fishing equipment. The Bank Act revision of 1954 permitted the banks to make loans secured by chattel mortgages and the National Housing Act of the same year opened up the field of residential mortgages, though only those insured by the government.

The conventional mortgage market remained out of bounds for the chartered banks.

The development of Canada's financial system and the rules governing that system have taken place over time and what seems appropriate in one era, for one reason or another, may lack credibility given a change of circumstances. In this context it is only natural that the Bank Act in existence in 1967 should be at least partly inappropriate for the economic conditions of that year.

During the period between Bank Act revisions the progressive attitudes of near banks and steadily rising interest rates, which were rapidly reaching the six percent ceiling imposed upon the chartered banks in the original Bank Act of 1871, led to a serious erosion of the banks' competitive powers. Customer demand for the financial instruments of the banks declined and the banks were forced to raise the rate paid on deposits as other firms offered more competitive services. This raised the costs of banking activities. The reserve requirements all banks were subject to reinforced this difficulty by forcing banks to hold part of their funds in low or non-interest bearing assets. Relative to other institutions bank output declined while their interest rates accelerated upward to cover costs. This latter trend was reinforced by the generally rising nature of all interest rates in response to inflationary pressures within the economy.

The banks were caught in the midst of an economic squeeze. They had to raise rates to remain competitive, but the legally imposed

ceiling indicated they could go no higher. The bank prime rate hit the ceiling in December 1965 and other market rates continued upward. The banks utilized methods such as compensating balances which enabled them to partially circumvent the restriction, but such methods were demeaning in principal and costly in practice. The banks soon began to lose strength in both deposit and loan markets. In the N.H.A. mortgage market, the banks had begun dropping out as early as 1959 when N.H.A. rates reached the ceiling. In this instance, at least, they found themselves unable to cover costs.

Section 2. The Legislation

There is little doubt that the Bank Act in effect prior to 1967 was no longer appropriate for the situation it was designed to control. The Porter Commission was appointed in 1961 to recommend a regulatory framework that would be more suitable. Their report submitted February 5, 1964 proved sympathetic to the bankers' position. In the Commission's own words, "Despite the fact that they (the banks) have served the country well on the whole, their relative position has declined. This has resulted from the changed nature of the economy's credit requirements . . . (and) from the limitations on the banks' activities . . ."[16] The Porter Commission recognized that the inefficient and non-aggressive attitudes of the banks were

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[16] Canada, Report on the Royal Commission on Banking and Finance, 1964. (Ottawa: Queen's Printer, 1965), p. 146.

partly responsible for their (the banks') relative decline but the Commission's position on the restrictive nature of the regulatory framework was quite clear.

With the rationale that more competitive markets could best be promoted through the reduction of legal barriers and restrictions pertaining to the chartered banks, the Porter Commission gave nine basic recommendations for legislative change as follows:[17]

(1) Banking should be defined to include all deposit-taking institutions and reserve requirements should be required of every one of them (362)

(2) Mortgage market restrictions on the chartered banks should be removed (364)

(3) The interest rate ceiling on chartered bank loan activity should be removed (365)

(4) Collusive pricing agreements on the part of the chartered banks should be statutorily illegal (370)

(5) The primary reserve ratio should be a function of the riskiness of the liability in question (396)

(6) Banks should be restricted to owning less than 10% of the stock of other financial institutions (371)

(7) A deposit insurance scheme should be set up but the chartered banks should not be required to participate (382)

(8) Foreign banks should be permitted to open agencies in

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[17] The bracketed figures represent a page number of the report where each issue is discussed.

Canada, but not allowed to pursue deposit attraction (372)

(9) The purchase of banking stock by foreign interests should be subject to treasury board approval (373)

With this report as his primary source of documentary evidence, the Liberal finance minister, D. Walter Gordon sponsored Bill C-102 which was tabled on May 6, 1965. The content of the legislation made it obvious that Gordon had only partly agreed with the Commission. He incorporated only recommendations (2), (4) and (6) without alterations. Banking was to continue to be defined institutionally with reserve requirements applicable to chartered banks only; the interest rate ceiling was to remain effective in the interests of small businessmen and there was still to be a single reserve ratio for all types of deposits. In turn, certain proposals that the Porter Commission had not recommended and in some cases even argued against were introduced. Examples of the latter were changes in the timing of the reserve adjustment procedure, making it a fortnightly exercise rather than monthly and the institutionalizing of the secondary reserve requirement.

The Gordon sponsored legislation was abandoned as a result of an impending election and though the Liberals were eventually re-elected, there was a new Finance Minister, Mitchell Sharpe. Sharpe reproposed the banking legislation in the fall of 1966. This second proposal was not identical to Gordon's and tended to be more compliant with the Porter Commission's proposals. Most importantly, the interest rate ceiling, though not completely removed, was to be

dissolved gradually and a varying reserve requirement adopted.

The legislation in its final form, Bill C-222 became law on May 1, 1967. At this time the various elements of the new law will be listed separately to provide a comprehensive understanding of what is meant by the term already utilized, "the 1967 Bank Act revision."[18]

The final elements of the legislation were as follows:[19]

(1) In compliance with Porter's primary recommendation the interest rate ceiling on chartered bank loans was removed. The legislation provided for a gradual removal of the restriction to create an orderly transition. The formula set a ceiling 1 3/4 percentage points above the average yield on short term government bonds. If this average was to rise above 4 1/2%, the ceiling would collapse. A fixed ceiling of 7 1/4% would be in effect until the beginning of 1968. In practise the ceiling was removed totally on January 1, 1968.

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[18] In reality, there were a number of significant pieces of financial legislation in 1967, including not only the revision of the Bank Act but also the Canada Deposit Insurance Act, revisions to the Bank of Canada Act and complementary provincial legislation on deposit insurance. For simplicity any and all of these relevant changes will be referred to collectively as the 1967 Bank Act revision.

[19] For a more detailed description of the legislation, see Harvey J. Perry, "1967 Bank Act Revision," The Canadian Banker, Vol. 74, II, 1967, pp. 28-43.

(2) The banks were allowed into mortgage lending in a gradual way. Originally they were restricted to holding assets in mortgage form to up to 3% of Canadian dollar deposit and debenture liabilities with an increase of one percentage point per year up to 10% by 1974.

(3) Primary reserves of the chartered banks would be fixed rather than variable, and were to be applicable to bank deposits dependent upon a dual liquidity distinction. Reserves on demand accounts were to increase 1/2 a percentage point each month from the then effective rate of 8% until 12% was attained while the reserve ratio on term and savings deposits would fall by the same 1/2 percentage point until 4% was reached.

(4) The previously voluntary and rigid secondary reserve ratio became a legally instituted variable option for the Bank of Canada's monetary policy requirements. This ratio could vary anywhere from 0 to 12% of all deposits with a maximum shift of one percentage point per month.

(5) The adjustment of reserves had always taken place monthly. The new legislation shortened this to a fortnightly procedure.

(6) The banks were given the option of offering debentures as an additional means of attracting funds.

(7) The ownership and control of non-deposit-taking institutions by the banks was to be limited to 50% of total shares

provided that the original cost did not exceed $5 million and 10% if the cost was over that amount. Banks were forbidden to hold more than 10% of any deposit-taking firm. These restrictions would not be applicable to institutions offering services complementary to the business of banking.

(8) Interlocking directorships between chartered banks and other deposit-taking institutions were explicitly prohibited.

(9) The banks were forbidden to make binding agreements on the interest rates of domestic loan and deposit activity. Any violation was to be subject to a $10,000 fine.

(10) Foreign ownership of a Canadian chartered bank could not exceed 25% of the voting stock and a single individual's ownership could not exceed 10%. These restrictions were qualified to permit foreign ownership above the 25% rule, if a bank kept total liabilities at less than 20 times authorized capital.

(11) All federally chartered banks and trust and loan companies were compelled to insure their deposits up to a level of $20,000 for a single account at the rate of 1/13% of total insurable deposits. There was also complementary provincial legislation requiring the insuring of deposits at provincially chartered trust and loan companies.

(12) A number of changes required increased disclosure of the operations of the chartered banks. Each bank had to publicize yearly statements of assets and liabilities,

revenues and expenses including undivided profits and accumulated appropriations for losses. Further, they had to provide the minister of finance with monthly and yearly reports.

While the final content of the legislation did not embody all of the Porter Commission's recommendations it is obvious that the main emphasis was in compliance with the Commission's position that more competitive banking markets should be promoted. Market entry barriers that the chartered banks had been facing were either removed, as in the case of the interest rate ceiling or reduced as in the cases of the primary reserve requirements and restrictions on conventional mortgage activity. Interdependent pricing on deposit and loan rates was legally prohibited by the revision, though this did not apply to demand deposit service charges. Ownership and boardroom relationships across institutional boundaries were to be curtailed or reduced. The direction of this study will now shift to the analysis of whether or not the revision did in fact result in a greater degree of competition in banking markets.

CHAPTER IV

THE EFFECT OF THE 1967 BANK ACT REVISION ON INSTITUTIONAL COMPETITION

This chapter is concerned with the effect of the 1967 Bank Act revision on competitiveness within individual institutional groups. It relates to the evaluation of the hypothesis since shifts in institutional competitiveness can be expected to have an effect on all markets in which the institutions participate. For example, if the legislation caused a reduction in chartered bank entry barriers and resulted in a number of new banking entrants, it would have affected a competitive stimulus to each of the five banking markets provided some or all of the new banks became involved in each market. Thus, this initial analytical step will relate to all five markets to be examined and will provide information to be alluded to later in the individual market evaluations and the summary and conclusions chapter.

In Chapter I it was described how shifts in competition would be measured by identifiable changes in structure and conduct. To recap, the elements of structure examined will be the numbers and sizes of firms and the existence or non-existence of entry barriers. The elements of conduct to be looked at will be pricing behaviour and non-pricing behaviour.

As Table 1 showed, chartered banking was enjoying the stimulation of few newcomers prior to 1967. One of the prime reasons for this was the existence of significant entry barriers which discouraged most prospective banking groups. These barriers were

both legal and market-oriented.

The two major legal restraints on banking entry have been the incorporation and financial barriers. Prior to 1967, the incorporation or chartering of a chartered bank required a special act of Parliament and that involved a lengthy process. First, a private member's bill had to be passed by Parliament during the private member's hour where it could easily be delayed by a few members. If it passed second reading, it was referred to a standing committee which could question the bill's sponsors regarding their capacity to carry on a banking business. Once the charter had been given, the new bank still had to wait for a certificate from the government which entitled them to open for business. Before issuing such a certificate the government first had to ensure that all legal requirements were met. To give an idea of this process in action, two charters applied for prior to 1967, those of the Bank of British Columbia and La Banque Populaire both took more than four years from the date of application to the dates they actually opened for business (see Table 2).

The Bank Act also set out a financial barrier in the form of a minimum capital requirement of $1 million. At least half of this was to be on deposit with the Minister of Finance before a board of directors could be appointed or the operational certificate applied for. The bank had to raise the funds within one year of its incorporation or its charter would lapse. This figure of $1 million is much higher than similar provisions in the United States, which

TABLE 2

DATES OF APPLICATION FOR BANK CHARTERS AND DATES OF COMMENCED BUSINESS, 1925-1974

	Date of Application for Charter	Date Business Commenced
Barclay's Bank	December, 1928	September, 1929
Mercantile	October, 1952	December, 1953
Bank of B.C.	March, 1964	July, 1968
La Banque Populaire	September, 1964	November, 1968
Unity Bank	March, 1971	March, 1973

Dale Orr, "The Economic Determinants of Entry into Canadian Banking: 1963-7," Canadian Journal of Economics, VII, No. 1, February, 1974. pp. 82-99.

Senate Proceedings, "An Act to Incorporate the United Bank of Canada," Issue No. 34, Sept. 15, 1971 and Issue No. 37, Oct. 6, 1971.

ranged from $50,000 to $200,000 depending upon city size.[20] In contrast to Canada, the American system has fostered the development of a large number of operating banks, many of which have much less of an asset base than the smallest of Canadian chartered banks. It should be noted that since the financing requirement is in nominal terms, its burden has lessened over time. In the present it no longer seems to be a major restriction.

These legal barriers to entry have been significant in keeping entry to Canadian chartered banking at a minimum. But the very structure of the banking industry and the existence of scale economies have been even more important in the sense that they present operational barriers which would preclude most prospective banking groups from even considering a charter application.

In the loan markets, new banks face the size, nation-wide branch networks, experience and wide range of services that existing chartered banks have developed over years of operation. Attracting loan customers in such an environment is a difficult hurdle to surmount. In the deposit markets new banks must compete in a market in which the major existing banks operate on a national scale and where few market opportunities ever surface. The small size of an emerging bank raises questions regarding its soundness and stability as a financial institution.

Banking as an industry is subject to economies of scale so that not only do prospective new banks face the initial difficulty of gaining entry to the market, but they are also likely to encounter

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[20] Bond and Shearer, Financial Systems, p. 322.

serious cost disadvantages in their day-to-day operations. The scale economies depend upon the nature of the business being pursued, with strong scale economies in commercial business promotion and lesser economies in the handling of demand and term deposits. The research is not available to indicate the impact scale economies do have in Canadian banking, but it does seem apparent that a small emerging chartered bank would, at least initially, be facing serious cost disadvantages. As a final point it should be noted that these structural effects should be considered barriers in general. Specific examples do exist wherein a chartered bank's small size has not been a major problem (e.g. the Mercantile Bank has managed to fare well in the wholesale markets for term deposits and large-denomination credit instruments).

Along with these barriers there are also incentives to entry which should be considered. Primarily, these are the high profit and growth rates of the banking group. Dale Orr examined these two rates in banking and found them substantially larger than equivalent rates in the manufacturing sector.[21] The combination of large incentives to entry and few new additions provides evidence of the severity of the entry barriers.

Orr estimated that given incentives and barriers similar to those existing in manufacturing, banking could expect two new

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[21] Dale Orr, "The Economic Determinants of Entry into Canadian Banking: 1963-67," Canadian Journal of Economics, Vol. VII, No. 1, Feb. 1974.

entrants per year. That the observed rate is significantly lower, he attributes primarily to the various provisions of the Bank Act.[22] The Economic Council echoed these sentiments saying that "Since profit rates in banking are relatively high . . . the removal of regulatory barriers would likely result in greater direct entry into banking."[23]

Entry into banking has not been significant during the post-1967 years either. The Bank of British Columbia and La Banque Populaire both began operations in 1968, but by 1971 the latter had merged with Banque Provinciale. In 1973 the Unity Bank began operations. This left 10 banks operating in Canada in 1974 compared to 8 in 1966. Even this meager influx into banking is likely overstated to some degree since the post-1967 entrants concentrated their operations in specific areas of concern. For example, the Bank of British Columbia carries out a large portion of its business in the province of British Columbia.

The 1967 legislation actually increased regulatory barriers to banking. It legally banned foreign owned chartered banks, requiring the one foreign owned operation (The Mercantile) to sell a majority portion to Canadian interests. Further, it made the establishment of chartered banks by near banks difficult propositions through restric-

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[22] Ibid., p. 97.

[23] Economic Council, Efficiency and Regulation, p. 40.

tions on joint ownership and interlocking directorships between the chartered banks and the near banks.

Near banks other than the Quebec Savings Banks are far less concentrated than are the chartered banks. As Table 3 shows there were 65 trust companies and 4,934 co-operatives at the end of 1966. Bond and Shearer note that entries into non-banking areas of deposit-taking had been significant during the pre-1967 period. Between 1950 and 1966 the number of co-operatives increased in the neighbourhood of 50%, while trust and loan companies doubled in number.[24]

The near banks do not have as severe an incorporation barrier as do the chartered banks. For trust and mortgage loan companies there are a number of operating requirements such as minimum capital to liability ratios, something to which banks are exempt, but the only primary pre-operating requirement is an initial capital level of $500,000. By itself, this is a minimal barrier. Co-operatives are only constrained by the need to register a group which holds a common bond of association whether through ethnic background, geographical location, a common employer, group members, etc.

After 1967, entry in near banking was much reduced from the expansion of previous periods. Cooperative bank numbers fell from 4,934 to 4,256 over the 1966-73 period, while the number of trust companies was unchanged at 65 over the years 1966-74 (see Table 3).

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[24] Bond and Shearer, Financial System, p. 325. They give these figures as estimates due to a lack of accurate comprehensive information.

TABLE 3

NEAR BANKS (NUMBER OF MARKET PARTICIPANTS) 1964-74

Year	Co-operatives	Trust Companies
1964	4870	63
1965	4938	65
1966	4934	65
1967	4911	64
1968	4861	63
1969	4769	61
1970	4595	(59) est.
1971	4444	61
1972	4350	61
1973	4256	63
1974		65

Sources: Statistics Canada, Credit Unions, catalogue number 61-209.

Department of Agriculture, Credit Unions in Canada.
The Trust Companies Association of Canada, General Information Bulletin.
The Trust Companies Association of Canada, Directory of Canadian Trust Companies.

This decline in entry can be at least partially attributed to the near banks' fear of expanded bank powers that resulted from the revision. Those near banks which survived prospered in terms of sales volume, but the reduction in rate-yield spreads necessitated by expanding bank prominence in term deposits made feasible operations difficult for fringe members of the near banking community.

The competitive strength of the chartered banks relative to the near banks was influenced primarily by the removal of the interest rate ceiling on chartered bank loans and the reduction of the primary reserve requirement. The removal of the rate ceiling enabled the banks to compete more vigorously in deposit markets by enabling them to increase the size of their overall deposit rate structure. The primary reserve requirement was split to become 4% for term and savings deposits and 12% for demand deposits. Effectively the requirement settled at 6 - 6 1/2% of all deposits, below the previously legislated level of 8%. The Chartered banks' primary reserve requirement is satisfied by low or non-interest bearing assets and the reduction in the banks' required holdings of these types of assets increased their earnings potential and, in turn, resulted in a negative effect on the earning potential of the near banks.

Within banking itself concentration remained at a very high level. The five-firm concentration ratio declined only slightly from 93.2% in 1966 to 91.3% in 1974. The three largest banks lost some ground relative to the others. The Royal Bank fell from 25.1% to 23.6% of all bank assets over the 1966-74 period while equivalent figures for the Commerce were 24.0% to 20.9% and for the Bank of

Montreal, 19.7% to 18.9% (see Table 4). All the smaller banks increased their share so to some extent the strength of the larger banks lessened, but such small degrees of change at such high degrees of concentration are not likely representative of shifts in market power.

In the area of pricing behaviour the legislation prohibited interdependent price setting among the chartered banks except in the case of service charges on demand deposits. However, as will be seen in the analysis of bank pricing behaviour within the individual markets,[25] that though the banks pricing practices were altered, in reality the results were much the same. The analysis will show that since the revision, the collusive price setting activities of the chartered banks has given way to price determination which is dependent on one or more of the banks for price leadership or alternatively follows the direction of the central bank which indicates its concerns through changes in the bank rate.

In the non-price behaviour area of conduct, the chartered banks had traditionally been slow to adopt modern management techniques. In the post-1967 period, however, this was changing. They quickly developed new methods of analyzing customers in terms of yields, credit worthiness, size and turnover rate. They diversified in terms of the types of deposits and loans they offered and stepped up their degree of innovativeness overall. On line or computerized

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25 In particular see the discussion in Chapter V on how the chartered banks' prime rates were determined in the post-1967 period.

TABLE 4

INDIVIDUAL BANK ASSETS, 1964-74

(billions of dollars, percentage of all banks in brackets)

Five-firm concentration Ratio	93.3%	93.0%	93.2%	93.3%	93.4%	93.0%	92.3%	91.9%	91.6%	91.7%	91.3%
Bank/Year	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974
Bank of Montreal	4.9 (20.5)	5.1 (19.7)	5.5 (19.7)	6.3 (19.9)	6.9 (19.1)	8.4 (19.7)	9.4 (19.3)	10.4 (19.1)	11.7 (18.5)	15.5 (19.4)	18.4 (18.9)
Bank of Nova Scotia	3.0 (12.6)	3.3 (12.7)	3.7 (13.3)	4.3 (13.6)	5.3 (14.6)	5.9 (13.8)	6.6 (13.6)	7.3 (13.4)	9.1 (14.4)	10.8 (13.6)	14.3 (14.7)
Toronto Dominion	2.7 (11.3)	3.0 (11.6)	3.1 (11.1)	3.6 (11.4)	4.4 (12.2)	5.2 (12.2)	5.9 (12.1)	6.6 (12.1)	8.0 (12.7)	10.3 (12.9)	12.8 (13.2)
Banque Provincial	.5 (2.1)	.5 (1.9)	.6 (2.2)	.6 (1.9)	.7 (1.9)	.9 (2.1)	1.2 (2.5)	1.5 (2.8)	1.8 (2.8)	2.1 (2.6)	2.7 (2.8)
Imperial Bank of Commerce	5.7 (23.8)	6.2 (23.9)	6.7 (24.0)	7.5 (23.7)	8.8 (24.3)	9.5 (22.2)	10.8 (22.2)	12.1 (22.2)	13.6 (21.5)	17.0 (21.3)	20.3 (20.9)
Royal Bank	6.0 (25.1)	6.5 (25.1)	7.0 (25.1)	7.8 (24.7)	8.4 (23.2)	10.7 (25.1)	12.2 (25.1)	13.7 (25.1)	15.5 (24.5)	19.5 (24.5)	22.9 (23.6)
Banque Canadienne Nationale	1.0 (4.2)	1.1 (4.2)	1.1 (3.9)	1.3 (4.1)	1.5 (4.1)	1.7 (4.0)	2.1 (4.3)	2.4 (4.4)	2.8 (4.4)	3.5 (4.4)	4.4 (4.5)
Mercantile Bank	.1 (0.4)	.2 (0.8)	.2 (0.7)	.2 (0.6)	.2 (0.6)	.2 (0.5)	.2 (0.4)	.3 (0.6)	.4 (0.6)	.6 (0.8)	.7 (0.7)
Bank of B.C.	— (—)	— (—)	— (—)	— (—)	— (—)	.1 (0.2)	.1 (0.2)	.2 (0.4)	.3 (0.5)	.3 (0.4)	.5 (0.5)
La Banque Populaire	— (—)	— (—)	— (—)	— (—)	— (—)	.1 (0.2)	.1 (0.2)	— (—)	— (—)	— (—)	— (—)
Unity	— (—)	— (—)	— (—)	— (—)	— (—)	— (—)	— (—)	— (—)	— (—)	.1 (0.1)	.1 (0.1)
TOTAL	23.9	25.9	27.9	31.6	36.2	42.7	48.6	54.5	63.2	79.7	97.1

Source: Canada Gazette, Chartered Banks of Canada, Statement of Assets and Liabilities, Year end issues, 1964 to 1974.

banking provided quicker deposit-withdrawal services and greater internal bank efficiency. Financial information services were offered. Business hours were extended and tailored to meet the needs of a branch's clientele. Specialty branches and satellite banking enhanced their image through the development of a full service product core. Specialized accounts provided a personalized service and advertising was utilized to take the chartered banks' message to their customer.

The list could go on but the point has been made. The banks were far more progressive in the post-1967 period than before. However, it is a difficult question to determine how much of this increased progressiveness is attributable to the Bank Act revision and how much is due to the changes in economic conditions facing the banks. The pre-1967 period had become difficult times for the banks as the spread between their deposit and loan rates narrowed perceptably. A need arose for cost cutting and service innovations as a means of combatting the increased competitiveness from the near banks. As a result and even before the revision the chartered banks behaviour had already undergone modification as they began to follow a more innovative direction. What the Bank Act revision and the political events leading up to it did was to create an atmosphere of acceptance for this greater non-price competitive banking behaviour. No previous revision had recognized competition as a public policy objective but the 1967 Bank Act gave it centre stage.

This atmosphere was maintained subsequent to the revision through a number of governmental inquiries into competition among the

chartered banks and other financial institutions. Two of these inquiries are worth noting. First, in 1969, the Economic Council of Canada published the Interim Report on Competition Policy. This report recommended an extension of competition policy to the financial industry, making all financial institutions subject to anti combines law.[26] Second, also in 1969, a temporary Prices and Incomes Commission was established in Canada. The Commission had no legal power to control price and wage changes but it did set up and monitor non-compulsory guidelines backed by the support of the government.

On February 5, 1970, the chartered banks publicly accepted an agreement with the Commission to be effective through to the year end. The banks were not to increase the service charges on various banking provisions such as the chequing process, they were not to increase loan rates in an absolute amount greater than the change in their personal savings deposit rate and they were to reduce the loan rate to match any decrease in the savings rate.[27] Any loans where the chartered banks were deemed to lack discretionary pricing power, such as regulated loans, mortgage loans, etc., were exempt from the

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[26] Canada, Economic Council of Canada, Interim Report on Competition Policy, (Ottawa; Information Canada, 1969), pp. 155-6.

[27] Canada, Prices and Incomes Commission, Chartered Bank Operations and Earnings Under the Restraint Program, (Canada, Prices and Incomes Commission, October 30, 1970), p. 8.

agreement.[28] In retrospect, the Commission commented that "... on the basis of the available evidence ... the banks have lived up to their commitments under the restraint program."[29]

Subsequent to the expiration of the agreement with the Prices and Incomes Commission, the chartered banks jointly announced an increase in the service charges for chequing facilities. The Commission studied the nature of the increase and presented a fairly scathing report[30] on the attitude and behaviour of the banking group.

In commenting upon the obvious colluded price change the Commission stated that,

> "The fact that there is typically such a high degree of uniformity in the scale of bank service charges, and that changes in the scale are typically made at the same time and in the same manner by virtually all the banks, is bound to raise questions in the public mind."[31]

With somewhat of a hint of bitterness, they stated a concluding opinion, to wit:

> "The Commission has made it clear ... that the need has not lessened for responsible behaviour on the part of all Canadians in determining prices and incomes in 1971. It's difficult to see how this need is to be met if firms in as favourable an

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[28] Ibid., p. 12.

[29] Ibid., p. 5.

[30] Canada, Prices and Incomes Commission, Bank Service Charges, (Canada, Prices and Incomes Commission, April, 1971).

[31] Ibid., p. 25.

underlying position as the chartered banks raise their prices in areas of their business over which they have a large measure of discretionary control."[32]

This greater exposure and more precise identification of the problem of competition in the financial industry and the role played by the chartered banks could be expected to have a significant effect on the banks' behavioural patterns. The chartered banks were not without public awareness and in their attempts to remain or establish themselves as good corporate citizens it is expected that they would have adopted a more competitive outlook in response to these developments. Further, the legislation's removal of the 6% interest rate ceiling enabled the chartered banks to maintain profit levels and improved the feasibility of their developing their new inclination towards more progressive banking methods.

Since the 1967 revision was one of the initial stimuli to the change in mood and since it was also responsible for enabling the banks to be in a position to become more progressive, it should be considered to have made a strong positive contribution to the overall improvement in non-price competition that the chartered banks realized in the post- 1967 period. The magnitude of this positive contribution is not determinable though it is suggested here that much of the improved competitiveness would not have taken place without the revision.

This section has attempted to determine the effect of the 1967 Bank Act revision on institutional structure and conduct. To summarize, the revision caused some minimal raising of institutional

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[32] Ibid., p. 27.

barriers, the maintenance of high levels of institutional concentration, no effective change in pricing competitiveness and a positive influence on the development of an improved non-price competitive behaviour among the chartered banks.

CHAPTER V

THE EFFECT OF THE 1967 BANK ACT REVISION ON COMPETITION WITHIN CHARTERED BANK LOAN MARKETS

This chapter will analyze the effect of the 1967 Bank Act revision on the competitiveness within the markets for the major chartered bank assets. These assets are, in order of presentation, commercial credit, consumer credit and mortgage credit.

The chapter is divided into three sections, one for each asset type. Each of these three sections discusses changes in the four elements of structure and conduct and concludes with a short summary of the overall impact of the legislation on the specific market.

Section 1. The Effect of the 1967 Bank Act Revision on Competition Within the Commercial Credit Market

Commercial credit is the traditional market of the chartered banks. As such it is not surprising to find the banks being by far the most dominant participant. Their prime rate, the minimum interest charged to their most favoured borrower, was set by agreement in the pre-1967 environment. It would alter from time to time in response to various market pressures, but member banks always moved in unison.

The commercial credit market expanded by 255.8% over the 1966-74 period showing the largest increase of the three loan markets under study. Overall the banking share declined from 74.2% to 69.5%. There was an increase in the use of commercial paper as a credit

vehicle which represented 10.6% of the market in 1974 compared to 2.4% in 1966. Banker's Acceptances also increased from 2.0% to 3.0%. The cooperative banks (1.7% to 1.0%) and the Industrial Development Bank (3.8% to 3.5%) had mild declines while sales finance companies lost 5 percentage points, falling from 17.1% to 12.1% (see Table 5). Corresponding to the banks' loss of market share, the five and eight-firm concentration ratios fell from 69.0% to 62.4% and 80.3% to 73.5% respectively. The reduction in the ratios represented mostly a reduction in the strength of existing control and not a shift in the base of power, as the eight largest firms of 1966 were also the largest in 1974 with only a couple of minor changes in position among the leading banks (see Table 6).

Prior to 1967 there were two major entry barriers in the commercial credit market. The 6% interest rate ceiling had begun to hamper chartered bank activity though the effect was not as strong as in the case of consumer and mortgage credit where rates are generally higher. The barriers had not become totally restrictive, as the chartered banks maintained their market shares in the years immediately preceding the revision; however, there is little doubt that serious problems would have been realized had the rate ceiling remained in effect. The banks were, at least to some extent, already prevented from doing business with riskier loan applicants because of the higher rates required to make such loans profitable.

The 1967 legislation removed the rate ceiling. Its removal enabled the banks to maintain their existing scope in commercial loans as well as to apply a competitive thrust to the high risk end

TABLE 5

COMMERCIAL CREDIT MARKET

MARKET SHARES OF INSTITUTIONS, 1964-74*

Institution/Year	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974
Chartered Banks	4.93	5.77	6.17	6.93	7.59	8.65	8.90	11.07	13.46	17.14	20.57
	(73.0)	(73.3)	(74.2)	(74.8)	(74.2)	(73.2)	(71.7)	(72.7)	(75.7)	(75.7)	(69.5)
Sales Finance (and Consumer Loan)	1.18	1.40	1.42	1.36	1.49	1.64	1.48	1.75	1.95	2.77	3.57
	(17.5)	(17.8)	(17.1)	(14.7)	(14.6)	(13.9)	(11.9)	(11.5)	(11.0)	(12.2)	(12.1)
Cooperative banks	.11	.12	.14	.17	.18	.17	.18	.20	.18	.24	.31
	(1.6)	(1.5)	(1.7)	(1.8)	(1.8)	(1.4)	(1.5)	(1.3)	(1.0)	(1.1)	(1.0)
Industrial Development Bank	.24	.27	.32	.35	.39	.44	.50	.56	.64	.79	1.03
	(3.6)	(3.4)	(3.8)	(3.8)	(3.8)	(3.7)	(4.0)	(3.7)	(3.6)	(3.5)	(3.5)
Commercial Paper Outstanding	.28	.16	.20	.31	.46	.75	.95	1.24	1.17	1.33	3.15
	(4.1)	(2.0)	(2.4)	(3.3)	(4.5)	(6.3)	(7.7)	(8.1)	(6.6)	(5.9)	(10.6)
Banker's Acceptance	.01	.15	.17	.15	.12	.17	.40	.40	.39	.34	.90
	(0.1)	(1.0)	(2.0)	(1.6)	(1.2)	(1.4)	(2.6)	(2.6)	(2.2)	(1.5)	(3.0)
Finance Leasing Corporations										.04	.07
										(0.2)	(0.2)
TOTAL	6.75	7.87	8.27	9.27	10.23	11.82	12.41	15.22	17.79	22.65	29.6

Sources: Bank of Canada, Bank of Canada Review, selected issues, 1972-76.
Bank of Canada, Bank of Canada Statistical Summary, selected issues, 1966-71.
Statistics Canada, Financial Institutions, catalogue number 61-006.

* Credit in billions of dollars, market shares in brackets.

TABLE 6

COMMERCIAL CREDIT MARKET:

FIVE AND EIGHT FIRM CONCENTRATION RATIOS, 1966 & 1974

1966			1974		
Firm	Credit*	%age of Market Total	Firm	Credit*	%age of Market Total
1. Bank of Commerce	1532	18.5	1. Royal Bank	4767	16.1
2. Royal Bank	1411	17.1	2. Bank of Commerce	4624	15.6
3. Bank of Montreal	1323	16.0	3. Bank of Montreal	4064	13.7
4. Bank of Nova Scotia	719	8.7	4. Toronto Dominion	2589	8.7
5. Toronto Dominion	717	8.7	5. Bank of Nova Scotia	2444	8.3
6. IAC	420	5.1	6. IAC	1487	5.0
7. Banque Candienne Nationale	267	3.2	7. Banque Canadienne Nationale	1001	3.4
8. General Motors Acceptance	248	3.0	8. General Motors Acceptance	798	2.7
EIGHT-FIRM CONCENTRATION RATIO		80.3	EIGHT-FIRM CONCENTRATION RATIO		73.5
FIVE-FIRM CONCENTRATION RATIO		69.0	FIVE-FIRM CONCENTRATION RATIO		62.4

Sources: Canada Gazette, Banks Assets and Liabilities.
Financial Post, Survey of Industrials, (Toronto; Maclean-Hunter Limited, 1966 and 1974)
Bank of Canada, Review.
Bank of Canada, Statistical Summary.

* Credit in millions of dollars.

of the market. The significant reduction in the market share of the sales finance companies after 1967 is indicative of the effectiveness of this thrust.

The second major entry barrier in the commercial credit market was the legal barrier imposed upon trust companies which prohibited them from participating in the market because of a perceived conflict of interest which might arise given their fiduciary functions. This entry barrier was unaffected by the revision.

The Bank Act revision also erected a barrier by banning foreign controlled chartered banks. However, the barrier became largely ineffective because of a loop-hole in the legislation which allowed affiliates of foreign owned banks to operate in the country outside the jurisdiction of the Bank Act. All that was required was that they not use the word "banking" in their name or business activities. There is little data on the extent of this movement but a Canadian Bankers' Association estimate indicates "... there were nearly 200 foreign financial institutions operating in Canada in October 1975, including about 40 'resident representative' offices of foreign banks ... their activities have become so large that a substantial share of all commercial lending to Canadian business is now conducted by foreign banks and their controlled institutions."[33] The assets of Canadian incorporated intermediaries controlled by foreign interests was estimated at $260 million in 1972, $600 million in 1973, and

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33 The Canadian Banker's Association, "Background to the Revision," No. 1 in the series Bank Act 77, December, 1975, p. 12.

about $1.8 billion in 1974.[34]

The impact of these foreign bank affiliates on the market shares of other institutions was not accounted for in Table 5. This was due to the difficulty in making an estimate of the exact size of their commercial credit market operations. Their involvement can be measured by their Canadian dollar short and medium term business loans booked in Canada. The Bank of Canada Review reported on a partial survey of these institutions and data was available for 1974. Using the figures for "other business loans" from the Review table as a measure of the involvement of foreign bank affiliates in the commercial credit market and subtracting their short term paper issues from the total of outstanding commercial paper[35] results in an estimate for 1974 of 69.8% of the market controlled by the chartered banks and 3.3% by the foreign affiliates.

However, Sultan argues that a more accurate assessment is reached if U.S. dollar loans from U.S. banks booked in the United States to firms resident in Canada are added to the foreign total. This amount is estimated as being $3.7 billion in 1974.[36] Further, the chartered bank total should be augmented by the banks'

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[34] The Canadian Banker's Association, "The Industry's Brief," No. 2 in the series Bank Act 77, October, 1975, p. 12.

[35] A study of Sultan points out that it was paper issued by the foreign banks which accounted for much of the growth in the commercial paper's market share. See Ralph G.M. Sultan, "Banking Competition in the World Arena," an address before the Queen's University Conference on Canadian Monetary Issues, August, 1975, p. 6.

[36] Ibid., p. 8.

total loans in U.S. dollars to Canadian residents booked in Canada.[37] Making these adjustments gives the following figures for the commercial credit market for 1974:

TABLE 7

MARKET SHARES OF COMMERCIAL CREDIT MARKET ADJUSTED FOR THE SIZE OF FOREIGN BANK AFFILIATES

	ASSETS	MARKET SHARE
Chartered banks	22.65 (billion $)	64.3%
Sales finance companies	3.57	10.1
Cooperative banks	.31	0.9
Industrial Development Bank	1.03	2.9
Commercial Paper	2.14	6.1
Banker's Acceptances	.90	2.6
Leasing firms	.07	0.2
Foreign Subsidiaries	4.66	13.2
TOTAL	35.23	

These figures do give some indication of the importance of the foreign subsidiaries in Canada which, in this way, are estimated to control 13.2% of the market compared to 64.3% for the chartered banks. As Sultan sums up, "... traditional lending institutions in the Canadian business credit market have seen their market share whittled away by the U.S. banks. This may be attributed, in part, to

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37 It should be realized that a portion of either of these totals may be personal loans or loans of a long term nature, such as construction and residential mortgage loans, and not applicable to the short and medium term commercial credit markets. For this reason, the shifts caused by using these totals lose a degree of accuracy.

the noticeable capture of a large portion of the Canadian banks' U.S. dollar lending activities, booked in Canada by the American banks' "suitcase operations," booked outside of Canada."[38] It can be said that the circumvention of the 1967 legislation by foreign banks has created a strong competitive stimulus in the commercial market.

The chartered banks' share of the commercial credit market declined from 1966-74 due primarily to the competition from these foreign bank affiliates and the increased use of internal business financing through commercial paper. Most of this competitive stimulus can be attributed to the Bank Act revision and its removal of the interest rate ceiling. Subsequent to the complete abolition of the ceiling in January, 1968 the chartered banks were able to raise their overall rate structure. The chartered banks' prime rates fluctutated between 6 1/2% - 7 1/4% during 1968 (see Table 8) compared to 5 3/4% - 6 1/2% in 1967. The raising of commercial loan rates widened the gap between these rates and those of commercial paper instruments. This gap resulted in an increased propensity for the major corporations to issue commercial paper as a means of borrowing required funds. Note that in Table 7 commercial paper is estimated as representing 6.1% of the market after adjusting for foreign banks' usage of the commercial paper financial vehicle. However, this still suggests a strong increase from 2.4% in 1966 (see Table 5). Further, foreign bank subsidiaries had taken advantage of this same marketing opportunity. They were able to issue commercial paper then return

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[38] Sultan, "Banking Competition," p. 11.

TABLE 8

CHANGES IN INDIVIDUAL CHARTERED BANK PRIME LOAN RATES AND CENTRAL BANK BANK RATE

Date/Bank	Bank of Montreal	Bank of Nova Scotia	Canadian Imperial Bank of Commerce	Toronto-Dominion	Royal Bank of Canada	Banque Provinciale du Canada	Banque Canadienne Nationale	Bank of British Columbia	Mercantile Bank	Bank Rate
Jan. 67	6	6	6	6	6	6	6		6	5
April 1, 67	5 3/4									
April 5, 67			5 3/4							
April 7, 67										4 1/2
May 1, 67					5 3/4					
Sept. 27, 67										5
Oct. 11, 67					6					
Oct. 23, 67			6							
Nov. 20, 67										6
Nov. 22, 67	6		6 1/2							
Dec. 5, 67		6 1/2			6 1/2	6 1/2				
Jan. 2, 68	6 1/2									
Jan. 22, 68										7
Feb. 10, 68	6 3/4									
Feb. 15-19, 68		7	7	7	7	7	7		7	
Mar. 15, 68	7 1/4									7 1/2
May 6, 68				7 1/4						
May 14, 68		7 1/4	7 1/4		7 1/4					
May 18, 68							7 1/4			
July 2, 68										7
July 29, 68	7	7	7	7	7					6 1/2
Aug. 1, 68						7				
Sept. 1, 68	6 3/4									
Sept. 3, 68		6 3/4	6 3/4	6 3/4	6 3/4		6 3/4	6 3/4		6
Dec. 18, 68										6 1/2
Jan. 20, 69		7	7	7	7	7	7	7		
Feb. 1, 69	7									
Mar. 3, 69										7
Mar. 24, 69	7 1/2	7 1/2		7 1/2		7 1/2	7 1/2	7 1/2	7 1/2	
Mar. 27, 69					7 1/2					
Mar. 28, 69			7 1/2							
June 9, 69				7 3/4						
June 11, 69										7 1/2
June 16, 69	8	8		8 1/4	8		8			
July 1, 69	8 1/2	8 1/2	8 1/2	8 1/2	8 1/2				8 1/2	
July 16, 69										8
May 12, 70										7 1/2
June 1, 70										7
July 1, 70	8	8	8	8	8	8		8	8	

Date/Bank	Bank of Montreal	Bank of Nova Scotia	Canadian Imperial Bank of Commerce	Toronto-Dominion	Royal Bank of Canada	Banque Provinciale du Canada	Banque Canadienne Nationale	Bank of British Columbia	Mercantile Bank	Bank Rate	Unity
Sept. 1, 70										6 1/2	
Nov. 1, 70	7 1/2	7 1/2	7 1/2	7 1/2	7 1/2	7 1/2	7 1/2	7 1/4	7 1/2		
Nov. 12, 70										6	
Jan. 8, 71	7	7	7	7	7	7		6 3/4	7		
Jan. 13, 71							7				
Feb. 15, 71										5 3/4	
Feb. 16, 71				6 3/4							
Feb. 24, 71	6 1/2	6 1/2	6 1/2	6 1/2	6 1/2	6 1/2	6 1/2	6 1/2	6 1/2	5 1/4	
Oct. 20, 71	6 1/4	6 1/4	6 1/4	6 1/4	6 1/4	6 1/4	6 1/4				
Oct. 25, 71										4 3/4	
Oct. 26, 71	6	6	6			6	6		6		
Oct. 27, 71				6	6		6				6
Apr. 9, 73										5 1/4	
Apr. 10, 73	6 1/2	6 1/2	6 1/2	6 1/2	6 1/2						
Apr. 11, 73						6 1/2	6 1/2	6 1/2	6 1/2		6 1/2
May 14, 73										5 3/4	
May 14, 73	6 3/4										
May 16, 73	7	7	7	7	7	7	7	7	7		7
May 22, 73											6 3/4
May 28, 73	7 1/4										
May 31, 73				7 1/4							
June 1, 73		7 1/4	7 1/4		7 1/4	7 1/4	7 1/4	7 1/4	7 1/4		7 1/4
June 11, 73										6 1/4	
June 12, 73	7 3/4	7 3/4		7 3/4			7 3/4	7 3/4			
June 13, 73					7 3/4	7 3/4			7 3/4		
June 15, 73			7 3/4								
June 18, 73											7 3/4
Aug. 7, 73										6 3/4	
Aug. 8, 73	8 1/4	8 1/4	8 1/4	8 1/4	8 1/4	8 1/4	8 1/4	8 1/4	8 1/4		
Aug. 9, 73											8 1/4
Sept. 13, 73										7 1/4	
Sept. 17, 73	9	9	9	9	9	9	9	9	9		9
Dec. 10, 73	9 1/2								9 1/2		
Dec. 18, 73		9 1/2		9 1/2				9 1/2			
Dec. 19, 73							9 1/2				
Dec. 21, 73			9 1/2		9 1/2	9 1/2					9 1/2
Apr. 15, 74											8 1/4
Apr. 16, 74	10 1/2	10 1/2	10 1/2		10 1/2	10 1/2	10 1/2	10 1/2	10 1/2		10 1/2
Apr. 17, 74				10 1/2							
May 10, 74	11	11	11	11				11	11		
May 13, 74					11	11	11				11
May 13, 74										8 3/4	

Date/Bank	Bank of Montreal	Bank of Nova Scotia	Canadian Imperial Bank of Commerce	Toronto-Dominion	Royal Bank of Canada	Banque Provinciale du Canada	Banque Canadienne Nationale	Bank of British Columbia	Mercantile Bank	Bank Rate	Unity
June 24, 74										9 1/4	
July 22, 74			11 1/2								
July 24, 74		11 1/2		11 1/2	11 1/2	11 1/2	11 1/2	11 1/2	11 1/2		11 1/2
July 26, 74	11 1/2										
Nov. 18, 74										8 3/4	
Nov. 18, 74		11									
Nov. 19, 74			11	11				11			
Nov. 21, 74	11				11	11	11				
Nov. 25, 74									11		11
Jan. 13, 75										8 1/4	
Jan. 14, 75				10 1/2							
Jan. 15, 75	10 1/2	10 1/2	10 1/2		10 1/2	10 1/2	10 1/2	10 1/2			
Jan. 20, 75									10 1/2		
Jan. 22, 75											10 1/2
Feb. 1, 75	9 3/4	9 3/4	9 1/2	9 1/2	9 3/4	9 3/4	9 3/4	9 3/4	9 3/4		9 1/2
Feb. 26, 75					9						
Mar. 1, 75	9	9				9	9	9	9		
Mar. 5, 75			9	9							
Mar. 10, 75											9

Source: Bank of Canada, solicited information.

the funds solicited in this way to Canadian business through the acceptance of higher costing commercial loans. Much of their profit resulted from the price-differential between the two rates.

Pricing behaviour in the commercial credit market can be observed by watching the timing of changes in chartered bank prime rates. Table 8 gives all post-revision changes in the prime rates of the individual banks. Exact dates are given to help discern any developing patterns of bank pricing behaviour. From April 23, 1956 through April 1, 1967, a month prior to the effective date of the new legislation prime rate changes occured in total unison. Further, they occurred seldom.[39] Adjustments were made only eleven times between the above dates. Then, a month prior to the implementation of the Bank Act, first the Bank of Montreal followed closely by the Commerce independently lowered their prime rate from 6 to 5 3/4%. A few days later, on April 7, 1967 the bank rate was lowered from 5 to 4 1/2% as the central bank accepted lower levels of market rates.[40] On May 1, 1967 the Royal Bank made the same 6 to 5 3/4% change while all other banks made no adjustment.

This development of more autonomous pricing behaviour characterized the immediate post-1967 era. Eventually, the bank rate was to become an important parameter for determining movements in

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39 J.C.H. Jones and L. Laudadio, "Canadian Bank Mergers, The Public Interest and Public Policy," Banca Nazionale del Lavoro - Quarterly Review, no. 105, June, 1973, Table III, p. 120.

40 Bank of Canada, Annual Report of the Governor to the Minister of Finance; for the Year 1967, p. 47.

prime. However, the nature of that importance went through a gradual change. From mid-1967 through to early 1975 six fairly distinct periods of chartered bank pricing and central bank monetary policy interaction occurred.

The first period covered the exchange rate crisis of late 1967 to early 1968. This period was one of experimentation with a new form of price determination. The bank rate was of only partial use in directing the chartered bank's pricing policies. While prime rates were rising from a 5 3/4% to 6% spread to one of 7% to 7 1/4%, the bank rate moved from a low of 4 1/2% to 7 1/2%. A 3% rise in the latter coincided with a 1 1/4% rise in prime. It is obvious that the chartered banks had their own views of where market rates should be. Among the banks themselves there was a good deal of independent action and no one price leader was evident though the Bank of Montreal was somewhat more prominent. The Toronto-Dominion and the smaller banks all operated somewhat independently.

The second period lasted from July 1968 through to February 1, 1969. Overall, the response mechanism was similar to that of the previous period but one important difference concerns inter-bank pricing behaviour. In the second period, the five major banks appeared to be more in unison in regards to movements in prime.

The third period occurred over a second exchange crisis lasting from March 1969 through to July 1969. The period is difficult to interpret. While the chartered banks were complying with the general upward movement of the bank rate and doing so more closely than before, there was still a good deal of singular activity,

particularly from the Toronto-Dominion which led prices up at one stage, the Commerce which made an independent stand against the rising rates until they went higher yet and the smaller fringe banks which continued to operate with considerable autonomy.

The fourth period lasted from mid-1969 to mid-1971. In early 1970, credit conditions were generally easing and the bank rate began to fall in response to market circumstances.[41] In six successive steps from May 1970 to February 1971, it was lowered from 8% to 5 1/4%. It appears that the central bank was attempting to guide rates downward while the chartered banks generally acquiesced but in their own time and in some cases initiated the moves. Changes among the banks themselves followed a far more unified pattern than previous periods. This was especially so among the five largest while independent action among fringe members was not as prevalent as before.

Beginning late in 1971, the central bank faced its third exchange crisis in post-1967 years. Upward pressure on the dollar occurred in response to extreme term deposit rate competition which attracted large blocks of foreign capital. On October 25, 1971 the bank rate was reduced from 5 1/4% to 4 3/4% as a suggestion to the banks that the vigorous competition was not in compliance with the central bank desires.[42] The prime rate for all but the Bank of

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41 Bank of Canada, Annual Report of the Governor to the Minister of Finance; for the year 1970, p. 50.

42 Bank of Canada, Annual Report of the Governor to the Minister of Finance; for the year 1973, p. 29.

British Columbia and the Mercantile had preceeded the bank rate down by five days, falling from 6 1/2% to 6 1/4% on October 20. On October 26 and 27, all chartered banks came down to 6% with the overall reduction matching the drop in the central bank rate. Subsequently the rates did not change again until April 1973. This was a similar period to that of the extreme term deposit competition and the central bank was maintaining a low bank rate to support its efforts in the exchange market. The chartered banks complied by not altering prime.

The sixth period was one of generally rising Canadian interest rates in the face of a worldwide inflationary spiral. On April 9, 1973 the bank rate began an upward journey. During the period, the central bank shifted the bank rate in response to the market, transmitting its views of the existing conditions to the chartered banks.[43] In general, the banks accepted the central bank's interpretation but did make two independent moves that sent rates even higher. The chartered bank initiated changes are more singular in that it took a greater time for all banks to adjust than if the central bank had been the instigator.

The chartered banks seemed to have settled on a pattern of passive acceptance of the direction of change and only needed to settle on the degree through inter-bank dealings. When the banks changed rates on their own they operated more in a price-leadership fashion with one or a few banks making the first step and the others

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[43] Ibid., p. 29.

falling in behind. Maverick type stands resisting changes did not occur over the sixth period but a consistent designated leader did not appear to exist either. Further, the smaller banks operated with less autonomy than previously.

By the end of 1974 the collusive pricing mechanism that the chartered banks had employed prior to 1967 may not have been legally functional but the banks had gradually, by trial and error, developed an alternative method. They improvised a system whereby the central bank's bank rate became largely responsible for the direction of prime rate movements. A secondary source was a price leadership form of determining prime whereby one bank would test the others' intentions through an initial price adjustment. As a rule, the other banks would copy the leader within a few days. The overall change in effect was minimal, the chartered banks' prime rate was still being determined by an oligopolistic pricing mechanism which approximated the results of openly collusive tactics.

Finally, there were no obvious changes in non-price competitive behaviour in the commercial credit market which can be linked directly to the Bank Act revision. However, the general improvements in non-competitive behaviour discussed in Chapter IV would affect the commercial credit market. The banks were already in the practice of providing a more personalized service to business customers but improvements in quality of service would still be expected to result from the innovative advances the banks undertook after the revision.

To summarize, the 1967 Bank Act revision caused an improvement in the competitiveness of the commercial credit market. The

revision's removal of the 6% interest rate ceiling on chartered bank loans allowed the banks to provide a competitive thrust towards the higher risk end of the commercial credit market. Further it stimulated the development of foreign bank subsidiaries and the increased use of commercial paper and this resulted in reductions in the market's concentration ratios. Chartered bank pricing behaviour was no longer openly collusive, but the development of new oligopolistic pricing techniques meant there was little effective change. There was some additional positive change through general improvements in the non-price competitive behaviour element.

Section 2. The Effect of the 1967 Bank Act Revision on Competition Within the Consumer Credit Market

Entry barriers in the consumer credit market prior to 1967 were very similar to those in the commercial credit market. The 6% interest rate ceiling was restrictive to the chartered banks' activities and the higher rates in the consumer credit market made this restriction more serious than in the case of commercial credit. Another important legal barrier prevented the trust and mortgage loan companies from entering the market except for a marginal amount which depended on a basket clause. This basket clause varied from province to province. As an example, looking at the Ontario Loan and Trust Corporation Act, the basket clause assets were limited to "... not more than the larger of 15% of a trust company's unimpaired capital and reserves or such percentage as the Registrar of trust companies

may approve."[44] In actual fact the trust and loan companies chose not to be involved with consumer credit at all.

The consumer credit market grew 164.3% from 1966 to 1974. The chartered banks had the greatest success over that period increasing their share of the market from 33.6% to 52.6%. The cooperative banks also gained with their percentage of the market rising slightly from 12.0% to 13.4%. Other institutions, primarily sales finance (16.2% to 5.7%) and consumer loan companies (14.0% to 8.7%) but also retail dealers (18.5% to 12.1%) and life insurance companies' policy loans (5.8% to 5.2%) declined in importance (see Table 9). Further, the five and eight-firm concentration ratios increased from 31.3% to 47.7% and 39.9% to 54.6% respectively. In 1974, seven of the eight largest market participants were chartered banks (see Table 10).

The chartered bank involvement in consumer credit had been on the rise for some time. Since 1957 when the banks controlled about 14%[45] of the market that figure had increased steadily to the 1966 level, despite the partial barrier erected by the rate ceiling. However, the rate of increase in bank involvement slowed considerably in the last year before the revision. In absolute terms chartered bank personal loans increased only 9.7% from 1965 to 1966 compared to 25.0% a year earlier and the banking share of the market rose only

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44 Nicolas Matossian, "Review of the Bank Act (1977)", a brief submitted to the Department of Finance on behalf of the Trust Companies Association of Canada, October, 1975, p. 47.

45 Statistics Canada, Consumer Credit, catalogue number 61-004.

TABLE 9

CONSUMER CREDIT MARKET

MARKET SHARES OF INSTITUTIONS, 1964-74*

Institution/Year	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974
Chartered Banks	1.79 (28.7)	2.24 (31.3)	2.46 (31.6)	2.98 (34.6)	3.67 (37.3)	4.16 (37.3)	4.66 (39.8)	5.78 (45.6)	7.14 (48.0)	8.88 (50.2)	10.82 (52.6)
Sales Finance Co.	1.09 (17.4)	1.20 (16.7)	1.26 (16.2)	1.18 (13.7)	1.22 (12.4)	1.37 (12.3)	1.14 (9.7)	.89 (7.0)	1.03 (6.9)	1.15 (6.5)	1.17 (5.7)
Consumer Loan Co.	.85 (13.6)	.98 (13.6)	1.09 (14.0)	1.23 (14.2)	1.42 (14.4)	1.68 (15.0)	1.59 (13.6)	1.48 (11.6)	1.62 (12.9)	1.76 (10.0)	1.80 (8.7)
Quebec Savings Banks	.02 (0.2)	.02 (0.2)	.02 (0.2)	.02 (0.2)	.02 (0.2)	.02 (0.2)	.02 (0.2)	.03 (0.2)	.03 (0.2)	.04 (0.2)	.04 (0.2)
Life Insurance Co.	.40 (6.4)	.41 (5.7)	.45 (5.8)	.49 (5.6)	.55 (5.6)	.66 (5.9)	.76 (6.5)	.78 (6.2)	.81 (5.5)	.88 (5.0)	1.06 (5.2)
Retail Dealers	1.30 (20.7)	1.39 (19.4)	1.44 (18.5)	1.49 (17.3)	1.57 (15.9)	1.68 (15.1)	1.74 (14.8)	1.83 (14.5)	1.98 (13.3)	2.23 (12.6)	2.50 (12.1)
Cooperative Banks	.71 (11.3)	.81 (11.3)	.94 (12.0)	1.09 (12.7)	1.25 (12.7)	1.40 (12.6)	1.49 (12.8)	1.69 (13.3)	2.00 (13.4)	2.42 (13.7)	2.76 (13.4)
Public Utility Co.	.11 (1.8)	.12 (1.6)	.13 (1.7)	.14 (1.6)	.15 (1.5)	.16 (1.5)	.18 (1.5)	.20 (1.6)	.23 (1.6)	.24 (1.4)	.27 (1.3)
Trust and Mortgage Loan Cos.									.05 (0.3)	.08 (0.5)	.15 (0.7)
TOTAL	6.25	7.16	7.78	8.62	9.86	11.13	11.71	12.67	14.89	17.68	20.56

Source: Statistics Canada, Consumer Credit, catalogue number 61-004.

* Credit in billions of dollars, market shares in brackets.

TABLE 10

CONSUMER CREDIT MARKET:

FIVE AND EIGHT FIRM CONCENTRATION RATIOS, 1966 & 1974

1966			1974		
Firm	Credit*	%age of Market Total	Firm	Credit*	%age of Market Total
1. Bank of Commerce	610	7.8	1. Royal Bank	2507	12.3
2. Royal Bank	562	7.2	2. Bank of Commerce	2431	11.9
3. Bank of Montreal	527	6.8	3. Bank of Montreal	2137	10.5
4. IAC	455	5.8	4. IAC	554	2.7
5. Bank of Nova Scotia	286	3.7	5. Toronto Dominion	1362	6.7
6. Toronto Dominion	285	3.7	6. Bank of Nova Scotia	1285	6.6
7. General Motors Acceptance	269	3.5	7. Banque Provinciale	327	1.6
8. Banque Canadienne Nationale	106	1.4	8. Banque Canadienne Nationale	527	2.6
EIGHT-FIRM CONCENTRATION RATIO		39.9%	EIGHT-FIRM CONCENTRATION RATIO		54.6%
FIVE-FIRM CONCENTRATION RATIO		31.3%	FIVE-FIRM CONCENTRATION RATIO		47.7%

Sources: Canada Gazette, Bank Assets and Liabilities.
Financial Post, Survey of Industrials, "Personal Loans."
Bank of Canada, Review.

* Credit in millions of dollars.

0.3 percentage points, the smallest increment since the mid-1950's. This indicates that the ceiling combined with generally rising interest rates had begun to be prohibitive to the chartered banks.

The removal of the interest rate ceiling enabled the chartered banks to maintain their price competitiveness in the consumer credit market. This had a strong effect on the chartered banks' actions and consumer credit rose from 10.9% to 16.0% of their total assets from 1966-74 (see Table 14).

On the positive side of the revision, the removal of the rate ceiling allowed the chartered banks to offer consumer loans to some higher risk credit seekers. As a result, a greater number of borrowers were now afforded access to lower consumer credit rates and ones which would fluctuate more responsively to overall market trends than the more rigid high risk rates tend to do. The decline in the combined market shares of retail dealers, consumer loan and sales finance companies from 48.7% to 26.5% between 1966-74 is indicative of this stronger higher risk competition from the banks.

Pricing information on personal loans of the individual chartered banks and other institutions has not been gathered. None is published in a form directly available for public access, and the banks themselves will not divulge any information for "competitive" reasons. However, it is likely that the rates on chartered bank consumer loans are closely tied to a given bank's prime lending rate. For this reason it is expected that chartered bank pricing policy in this market would have followed the same pattern exhibited in the commercial credit market, such that the rates on consumer loans

though no longer determined by open agreement, as was the case prior to the revision, would now be determined through the oligopolistic pricing practices that the banks developed subsequent to the revision.

Non-price competitive behaviour in the consumer credit market was affected by the general improvement in charterd bank progressiveness. Additionally, the trust and mortgage loan companies reacted to increased chartered bank involvement in the mortgage credit market by looking for ways to diversify their asset base. They began to utilize consumer credit through the basket clause described above and by 1974 they controlled 0.7% of the market. These companies are still restrained by the legal entry barrier on the amount of consumer loans they can legally issue and as long as it remains in place are not likely to provide a major threat to the chartered banks and co-operative banks. However, the development was a definite competitive improvement related to the 1967 Bank Act revision.

In summary, there appears to have been some modest improvements in competition through the removal of a serious market entry barrier (the rate ceiling) resulting in a better availability of consumer credit for some of those who are higher credit risks, and some improvement in non-price competition. On the other side of the ledger a great deal of the greater degree of market concentration can be attributed to the revision. This increase in concentration is severe enough to weight heavier than the competitive improvements and leads to the conclusion that the consumer credit market became less

competitive as a result of the revision.

Section 3. The Effect of the 1967 Bank Act Revision on Competition Within the Mortgage Credit Market

Mortgage credit is much akin to consumer and commercial credit in that it solicits the same customers but the terms such as size and length of contract are in most cases larger and longer. Mortgage customers have unique demands and many institutions have found it a useful market to participate in. This led to a good deal of product differentiation and price competition in the pre-1967 market.

The long-term nature of most mortgages creates some matching risk for those institutions involved on a large scale. This risk must be either reduced through the issuing of longer term liabilities or accepted as a counterpart to the expanded revenues forthcoming from mortgage advancement. Because of the high rate of return, most financial institutions have maintained at least a portion of their portfolios in mortgages.

Other than liquidity concerns, the entry barriers in play in the mortgage credit market prior to 1967 related primarily to the chartered banks. They were not allowed to issue conventional mortgages and the interest rate ceiling was harmful to their competitive position in the market for National Housing Act mortgages. With mortgage rates being considerably higher than commercial and consumer credit rates, this barrier was a serious one. The restrictive nature of the legal barriers had yet to drive the banks from the market but it soon would have. From 1964 to 1966 the chartered banks' market

share declined from 6.3% to 4.3%.

The banks had entered the mortgage market with a vengeance in 1954 and quickly became a major factor. From 1955-59 the chartered banks accounted for 53% of all NHA mortgage initiations.[46] But in the face of swelling loan demand and rising interest rates on all varieties of loans, the chartered banks began to reduce their mortgage lending activity. This culminated in the complete withdrawal of the chartered banks from primary mortgage initiation toward the end of 1959. At that time the interest rate on NHA mortgages became higher than the 6% ceiling. Subsequently the chartered banks were forced to obtain their mortgage holdings in a secondary market, primarily through the trust and mortgage loan companies which assumed the role of "mortgage bankers." As an indication of this development, the trust companies share of NHA initiations had increased from 7% over the years 1955-59 to 22% from 1960-63.[47] These statistics leave little doubt as to the restrictiveness of the rate ceiling as a mortgage market entry barrier for the chartered banks.

The mortgage market expanded in size by 175.8% from 1966 to 1974. In terms of market shares the trend is quite apparent, the life insurance companies have lost considerable ground while the deposit-taking institutions have been gaining. In 1966 the life

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[46] Lawrence B. Smith, "Financial Intermediary Lending Behaviour in the Postwar Canadian Mortgage Market," Quarterly Journal of Economics, LXXXI, August, 1967, p. 502.

[47] ibid., p. 503.

insurance companies were the primary source of mortgage funds, holding 31.6% of the market. By 1974 they were still the second most prominent source but their share had declined to 17.3% (see Table 11).

One reason commonly given for the decline of the life insurance companies was the development of the term residential mortgage which is re-negotiated every five years. This is more appropriate to the asset-liability structures of the deposit taking institutions since, in effect, it simply increases mortgage liquidity. As a result, this newer style of mortgage credit is not as suited to the life insurance companies which have extremely long term liabilities. However, the data indicates that mortgages have declined only slightly as a percentage of total assets for the life insurance companies (see Table 14). The life insurers have maintained their interest in conventional non-residential mortgages where the term mortgage is not as common.

An explanation for the declining market share of the life insurance companies comes from a different source. The life insurers were not stimulated by a rapidly expanding financial base to the same extent that the deposit-taking institutions were in the post-1967 period. The lag in their liability base seriously restricted their mortgage expansion relative to the banks and near banks. This suggests that part of the decline in mortgage market concentration was attributable to the exogenous influence of rapidly expanding monetary aggregates which meant large increases in available funds for deposit taking institutions but not the life insurance companies.

TABLE 11

MORTGAGE CREDIT MARKET

MARKET SHARES OF INSTITUTIONS, 1964-74

(billions of dollars with market shares in brackets)

Institution/Year	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974
Chartered Banks	.85	.82	.78	.84	1.04	1.34	1.46	2.31	3.39	4.56	6.02
	(6.3)	(5.3)	(4.5)	(4.3)	(4.9)	(5.7)	(5.6)	(7.9)	(10.1)	(11.2)	(12.5)
Trust Companies	1.50	1.98	2.17	2.41	2.73	3.26	3.82	4.48	5.46	7.19	8.85
Intermediary Funds	(11.1)	(12.7)	(12.5)	(12.5)	(12.9)	(13.8)	(14.8)	(15.3)	(16.3)	(17.6)	(18.4)
Trust Company	1.04	1.24	1.42	1.51	1.67	2.01	2.14	2.15	2.18	2.55	2.78
Fiduciary Funds	(7.7)	(8.0)	(8.2)	(7.8)	(7.9)	(8.5)	(8.3)	(7.4)	(6.5)	(6.3)	(5.8)
Mortgage Loan	1.49	1.84	1.95	2.07	2.24	2.51	2.87	3.15	3.75	4.75	5.51
Cos.	(11.1)	(11.8)	(11.2)	(10.7)	(10.6)	(10.6)	(11.1)	(10.8)	(11.2)	(11.7)	(11.5)
Cooperative Banks	.62	.70	.86	.98	1.11	1.20	1.33	1.63	2.32	3.26	4.04
	(4.6)	(4.5)	(4.9)	(5.1)	(5.3)	(5.1)	(5.1)	(5.6)	(6.9)	(8.0)	(8.4)
Quebec Savings	.15	.20	.23	.24	.25	.27	.31	.32	.34	.39	.45
Bank	(1.1)	(1.3)	(1.3)	(1.2)	(1.2)	(1.1)	(1.2)	(1.1)	(1.0)	(1.0)	(0.9)
Consumer Loan &	.06	.07	.07	.10	.11	.19	.25	.27	.33	.45	.61
Sales Finance	(0.4)	(0.4)	(0.4)	(0.5)	(0.5)	(0.8)	(1.0)	(0.9)	(1.0)	(1.1)	(1.3)
Mutual & Closed-	.01	.01	.01	.01	.01	.01	.01	.21	.28	.35	.39
end Funds	(0.1)	(0.1)	(0.1)	(0.1)	(0.0)	(0.0)	(0.0)	(0.7)	(0.8)	(0.9)	(0.8)
Life Insurance	4.49	4.98	5.49	5.79	6.14	6.44	6.59	6.72	7.04	7.61	8.28
	(33.3)	32.0)	(31.6)	(30.0)	(29.1)	(27.2)	(25.5)	(23.0)	(21.0)	(18.7)	(17.3)
Mortgage Invest-	—	—	—	—	—	—	—	—	.03	.32	.48
ment Trust Cos.	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(—)	(0.1)	(0.8)	(1.0)

Institution/Year	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974
Trusteed Pension	.55	.62	.68	.72	.78	.86	1.02	1.17	1.3	1.55	1.94
Plans	(4.1)	(4.0)	(3.9)	(3.7)	(3.7)	(3.6)	(3.9)	(4.0)	(3.9)	(3.8)	(4.0)
Fraternal Benefit	.05	.05	.05	.06	.06	.06	.07	.07	.08	.09	.10
Societies	(0.4)	(0.3)	(0.3)	(0.3)	(0.3)	(0.3)	(0.3)	(0.2)	(0.2)	(0.2)	(0.2)
Non-financial	.35	.41	.45	.51	.53	.54	.53	.58	.47	.57	.60
corporations	(2.6)	(2.6)	(2.6)	(2.6)	(2.5)	(2.3)	(2.0)	(2.0)	(1.4)	(1.4)	(1.3)
Federal Government	2.26	2.59	3.16	4.00	4.37	4.89	5.38	5.99	6.47	6.86	7.63
Institutions	(16.8)	(16.6)	(18.2)	(20.7)	(20.7)	(20.7)	(20.8)	(20.5)	(19.3)	(16.8)	(15.9)
Provincial Government	.04	.05	.05	.05	.02	.05	.07	.10	.11	.17	.20
Institutions	(0.3)	(0.3)	(0.3)	(0.3)	(0.1)	(0.2)	(0.3)	(0.3)	(0.3)	(0.4)	(0.4)
TOTAL	13.48	15.58	17.39	19.32	21.09	23.66	25.89	29.19	33.60	40.74	47.97

Sources: Bank of Canada, Review.
Bank of Canada, Statistical Summary.
Statistics Canada, Financial Institutions, catalogue number 61-006.
Statistics Canada, Federal Government Enterprise Finance, catalogue number 61-203.
Statistics Canada, Provincial Government Enterprise Finance, catalogue number 61-204.
Statistics Canada, Corporation Financial Statistics, catalogue number 61-207.
Report of the Superintendent of Insurance for Canada, Volume III. Annual Statements — Life Insurance Companies and Fraternal Benefit Societies.
The Trust Companies Association of Canada, General Information Bulletin.
Central Mortgage and Housing Corporation, Canadian Housing Statistics.

The big gainers in the market were the trust companies, whose market share expanded from 12.5% to 18.4%,[48] making them the largest supplier in 1974; the chartered banks whose share rose from 4.5% to 12.5% and the cooperative banks where the share increased from 4.9% to 8.4%. The mortgage loan companies stayed relatively steady, changing from 11.2% to 11.5% and government institutions' share, primarily through Central Mortgage and Housing Corporation declined from 18.2% to 15.9%. The overall share of all deposit-taking institutions increased from 34.4% to 52.2%. Corresponding to the decline in the power of the life insurance companies, the five and eight-firm concentration ratios fell from 20.2% to 17.5% and 28.4% to 22.8% respectively (see Table 12). Further indication of the less concentrated nature of this market comes from examining the individual firms listed in Table 12. In 1966, the top eight firms consisted of six life insurance companies, two of which controlled over 5% of the market each and two mortgage loan companies. In 1974, there were only two life insurance companies in the top eight, with three trust companies, two mortgage loan companies and the Bank of Commerce comprising the rest. Royal Trust, the number one firm in 1974, was in control of only 4.4% of the overall market.

The only significant pre-1967 market barriers, those on the operations of the chartered banks, were lifted. The banks were allowed into the conventional mortgage market up to a percentage

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[48] A fair number of mortgages are held in the ETA accounts of the trust companies. When added to the intermediary totals the change in the trusts' share went from 20.7% to 24.2%.

TABLE 12

MORTGAGE CREDIT MARKET;

FIVE AND EIGHT FIRM CONCENTRATION RATIOS, 1966 & 1974

1966			1974		
Firm	Credit*	%age of Market Total	Firm	Credit*	%age of Market Total
1. Sun Life Assurance	976	5.6	1. Royal Trust	2092	4.4
2. London Life Insurance	925	5.3	2. Huron and Erie Mortgage	1839	3.8
3. Manufacturers Life Insurance	588	3.4	3. Canada Permanent Mortgage	1804	3.8
4. Canada Permanent Mortgage	521	3.0	4. London Life Insurance	1458	3.0
5. Great-West Life Assurance	511	2.9	5. Sun Life Assurance	1219	2.5
6. Huron and Erie Mortgage	508	2.9	6. Victoria and Grey Trust	905	1.9
7. Mutual Life Assurance	482	2.8	7. Bank of Commerce	854	1.8
8. Canada Life Assurance	440	2.5	8. Guaranty Trust	775	1.6
EIGHT-FIRM CONCENTRATION RATIO		28.4%	EIGHT-FIRM CONCENTRATION RATIO		22.8%
FIVE-FIRM CONCENTRATION RATIO		20.2%	FIVE-FIRM CONCENTRATION RATIO		17.5%

Sources: Canada Gazette, Bank Assets and Liabilities.
Financial Post, Survey of Industrials, "Personal Loans."
Bank of Canada, Review.
Report of Superintendent of Life Insurance, Annual Statements.

* Credit in millions of dollars.

of their Canadian dollar deposits plus debentures. This percentage was to rise gradually until it reached 10% in 1974. In actuality, chartered bank mortgage holdings were not hampered by the 10% maximum with the overall average for chartered banks being 5.6% of Canadian dollar deposits plus debentures as of the end of December, 1974. For the individual banks the percentage varied from 1.6% for the Mercantile to 8.6% for Banque Canadienne Nationale. The five major banks were all within one percentage point of the overall average (see Table 13). The removal of this barrier coupled with the removal of the 6% interest rate ceiling enabled the banks to expand their mortgage holdings and helped reduce overall market concentration. Mortgage credit rose from 3.3% of all chartered bank assets to 8.9% from 1966-74.

One other competitive stimulus in the mortgage credit market partly attributable to the Bank Act Revision was the increased activity of the cooperative banks. The cooperatives faced strong competition from the chartered banks in the consumer credit market. To compensate they chose to shift their asset base somewhat and concentrate more on mortgage credit. The strong increase in their market share was indicative of this (see Table 11). In 1966 the cooperative banks held 28.8% of their assets in mortgages and 32.1% in consumer credit. By 1974 that balance had reversed with 39.2% of cooperative bank assets being mortgages and 26.8% consumer credit (see Table 14).

Price in the mortgage market is primarily determined by the rates in other markets, usually settling 2 - 3 1/2 percentage points

TABLE 13

INDIVIDUAL CHARTERED BANK HOLDINGS OF MORTGAGES AS PERCENTAGE OF CANADIAN DOLLAR DEPOSITS PLUS DEBENTURES, AS OF DECEMBER 31, 1974

	(1) Canadian Dollar Deposits + Debentures (000,000)	(2) Mortgages (000,000)	(2)/(1) (%)
Bank of Montreal	11,440.9	543.1	4.7
Bank of Nova Scotia	6,650.5	372.7	5.6
Toronto Dominion	7,337.6	365.2	5.0
La Banque Provinciale	2,005.4	124.1	6.2
Canadian Imperial Bank of Commerce	14,081.3	854.4	6.1
Royal Bank	13,660.1	741.0	5.4
Banque Canadienne Nationale	3,407.8	292.3	8.6
Bank of British Columbia	358.8	11.7	3.3
Unity Bank	109.9	4.3	3.9
Mercantile	525.6	7.2	1.4
All Chartered Banks	59,577.6	3,316.0	5.6

Source: Canada Gazette, Bank Assets and Liabilities, Year end issue, 1974.

TABLE 14

TRENDS IN ASSET AND LIABILITY STRUCTURES*, SELECTED YEARS

Mortgage Credit	1964	1967	1970	1974
Chartered banks	4.5	3.3	4.3	8.9
Trust companies	51.7	54.8	57.9	71.4
Mortgage loan cos.	78.4	73.9	75.5	82.2
Life insurance cos.	40.8	42.9	42.0	38.2
Cooperative banks	28.2	28.8	28.9	39.2
Consumer Credit	**1964**	**1967**	**1970**	**1974**
Chartered Banks	9.6	11.7	13.8	16.0
Sales Finance & Consumer Loan cos.	52.4	53.6	51.8	31.6
Cooperative Banks	32.3	32.1	32.4	26.8
Life insurance cos.	3.6	3.6	4.8	4.9
Commercial Credit	**1964**	**1967**	**1970**	**1974**
Chartered Banks	26.4	27.3	26.3	30.4
Sales Finance & Consumer loan cos.	31.9	30.2	30.7	44.6
Cooperative banks	5.0	5.0	3.9	3.0
Liquid Deposits	**1964**	**1967**	**1970**	**1974**
Chartered Banks	72.9	67.9	57.7	44.2
Trust Companies	36.2	26.4	22.3	17.8
Mortgage loan cos.	17.3	14.3	12.6	9.8
Cooperative banks	88.2	84.2	74.8	63.3
Non-liquid (term) Deposits	**1964**	**1967**	**1970**	**1974**
Chartered Banks	10.1	17.9	25.4	33.9
Trust Companies	53.1	61.6	66.8	73.5
Mortgage Loan Cos.	43.2	38.6	48.9	59.7
Cooperative banks	2.3	5.3	14.8	28.3
Sales Finance & Consumer Loan Cos.	23.2	19.3	23.5	30.3

* Figures represent per cent of total assets and liabilities represented by loan and deposit types for each institution.

Source: Bank of Canada, Review.
Bank of Canada, Statistical Summary.

above the chartered banks' prime rates. The major issuers come from various institutional types and market concentration is relatively low. Under such a situation it is unlikely that overall communications are as open as they are between the banks themselves.

Towards the end of the 1966-74 period, the differential between prime and mortgage rates narrowed perceptibly. At the end of the first quarter, 1973, when prime rates were at 6%, the conventional mortgage rate stood at 9.07%. At the end of the second quarter, 1974, when the prime rate was 11%, the conventional mortgage rate was only 11.37%.[49] It is unlikely this shift can be attributed to a more efficient and competitive pricing mechanism in the mortgage market. What is more likely is that the relationship between the medium and long term mortgage rates and short term prime rates was influenced by a shift in the overall term structure of interest rates as short term rates responded sensitively to strong pressure of credit demands on the available supply of funds in Canadian and international financial markets.

Two elements of the legislation may have been an influence in preventing a rise in the degree of non-competitive pricing in the mortgage credit market. The legislation made it illegal for the chartered banks to own more than 10% of other deposit-taking operations and prohibited the use of interlocking directorships between such operations. The rule against ownership affected three

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[49] Bank of Canada, Review, See Table on "Selected Interest Rates."

chartered banks; the Bank of Nova Scotia which owned approximately 20% of Eastern and Chartered Trust Company, the Toronto-Dominion Bank which owned about 20% of Canada Permanent Mortgage Company and the Bank of Commerce which owned about 15% of National Trust Company.[50] Two chartered banks were affected by the restrictions on interlocking directorships; the Bank of Montreal, which had thirteen directors in common with Royal Trust and the Royal Bank which had sixteen directors in common with Montreal Trust.[51] All of these relationships were curtailed and this may have helped reduce any interinstitutional price setting. However, given the experience of prime rate determination described earlier, it is difficult to see how large sized and influential financial institutions could be prevented from operating collusively if they so desired.

Again, the overall improvement in chartered bank technology could be expected to improve non-price competition, though it would not be as significant a factor for mortgage credit where the banks' share was much smaller. A more significant development for mortgage credit was the introduction of a number of new financial institutions into the market. In particular, the sales finance and consumer loan companies diversified into mortgages in response to the stiff competition they were facing from the chartered banks in their more traditional markets of consumer and commercial credit. This was an

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[50] John McCallum, "The 1967 Revision of the Bank Act and the Effect It Had and Will Have on the Chartered Banks," Master's Research Paper, University of Manitoba, 1967, pp. 90-1.

[51] Ibid., p. 91.

indirect effect of the revision. The market share of the sales finance and consumer loan companies amounted to 1.3% of the market in 1974. Other new institutions in the market were Mutual Funds which rose from 0.1% to 0.8% of the market from 1966-74 and Mortgage Investment Corporations (MICS) which were introduced in 1972 and represented 1.0% of the market in 1974. These two latter institutions' movement into the market may be loosely linked to the improved competitive atmosphere resulting from the revision.

In summary, the 1967 Bank Act revision created a good deal more competition in the mortgage credit market. The removal of two severe entry barriers on the chartered bank's operations helped reduce concentration within the market. There was also some improvement in non-price competition through improved chartered bank progressiveness and some institutions becoming initially involved in the market.

CHAPTER VI

THE EFFECT OF THE 1967 BANK ACT REVISION ON COMPETITION WITHIN CHARTERED BANK DEPOSIT MARKETS

This chapter will analyze the effect of the 1967 Bank Act revision on the competitiveness within the markets for the major liabilities of the chartered banks. These liabilities are, in order of presentation, term deposits, and transaction (savings and demand) deposits. The chapter is divided into two sections, one for each deposit type. Both of these sections discuss changes in the four individual structure and conduct elements and conclude with a short summary on the overall impact of the legislation on the specific market.

Section 1. The Effect of the 1967 Bank Act Revision on Competition Within the Term Deposit Market

In 1966 term deposits represented 23.6% of the combined value of all deposits. In the 1966-74 period term deposits expanded at a phenomenal rate (478.3%) and by 1974 represented 46.6% of the combined deposit market value. This rapid expansion occurred in response to a shift in the needs of financial customers who were attaining higher degrees of affluence and learning to limit their transaction balances, both factors which raised the level of available investment funds. Rising opportunity costs of capital during the period also provided the rationale for individual economic units to reduce trans-

action balances. Term deposits were an idealy suited financial instrument for such circumstances. They are non-speculative yet provide a good safe rate of return for those funds that do not require a large amount of liquidity.[52]

Prior to 1967 entry barriers in the term deposit market were minimal for most institutions except the chartered banks. The 6% interest rate ceiling limited the deposit rates the banks could offer since loan rates were approaching the maximum allowed. In response the banks share of the market declined from 39.5% in 1965 to 38.9% in 1966 (see Table 15).

The 1967 revision removed the rate ceiling and prevented this emerging barrier from becoming effective. The revision also created a situation in which term deposits became more attractive to the chartered banks. The reduction of the partial barrier on chartered bank activity in the mortgage credit market combined with the removal of the interest rate ceiling enabled the chartered banks to move into riskier, higher yielding loans with which term deposits are a better liability match. Also, the new split reserve requirement meant demand accounts would require greater holdings of low interest

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[52] Turnover ratios provide evidence of the trend toward more economical use of transaction balances. Between 1966-74 the turnover rate of demand deposits increased from 90/1 to 148/1 meaning many more cheques were being cashed on a given dollar value of deposit. Statistics Canada, Cheques Cashed in Clearing Centres, Catalogue no. 61-201.

TABLE 15

TERM DEPOSIT MARKET

MARKET SHARES OF INSTITUTIONS, 1964-74

(billions of dollars with market shares in brackets)

Institution/Year	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974
Chartered Banks	1.88 (32.5)	2.78 (39.7)	3.14 (38.9)	4.54 (45.3)	6.49 (49.2)	6.85 (43.7)	8.59 (45.2)	9.85 (45.3)	12.47 (47.4)	17.35 (49.1)	22.92 (49.0)
Trust Companies	1.54 (26.6)	1.98 (28.3)	2.40 (29.7)	2.71 (27.0)	3.19 (24.2)	3.81 (24.3)	4.41 (23.2)	5.10 (23.5)	5.82 (22.1)	7.56 (21.4)	9.12 (19.5)
Mortgage Loan Companies	.82 (14.2)	.95 (13.6)	.95 (11.9)	1.08 (10.8)	1.22 (9.2)	1.45 (9.3)	1.86 (9.8)	2.02 (9.3)	2.57 (9.8)	3.44 (9.7)	4.00 (8.6)
Cooperative Banks	.05 (0.9)	.07 (1.0)	.12 (1.5)	.18 (1.8)	.26 (2.0)	.45 (2.9)	.68 (3.6)	1.08 (5.0)	1.43 (5.4)	2.09 (5.9)	2.91 (6.2)
Quebec Savings Banks	.01 (0.2)	.02 (0.3)	.02 (0.2)	.03 (0.3)	.04 (0.3)	.07 (0.4)	.10 (0.5)	.15 (0.7)	.16 (0.6)	.20 (0.6)	.26 (0.6)
Sales Finance Cos. (Cdn & short-term paper)	.86 (14.9)	.73 (10.4)	.90 (11.1)	.87 (8.7)	1.21 (9.2)	1.40 (8.9)	1.29 (6.8)	1.22 (5.6)	1.52 (5.8)	2.43 (6.9)	2.88 (6.2)
Commercial paper	.28 (4.8)	.16 (2.3)	.20 (2.5)	.31 (3.1)	.46 (3.5)	.75 (4.8)	.97 (5.0)	1.24 (5.7)	1.17 (4.5)	1.33 (3.8)	3.15 (6.7)
Banker's Acceptance	.01 (0.2)	.15 (2.1)	.17 (2.1)	.15 (1.5)	.12 (0.9)	.17 (1.1)	.40 (2.1)	.40 (1.8)	.39 (1.5)	.34 (1.0)	.90 (1.9)
Federal Treasury Bills held by General Public	.33 (5.7)	.16 (2.3)	.17 (2.1)	.16 (1.6)	.20 (1.5)	.27 (1.7)	.25 (1.3)	.17 (0.8)	.19 (0.7)	.10 (0.3)	.23 (0.5)
Provincial & Municipal Treasury Bills	— (—)	— (—)	— (—)	— (—)	— (—)	.44 (2.8)	.46 (2.4)	.49 (2.3)	.57 (2.2)	.50 (1.4)	.36 (0.8)
TOTAL	5.8	7.00	8.08	10.03	13.19	15.66	18.99	21.72	26.29	35.34	46.73

Sources: Bank of Canada, Review.
Bank of Canada, Statistical Summary.

bearing reserves than the less liquid term accounts. This lessened the costs of maintaining term deposits relative to the demand variety.

The revision, then, opened up the term deposit market for the chartered banks as well as making term deposits a more attractive alternative for them. The result, to be expected, was considerable increase in the banks' market share and rising market concentration ratios. The banks operating under the incentives of the Bank Act increased their term deposits 629.9% and their market share climbed from 38.9% to 49.0% from 1966-74. Other significant advances came from the cooperative banks whose share rose from 1.5% to 6.2%, and the use of commercial paper by large corporations. Outstanding balances of this latter instrument represented 2.5% of the market in 1966 and 6.7% in 1974. The important losers in terms of market share were the trust companies whose percentage dropped from 29.7% to 19.5%, mortgage loan companies (11.9% to 8.6%), outstanding paper of finance companies (11.1% to 6.2%) and the treasury bills held by the general public (2.1% to 0.5%) (see Table 15). The five and eight firm concentration ratios increased from 35.4% to 41.8% and from 47.4% to 52.8%, respectively. The expanded powers of the chartered banks in this market are further emphasized by the listing of the top eight firms by size. The banks held the top five positions and the eighth in 1974 whereas in 1966 they had held the top three, the fifth and the eighth (see Table 16).

Legal entry barriers for near banks were not affected by the

TABLE 16

TERM DEPOSIT MARKET

FIVE AND EIGHT FIRM CONCENTRATION RATIOS, 1966 & 1974

1966			1974		
Firm	Deposits*	%age of Market Total	Firm	Deposits*	%age of Market Total
1. Bank of Commerce	732	9.1	1. Bank of Commerce	5336	11.4
2. Royal Bank	680	8.4	2. Royal Bank	4885	10.5
3. Bank of Montreal	641	7.9	3. Bank of Montreal	4072	8.7
4. Royal Trust	451	5.6	4. Toronto Dominion	2842	6.1
5. Bank of Nova Scotia	355	4.4	5. Bank of Nova Scotia	2401	5.1
6. Canada Permanent Mortgage	343	4.2	6. Royal Trust	2155	4.6
7. Huron and Erie Mortgage	328	4.1	7. Huron and Erie Mortgage	1478	3.2
8. Toronto Dominion	299	3.7	8. Banque Candienne Nationale	1477	3.2
EIGHT-FIRM CONCENTRATION RATIO		47.4%	EIGHT-FIRM CONCENTRATION RATIO		52.8%
FIVE-FIRM CONCENTRATION RATIO		35.4%	FIVE-FIRM CONCENTRATION RATIO		41.8%

Sources: Canada Gazete, Bank Assets and Liabilities.
Financial Post, Survey of Industrials.
Bank of Canada, Review.
Bank of Canada, Statistical Summary.

* Deposits in millions of dollars.

legislation. The term deposit market has always been relatively open and accessible to a large variety of financial institutions. However, structural barriers were affected by the enhanced competitiveness of the chartered banks. With the banks raising their deposit rates to unprecedented heights, a deterrent to prospective market participants, such as fringe member trust and loan companies, resulted. The declines in the market shares of these types of institutions is indicative of this effect.

The issuing of finance company paper is dependent on finance company funding requirements. These slackened during the period, particularly 1969-71 when the percentage of new cars financed through point of purchase credit with sales finance and consumer loan companies declined from 26.4% to 21.5%, and the number sold was almost stationary.[53] During this same period the share of finance company paper in the term deposit market fell from 8.9% to 5.6%. The only other significant fall in the finance paper share had come in 1966-67 under similar circumstances. Most of this decline in finance company funding requirements may be attributed to the revision's removal of the interest rate ceiling on chartered bank loans. This improved the banks' competitiveness in the higher risk ends of the consumer and commercial credit market where the finance companies

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53 J.J. Singer Consulting Economists Limited, "The Sales Finance and Consumer Loan Industry in the Competitive Environment of Canadian Financial Markets," prepared for the Canadian Consumer Loan Association and the Federated Council of Sales Finance Companies, October 31, 1975, see Table 10.

have traditionally operated, impinging on their asset base and reducing their finance paper requirements.

The amount of available commercial paper and banker's acceptances is dependent upon such factors as the credit requirements of business, the availability and cost of other forms of credit from financial institutions, and propensities and abilities for internal financing. The 1967 revision's removal of the interest rate ceiling enabled the chartered banks to raise their interest rates on commercial loans and this resulted in making commerical paper a more attractive borrowing alternative. As a result, the market shares of these instruments increased during the 1966-74 period.

The Bank Act legislation is one aspect of the regulatory framework which is relevant to financial institutions. Also important are shifts in the Government and central bank's day-by-day policy procedures. These changes and their effects must be treated as separate from those caused by the revision. At times they are apt to counteract the direction initiated by the revision.

Prior to 1967 Louis Rasminsky was Governor of the Bank of Canada. Rasminsky influenced the central bank into adopting a Keynesian approach to monetary policy whereby the control of credit conditions (i.e., the cost and availability of credit) was to be the means of influencing financial markets. This new policy was kept in place throughout Rasminsky's term. Gerald K. Bouey replaced Rasminsky on February 1, 1973. Bouey moved the central bank to a monetarist style policy but it wasn't until 1975 that the central

bank had identified its chief concern as being the defining of an appropriate monetary aggregate.[54]

Thus, from 1966-74, there was no substantive shift in the central bank's monetary policy philosophy. But while there was no change in the underlying philosophy, there were evident shifts in policy when it became obvious that desired results were not being achieved by the existing regulatory framework. The policy tool the central bank utilized in these circumstances can be called moral suasion.

The term 'moral suasion' itself suggests a catchall type of policy instrument which includes any attempt on the part of the central bank to influence a market situation which it is unable to manipulate in a desired fashion with the legal framework already in place. From 1967-74 the Bank used moral suasion a number of times. Specifically it intervened frequently in the term deposit market to prevent chartered bank rate competition which was either creating adverse repercussions for monetary policy, debt management, or extreme pressure on the operations of the near banks.

As one prominent banker noted just subsequent to the revision, and at the time of the first competitive round for term deposit rates, "The situation is in a state of flux, and most of the opening moves were partly defensive. With no single firm dominant in the

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[54] Michael Parkin, "The Control of Inflation in Canada: A Rational Expectations Analysis," prepared for the Canadian Economics Association meetings in Quebec City, May 31-June 2, 1976, p. 1.

industry, it would seem that price competition will be inherently unstable, with everyone being forced to match the highest price ..."[55]

This statement proved to be very accurate. Immediately following the revision, the banks began to utilize their expanded powers and competed aggressively for a larger share of the term deposit market. By late 1967 many trust and loan companies were finding it difficult to meet their withdrawals and the central bank decided to influence a return to a "more normal relationship."[56] The banks complied with the central bank's wishes almost immediately. With permission from the Minister of Finance, they formed the Non-Committee and met openly to discuss approporiate rates.

In mid-1969, the Bank intervened in the term deposit market once again. "The major purpose for which interest rates were controlled at that time was that the Bank alleged that interest rate competition among the banks was pulling up the whole structure of interest rates and in particular driving up the cost of servicing the National Debt, especially the rate on Canada Savings Bonds."[57] The restrictions were withdrawn December, 1970.

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[55] R.M. MacIntosh, "The 1967 Revision of the Canadian Banking Acts, Part II: A Banker's View," Canadian Journal of Economics, February, 1968.

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

[57] Brian Griffiths, "Competition and Regulation," p. 50.

A third intervention took place in June, 1972. An agreement arose after a series of events dating back to 1969. In that year, during a period of restraint, the Bank had aimed at reducing the availability of credit. In their annual report it is noted that, "The Bank of Canada's cash reserve management was directed towards reducing the liquidity of the banking system .... Nonetheless, bank loans continued to increase strongly ..."[58] The Bank increased the secondary reserve ratio but the banks were able to continue expanding loan activities by turning to the Euro-dollar market for the necessary funds. This increased foreign currency deposits and created upward pressure on the exchange rate. The pressure was abated when the Bank placed a ceiling on the amounts of swapped deposits.[59] But there was a strong showing in export markets and early in 1970 the Canadian government floated the dollar rather than let the inflationary pressure loose through internal expansion of the money supply. This was a monetarist approach to monetary policy but it proved to last only temporary. Almost immediately the policy prescription was reversed and the float stabilized near parity.[60]

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[58] Bank of Canada, <u>Annual Report, 1969</u>, p. 49.

[59] Ibid., p. 50.

[60] The floating of the dollar might have been a significant shift in the government's policy application, but once the new rate was established the float was managed to such an extent that, in reality, the only effect was to widen its range of fluctuation.

The Bank regulated a lid on domestic interest rates and the monetary aggregate expanded at the expense of bank liquidity. Unemployment was high due to an inflated labour force and this gave an aura of recession which turned out to be illusory. The combination of scarce liquidity and increased credit demand derived from expansionary forces let loose by rapidly rising monetary aggregates forced the banks to compete vigorously in the market for term deposits once again.

The result was exchange rate pressure as foreign funds gravitated to the abnormally high return Canadian term notes. "These distortions in financial markets were discussed in May and June during regular meetings with representatives of the chartered banks. In June the banks requested and received the concurrence of the Minister of Finance, in accordance with Section 138 of the Bank Act, to an agreement that rates of interest offered on deposits of $100,000 or more for terms up to 364 days would be limited to a maximum of 5 1/2%."[61] This was known as the Winnipeg Agreement and was in effect with various rate ceilings until January 15, 1975.

The importance of these agreements is that it was apparent that the degree of rate competition between chartered banks in the term deposit market could only go so far before it would adversely affect other policy objectives. This was, in part, a result of the central bank's concentration on controlling interest rates to promote speci-

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[61] Bank of Canada, Annual Report, 1970, p. 16.

fic external positions. As Griffiths summarizes, "During periods of rising interest rates, the banks have competed vigorously for large deposits. During each of these periods the Bank of Canada has had a definite view as to the level of rates and of the rapidity with which they should adjust to changed conditions, which was different from that which would have been produced by market forces ... Because its preferences differ from the interplay of market forces ... the Bank has imposed an interest rate ceiling in order to reduce competition".[62] The competitive stimulus between banks, resulting from the 1967 revision was at least partially reduced by these instances of moral suasion. On the positive side, however, the Bank's use of moral suasion reduced the problem of excessive or destructive competition between the banks and the near banks which could have resulted in a serious reduction in the number of near banks and created an eventual lessening in the degree of competition.

The legislation itself had resulted in excessive competitive pricing. As an example of the extreme nature of the competition that resulted, the 90-day term deposit rate rose above prime in May 1972 and was close to doing so both in late 1967 and early 1969. The term deposit market had been somewhat competitive prior to the revision but the spread between prime and 90-day term deposits was normally

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[62] Brian Griffiths, "Competition and Regulation," p. 52.

about one percentage point.[63]

With respect to the conduct element of non-price behaviour, little evidence can link any developments in the term deposit markets with the revision other than the general improvements in chartered bank progressiveness outlined in Chapter IV. However, this would still amount to some competitive improvement in the term deposit market along non-price lines.

One small exception worth noting was the revision's granting the chartered banks the right to issue debentures as an alternative liability instrument. The Toronto Dominion Bank made the first issue dated May 2, 1967[64] but further usage of this new power did not occur until much later. By the end of 1974 debentures totalled only 0.8% of total chartered bank liabilities.

In summary, the effect of the 1967 revision was to make the term deposit market less competitive. Reductions in entry barriers for the chartered banks led to a significant rise in the degree of concentration in the market. The resulting expansion of banking strength and excessive or destructive rate competition reduced entry incentives for potential trust and mortgage loan companies and caused a number of fringe member companies to drop out of the market.

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[63] Bank of Canada, Review, See Table on "Selected Interest Rates."

[64] McCallum, "The 1967 Revision," p. 78.

Section 2. The Effect of the 1967 Bank Act Revision on Competition Within the Transaction Deposit Market

Barriers in the transaction deposit market are structural in nature.[65] For instance, trust and mortgage loan companies mostly have concentrated their asset operations in the mortgage credit market and have tended to refrain from offering volatile deposit accounts in order to prevent the creation of any liquidity difficulties. Co-operative banks, in line with a more liquid asset base have been more inclined to accept these liquidity dangers and have become serious competitors in the market.

The 6% interest rate ceiling placed a restriction on the chartered banks' transaction deposit activities. Their loan rates were artificially low and this prevented them from raising deposit rates high enough to make a non-chequable savings account economically viable. Prior to the revision the banks were accepting only demand and chequable savings deposits.

The near banks proved to be sensitive to changing market stimuli and when individuals began to shorten their liquidity position or holdings of demand deposits, they provided non-chequable savings deposits as an alternative. This deposit offered rates considerably

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65 There are also regulatory barriers which preclude the functioning of non-deposit taking financial institutions in deposit markets, but these regulations serve to differentiate between financial service firms and near banks as part of the defining criteria of the latter is that they compete with the chartered banks in deposit-taking.

in excess of the chartered banks rates on chequable savings accounts. The banks did compete on a service basis and this partially made up for the lack of rate diversity but they lost out on the marginal accounts which were swayed by the increased earning potential at the near banks. This was a serious problem for the banks who were largely dependent upon savings deposits as a source of funds.

Transaction deposits grew by 93.1% over the 1966-74 period, far below the growth in term deposits and reflecting the increased tendency for firms and individuals to economize on their transaction balances. In 1966 transaction deposits had represented 76.4% of all deposits, declining to 53.4% by the end of the period.

After the 1967 Bank Act revision and the removal of the 6% interest rate ceiling the chartered banks were quick to introduce the non-chequable savings deposit. The Mercantile offered a non-chequable savings deposit at 4 1/2%, one and one-half percentage points above the existing chequable savings deposit rate even before the Act was through parliament.[66] Then, the Bank of Montreal became the first of the larger banks to react and announced a 4 1/2% true savings account to be introduced concurrently with the new legislation. By the end of April all others had announced similar intentions.[67] The new variety was an instant success and by 1969

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[66] McCallum, "The 1967 Revision of the Bank Act," p. 51.

[67] ibid., p. 52.

had surpassed chequable savings as the more dominant savings vehicle in the banks' liability portfolios. As of 1974, $11.8 billion was held in chartered bank non-chequable savings accounts while $6.5 billion was in their chequable savings accounts.[68] A large number of firms and individuals had begun using a combination of demand accounts and non-chequable savings accounts rather than continuing to hold their transaction balances solely in chequable savings deposits.

The chartered banks' introduction of a non-chequable savings account was a non-price competitive move linked directly to the passing of the revision. Among other post 1967 non-price competitive developments was the single charge service package which features zero service charges on each cheque, costing a flat monthly rate. This example and other changes in the services to transaction deposits can be linked to the revision's general improvements in competitive atmosphere as discussed in Chapter IV.

The chartered banks' share of the market declined from 59.2% in 1966 to 55.7% in 1974, suggesting that the banks lost a small portion of their control of transaction balances (see Table 17). However, it is likely the loss would have been greater if it had not been for the revision's removal of the interest rate ceiling which enabled the banks to compete with the non-chequable savings accounts of the near banks, and in particular the cooperative banks. Declines in the five-firm concentration ratio from 55.0% in 1966 to 50.9% in 1974

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[68] See Appendix, Table B.

TABLE 17

TRANSACTION DEPOSIT MARKET

MARKET SHARES OF INSTITUTIONS, 1964-74

(billions of dollars with market shares in brackets)

Institution/Year	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974
Chartered Banks	13.64 (59.0)	14.65 (59.1)	15.47 (59.2)	17.23 (60.2)	18.77 (61.3)	18.70 (60.1)	19.53 (59.1)	22.49 (57.1)	25.25 (56.3)	27.72 (57.6)	29.87 (55.7)
Trust Companies	1.05 (4.5)	1.11 (4.5)	1.10 (4.2)	1.16 (4.1)	1.23 (4.0)	1.34 (4.3)	1.47 (4.4)	1.69 (4.3)	1.98 (4.4)	2.04 (4.2)	2.20 (4.1)
Mortgage Loan Companies	.33 (1.4)	.36 (1.5)	.39 (1.5)	.40 (1.4)	.45 (1.5)	.44 (1.4)	.48 (1.5)	.55 (1.4)	.61 (1.4)	.65 (1.4)	.66 (1.2)
Cooperative Banks	1.94 (8.4)	2.21 (8.9)	2.50 (9.6)	2.86 (10.0)	3.10 (10.1)	3.22 (10.4)	3.44 (10.4)	3.99 (10.1)	5.01 (11.2)	5.97 (12.4)	6.52 (12.2)
Quebec Savings Banks	.36 (1.6)	.38 (1.5)	.40 (1.5)	.43 (1.5)	.47 (1.5)	.42 (1.4)	.43 (1.3)	.44 (1.1)	.49 (1.1)	.55 (1.1)	.56 (1.0)
Government Savings Institutions	.19 (0.8)	.19 (0.8)	.20 (0.8)	.22 (0.8)	.25 (0.8)	.30 (1.0)	.30 (0.9)	.34 (0.9)	.41 (0.9)	.48 (1.0)	.67 (1.2)
Canada Savings Bonds	5.61 (24.3)	5.87 (23.7)	6.09 (23.3)	6.32 (22.1)	6.36 (20.8)	6.68 (21.5)	7.40 (22.4)	9.92 (25.2)	11.11 (24.8)	10.73 (22.3)	13.17 (24.5)
TOTAL	23.12	24.77	26.15	28.62	30.62	31.10	33.05	39.42	44.86	48.14	53.65

Sources: Bank of Canada, Review.
Bank of Canada, Statistical Summary.

was similar to the decline experienced by the chartered banks. This is because the five largest banks are by far the major market participants (see Table 18). The increasing strength of the cooperative banks in attracting transaction balances is apparent as their share of the market increased from 9.6% in 1966 to 12.2% in 1974. The market share represented by Canada Savings Bonds increased marginally from 23.3% in 1966 to 24.5% in 1974. The amount of Canada Savings Bonds issued depends upon the financial requirements of the Government and may be treated as an exogenous factor. However, removing the influence of the bonds on transaction deposit market shares does not reverse the trend indicated with chartered bank shares declining and cooperative banks strengthening.

The market shares of other institutions such as trust companies (4.2% to 4.1%), mortgage loan companies (1.5% to 1.2%) and Quebec savings banks (1.5% to 1.0%) declined from 1966-74. There was a small amount of growth in market share for Government savings instituitions from 0.8% to 1.2% over the period (see Table 17).

Prior to 1967 all chartered bank savings deposit rates and service charges on demand accounts were determined collusively through open inter-bank agreements. For demand deposit service charges the legislation did nothing to legally restrict collusive price setting and subsequent alterations followed the same pattern (see Table 19). Interest rates are subject to market conditions and this restricts the amount of non-competitive pricing which may take place. As the Prices and Incomes Commission noted, service charges

TABLE 18

TRANSACTION DEPOSIT MARKET,

FIVE FIRM CONCENTRATION RATIOS, 1966 & 1974

(millions of dollars)

1966			1974		
Firm	Deposits	%age of Market Total	Firm	Deposits	%age of Market Total
1. Bank of Commerce	3939	15.1	1. Bank of Commerce	7172	13.4
2. Royal Bank	3040	13.9	2. Royal Bank	7143	13.3
3. Bank of Montreal	3233	12.4	3. Bank of Montreal	5943	11.1
4. Toronto-Dominion	1831	7.0	4. Toronto-Dominion	3587	6.7
5. Bank of Nova Scotia	1724	6.6	5. Bank of Nova Scotia	3431	6.4
FIVE-FIRM CONCENTRATION RATIO		55.0%	FIVE-FIRM CONCENTRATION RATIO		50.9%

Sources: Canada Gazette, Bank Assets and Liabilities.
Financial Post, Survey of Industrials.
Bank of Canada, Review.
Bank of Canada, Statistical Summary.

TABLE 19

SERVICE CHARGES ON SELECTED ACCOUNTS:

ALL BANKS, 1946-1971

August 1946	Current	.05¢
November 1948	Current	.06¢
May 1954	Current	.08¢
October 1956	Current	.10¢
October 1957	Personal Chequing	.10¢
July 1967	Current	.15¢
May 1967	Chequable Savings (previously .15¢)	.20¢
September 1969	Personal Chequing	.11¢
April 1971	Current	.20¢
April 1971	Personal Chequing	.14¢

Source: Griffiths, "Competition and Regulation," Table 4, p. 42.

"... are determined by the chartered banks under much less pressure of competition from alternative suppliers of financial services..."[69] For this reason the government had not thought it feasible to restrict collusive activity.

One effect of the Bank Act was to immediately increase deposit rates over the whole deposit spectrum. The banks argued that the lower rates had partly paid for the costs of chequing in the past and with the rise in rates this subsidization no longer existed. In 1971, the banks raised the service changes on demand accounts from 10¢ to 15¢ and on chequable savings from 15¢ to 20¢, justifying the moves as necessary to cover costs.

The Canadian Bankers' Association estimates of the costs of servicing various accounts are given in Table 20. The data seem to support the chartered banks' argument as it can be seen that in 1969 service charges were not high enough to cover the costs of the chequing process and the increases only went part-way towards making the demand accounts self-sufficient.

However, the American system, which is more decentralized, provides an interesting comparison. As the Price and Income Commission notes, in the United States, "... there appears to be a great diversity in the structure and level of service charges on chequing accounts offered by particular banks. Different banks offer

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[69] Prices and Incomes Commission, Service Charges, p. 14.

TABLE 20

CANADIAN BANKERS' ASSOCIATION COST ESTIMATES
ON SELECTED ACCOUNTS

	1969		1971	
	COST	CHARGE	COST	CHARGE
Current Account	18¢	15¢	19¢	20¢
Personal Chequing	20¢	10-11¢	21¢	14¢
Payment Acceptance (on behalf of third party)	33¢	15¢	35¢	20¢

Source: Prices and Incomes, Service Charges, p. 9.

varying combinations of basic maintenance charges, fees per cheque or per deposit, entry free chequing privileges related to the size of the minimum or average balance, and access to secondary service."[70] It further notes that according to Federal Reserve data, the costs are similar between the United States and Canada, but the loss per debit is much greater in the more competitive system.[71] That loss does not account for the secondary benefits

[70] Ibid., p. 7.

[71] Ibid., Table I, p. 10.

the banks derive from the servicing of chequing accounts through customer attraction, etc. In that sense, the United States cash loss may be a measure of that benefit. This leads to the interpretation that the resulting lower deficits accruing to the similar operations (demand accounts) of the Canadian chartered banks are evidence of an increase in the exploitation of their oligopoly position. However, the evidence is somewhat slim and as the commission notes, "Neither the data nor the banking systems are similar enough to derive direct conclusions from this comparison."[72]

On May 15, 1970 the banks did abolish the extra service charge applied to out of town cheques.[73] This was an actual reduction of existing prices. However, since this reduction came during the tenure of the agreement the banks had made with the Price and Incomes Commission, it could be surmised that it represented a token effort on behalf of the former to impress the latter and was not caused by the revision.

Price competition for savings deposits subsequent to the revision remained relatively lackluster with rates changing infrequently and independent pricing action almost non-existent. In fact, the evidence suggests that in many cases price agreements were organized similarly to before the revision. This is particularly true of the chequable savings accounts where all banks have tended to

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[72] Ibid., pp. 8-9.

[73] Ibid., p. 13.

alter their rates identically and on the same day (see Table 21). The non-chequable rates show somewhat more independent action (see Table 22). However, the first four changes to April 1, 1969 did not. On June 1, 1969 three banks, the Bank of Montreal, the Commerce and the Bank of British Columbia raised their rates from 5 1/2% to 6%. It took a month before more activity took place. At that time the five major banks and the Mercantile went to 6 1/2%, the Bank of British Columbia went to 6 1/4% and the Banque Provinciale and Banque Canadien Nationale both remained at 5 1/2%. A year later they all gravitated back to the same level at 6%. On November 1, the banks again moved together, though the Bank of British Columbia kept their rates at 1/4% higher than all others. Three rate changes in 1971 were also arrived at with few discrepancies from the common pattern. Unfortunately the source for this information only listed data to the end of 1971 and attempts to obtain more proved futile.

In summary, the 1967 Bank Act revision has caused the transaction deposit market to become more competitive overall. Price behaviour is still very much oligopolistic in nature but the reduction of the 6% interest rate barrier which had hampered the chartered banks actions and the improvements on non-price competitive lines were definite positive results. There were also declines in market concentration but it appears that these declines would have been even stronger if the revision had not occurred.

TABLE 21

CHANGES IN RATES PAID ON CHARTERED BANKS'

CHEQUABLE PERSONAL SAVINGS DEPOSITS

Date	Banks	Rate
1900-1933	All banks	3
May 1, 1933	All banks	2 1/2
November 1, 1934	All banks	2
June 1, 1936	All banks	1 1/2
December 1, 1953	All banks	2
August 1, 1956	All banks	2 1/4
September 15, 1956	All banks	2 1/2
February 1, 1957	All banks	2 3/4
July 1, 1962	All banks	3
May 1, 1967	All banks	3 1/2
November 1, 1970	All banks	3
November 1, 1971	All banks	2 3/4
May 1, 1973	All banks	3

Source: Bank of Canada, solicited information.

TABLE 22

CHANGES IN RATES PAID ON NON-CHEQUABLE SAVINGS DEPOSITS, BY INDIVIDUAL BANKS, 1967-71

Date/Bank	Bank of Montreal	Bank of Nova Scotia	Canadian Imperial Bank of Commerce	Toronto-Dominion	Royal Bank of Canada	Banque Provinciale du Canada	Banque Canadienne Nationale	Bank of British Columbia	Mercantile Bank
Apr., 67	4 1/2	4 1/2	4 1/2	4 1/2	4 1/2	4 1/2	4 1/2		4 1/2
Feb. 21, 68	5	5	5	5	5	5	5		5
Jan. 17, 69	5 1/4	5 1/4	5 1/4	5 1/4	5 1/4	5 /4	5 1/4	5 1/4	5 1/4
Apr. 1, 69	5 1/2	5 1/2	5 1/2	5 1/2	5 1/2	5 1/2	5 1/2	5 1/2	5 1/2
June 1, 69	6		6					6	
July 1, 69	6 1/2	6 1/2	6 1/2	6 1/2	6 1/2			6 1/4	6 1/2
July 1, 70	6	6	6	6	6	6	6	6	6
Nov. 1, 70	5 1/2	5 1/2	5 1/2	5 1/2	5 1/2	5 1/2	5 1/2	5 3/4	5 1/2
Jan. 8, 71	5	5	5	5	5	5		5 1/4	5
Jan. 13, 71							5		
Feb. 16, 71				4 3/4					
Feb. 24, 71	4 1/2	4 1/2	4 1/2	4 1/2	4 1/2	4 1/2	4 1/2	4 3/4	4 1/2
Oct. 26, 71	4	4	4			4			
Oct. 27, 71				4	4			4 1/4	

Source: Jones and Laudadio, "Canadian Bank Mergers."

CHAPTER VII

EVALUATING THE HYPOTHESIS: SUMMARY AND CONCLUSIONS

The analysis of Chapters V and VI looked at the effect of the 1967 Bank Act revision on the competition within individual banking markets. It is now time to consider this analysis in regards to the original hypothesis; that is, that the 1967 Bank Act revision improved the competitiveness of banking markets overall. This will require weighing the change in the individual markets and making a judgement in aggregate.

A summary of the competitive effect of the revision on the individual markets was provided earlier after the analysis was completed for each market. To recap, it was considered that the revision caused overall competitive improvement in the markets for commercial credit, mortgage credit and transaction deposits. The revision caused a movement towards less competition in the consumer credit and term deposit markets. The summary to follow treats the five markets in aggregate by first considering the overall effect of the legislative change on each of the four structure and conduct elements used as evidence of competitive shifts. A concluding statement will provide comment on the overall competitive effect of the 1967 Bank Act revision on banking markets in aggregate.

Entry Barriers

The 1967 Bank Act revision had two major effects on entry

barriers in banking markets. First, it raised barriers to the creation of new institutions and second, it lowered many of the barriers obstructing the operations of the chartered banks in the various markets.

The second effect was by far the stronger of the two. The legislation removed the 6% interest rate ceiling on chartered bank loans. This barrier had become restrictive to chartered bank activity in the mortgage credit market and soon would have become a serious problem for them in consumer and commercial credit. They were already feeling its impact in the riskier end of these markets where loan rates are considerably higher. Alternative methods of raising rates were developed such as compensating balances and the charging of interest on the initial loan balance rather than the outstanding principal. However, these were costlier and more complicated practices and the interest rate ceiling was slowly becoming restrictive. With the chartered banks' interest rates charged on loans being artificially repressed, the deposit rates they could offer were forced inordinately low, making it more difficult for them to compete for funds. The legislation removed this rate celing and allowed the banks to enter the market for conventional mortgages for the first time. These changes greatly reduced the barriers the chartered banks faced in the loan and deposit markets and had a strong positive effect on competition.

Higher entry barriers occurred when foreign controlled banks were prohibited from operating in Canada, but this restriction had

little impact since foreign bank affiliates were still able to enter the Canadian financial market by circumventing the legislation. The legislation did reduce entry incentives for near banks through its effect of increasing chartered banks' competitiveness. The greater freedom afforded the banks resulted in a serious operational constraint for the competing near banks.

Numbers and Size of Firms

Concentration ratios declined in three of the five markets; those of commercial credit, mortgage credit and transaction deposits. In the commercial credit market the decline was caused by the rising market shares of commercial paper and foreign bank subsidiaries. This increased usuage of alternative commercial funding can be linked to the revision and its removal of the interest rate ceiling on chartered bank loans. The revision's removal of mortgage market entry barriers to the chartered banks led to the reduction in that market's concentration ratios, though part of the reduction can be attributed to the exogenous influence of rising monetary aggregates and the retarding effect this had on the market share of the life insurance companies. In the transaction deposit market the decline in the concentration ratio was minimal and it would have declined even further had not the revision removed the interest rate ceiling on chartered bank loans.

In both the consumer credit market and term deposit market, the greater competitive freedom led to significantly higher market shares

for the chartered banks and increased market concentration ratios. In the term deposit market it took the exogenous intervention of the central bank to keep the concentration ratio from rising further.

In general the increases in concentration were greater than the declines but it is difficult to make an aggregate conclusion. This is even more apparent if an added factor is considered. The concentration ratios calculated for this study cover a fairly wide market area and specific localized markets were largely ignored. However, one localized market has been considered. In that case it was indicated that the greater market freedom afforded the chartered banks enabled them to provide a competitive thrust against the sales finance and consumer loan companies in the commercial and consumer credit markets. This was the result of an improved availability of chartered bank credit to riskier credit seekers than was the case previous to 1967.

Price Behaviour

In general prior to 1967 there was little price competition evident in the markets in which the chartered banks controlled a major share. The chartered banks were not legally restricted from using open rate collusion and there is nothing to indicate that they failed to take advantage of this in the markets for commercial credit, consumer credit and transaction deposits. All chartered bank rate charges in these markets were made in unison prior to 1967. The markets for mortgage credit and term deposits were less concentrated and

more diversified respectively, making them less susceptible to strict price setting.

The 1967 revision prohibited chartered bank collusion on all rates except the service charges on demand deposits. With this legal restriction in place there was some increase in independent pricing action among the chartered banks, but they soon developed alternative oligopolistic pricing techniques, in particular a price leadership model whereby price moves followed the pattern set by the central bank's bank rate or an independent move by one of the banks. The term deposit market was the major exception. Immediately following the revision the chartered banks began to compete vigorously for these deposits such that the ability of near banks to attract deposit funds was impaired. The central bank intervened to set rate ceilings in the market because to allow the competition to continue would have likely led to excessive levels such that a large number of near banks would have been driven out of business.

Non-Price Behaviour

There was a good improvement in the progressive nature of the chartered banks after 1967. The Bank Act revision's removal of operational barriers facing the banks coupled with a more pro-competitive atmosphere induced by the revision strongly influenced these changes in the chartered banks' conduct. Most of the new developments related to the operations of the chartered banks in general and there were few effects directly related to a specific banking market. One

major exception was the chartered banks' introduction of a non-chequable savings deposit immediately following the revision.

Conclusion

The 1967 Bank Act revision influenced a decline in entry barriers and greater non-price competition in the banking markets. These were positive competitive developments. On the negative side the legislation caused some overall rise in market concentration and in the only market where there was increased price competition, that competition became excessive.

The evidence of the study shows a range of change in the degree of competition in Canadian banking markets as a result of the 1967 Bank Act revision and the hypothesis fails to gain full support as a positive change is not consistently apparent. However, it is judged that there were increases in the degree of competition in the commercial credit, mortgage credit and liquid deposit markets. In addition, in the two markets where it was judged that there was a decline in competition there was still some isolated competitive strengthening. In conclusion the hypothesis gains qualified support.

APPENDIX: NOTES TO TABLES

NOTES TO TABLES

TABLE 5: Commercial Credit Market; Market Shares of Institutions, 1964-74.

Below is a list of financial institutions with the type of assets they hold which were considered part of the commercial loan market:

Sales Finance Companies; retail commercial paper
wholesale paper
business loans
Industrial Development Bank; loans outstanding
Chartered Banks; business loans
Leasing Corporations; retail sales financing
wholesale financing
commercial business loans
Cooperative Banks; business loans

Cooperative bank data on business loans were not available for 1964-66. To complete the series the growth rate of their personal loans over the 1964-66 period was taken as a proxy for the growth rate of business loans, then used to extrapolate the three missing years.

TABLE 6: Commercial Credit Market; Five and Eight Firm Concentration Ratios, 1966 and 1974.

TABLE 10: Consumer Credit Market; Five and Eight Firm Concentration Ratios, 1966 and 1974.

For the ith chartered bank, $B_i+C_i+R_i=G_i$, where B_i, C_i, R_i and G_i are commercial loans, consumer loans, residual loans, and total loans, respectively. The G_i are reported in the Canada Gazette.

Let $B_i = D_iG_i$ and $C_i = F_iG_i$, where D_i and F_i are the share of general loans of ith bank which are commercial and consumer, respectively.

Assume $D_i = Dx$ and $F_i = Fx$, the shares being constant for all banks. Also, $Dx = Bi/ Gi$ and $Fx = Ci/ Gi$. Then Dx and Fx may be calculated from <u>Bank of Canada Review</u>.

Then, $B_i = DxG_i$ and $C_i = FxG_i$.

Sales Finance companies report receivables in aggregate. These receivables are either commercial or consumer oriented.

Let R_i = total receivables of the ith finance company. Then $B_i + C_i = R_i$ where B_i and C_i are commercial and consumer receivables of the ith company. Then, $B_i = D_iR_i$ and $C_i =$

F_iR_i, where D_i and F_i are the shares of each company's receivables which are commercial and consumer related, respectively.

But, $Dx = B_i / R_i$ and $Fx = C_i / R_i$ and can be calculated from data in the Bank of Canada Review.

Assume that $D_i = Dx$ and $F_i = Fx$.

Then, $B_i = DxR_i$ and $C_i = FxR_i$.

TABLE 11: Mortgage Credit Market; Market Shares of Institutions, 1964-74.

Estimates were necessary for this table as follows:

a) Trust company fiduciary funds have money invested in mortgages both directly and through trusteed pension plans. Since mortgage holdings of all trusteed pension plans are reported in the table, to avoid overlap the pension fund mortgages of trust companies had to be removed from their fiduciary fund holdings. To do this, it was assumed that the trusteed pension plans of the trust companies had the same percentage invested in mortgages as did their overall fiduciary funds. Total fiduciary funds invested by pension plans were multiplied by this percentage giving an estimate of the overlap, which was then deducted from the Trust Company fiduciary fund totals.

b) Prior to 1969 mortgages held by consumer loan and sales

finance companies were aggregated with "Notes and Accounts Receivable" in the data reported in the Bank of Canada Review. In the table mortgage totals were estimated as 2.0% of Receivables over 1964-66 and 2.5%, 1967-68. These figures are roughly in line with the general increase of mortgage holdings percentages for finance and loan companies over the period of analysis. The percentage mortgages represented of receivables rose from 2.7% in 1969 to 7.0% in 1974.

c) The figures for mortgages held by non-financial corporations were only available for 1970 and 1971. For other years, both before and after, mortgages were included in more aggregative totals. To estimate the data for other years it was assumed that the average percentage mortgages represented of the more aggregative measures, over 1970-71, would be maintained for all years.

TABLE 12: Mortgage Credit Market; Five and Eight Firm Concentration Ratios, 1966 and 1974.

Trust and mortgage loan company mortgages were aggregated with other loans. To disaggregate them the following method was used:
Let $L_i = M_i + O_i$ where M_i = mortgages, O_i = loans and L_i = total mortgage and loan credit of the ith company. Then, $M_i + O_i = L_i = L$ where L = total loans plus mortgages of all trust and mortgage loan companies. $M_i / L_i = Ax$, the percentage mortgages represent of total loans plus mortgages of all trust and mortgage loan companies. This can be calculated from data in the

<u>Bank of Canada Review</u>. $M_i = A_i L_i$ where A_i = percentage mortgages represent of total credit for the ith company. Assume this is constant, i.e. $A_i = Ax$. Then $M_i = AxL_i$.

TABLE 15: Term Deposit Market; Market Shares of Institutions, 1964-74.

TABLE 17: Transaction Deposit Market; Market Shares of Institutions, 1964-74.

Disaggregated deposit totals were not available for all financial institutions. The statistical applications required to obtain these figures follow on an institution by institution basis.

A. <u>Chartered Banks</u>

Table A shows the raw data available for chartered bank deposits by type (excluding demand deposits).

TABLE A

Chartered Banks' Savings and Term Deposits, 1964-74

(millions of $)

	Personal Savings			Non-Personal Term & Notice			
	Chequable	Non-Chequable	Fixed Term	Chequable	Non-Chequable	Bearer Term	Fixed Term
1964		(8846)			(1498)		
1965		(9642)			(2303)		
1966		(10140)			(2480)		
1967	7592	2775	1261		(3652)		
1968	6583	4340	2539		(4395)		
1969	5634	5663	3594		(3622)		
1970	5203	6784	4481		(4570)		
1971	5669	7731	4127		(6372)		
1972	6216	8324	5191	426	559	1203	6077
1973	6572	9127	8579	394	526	1759	7008
1974	6052	11249	12145	405	592	1369	9404

Source: Bank of Canada, Review.

Bank of Canada, Statistical Summary.

The bracketed figures in TABLE A mean they are not disaggregated further than the overall categories of Personal Savings and Non-personal Term and Notice. TABLE B is estimated from Table A and gives a more disaggregated data set.

TABLE B

Chartered Banks' Savings and Term Deposits (Adjusted), 1964-74

(millions of $)

	Personal Savings			Non-Personal Term & Notice			
	Chequable	Non-Chequable	Fixed Term	Chequable	Non-Chequable	Bearer Term	Fixed Term
1964	8305	-	541	155	-	1343	
1965	8928	-	714	233	-	2070	
1966	9231	-	909	251	-	2229	
1967	7592	2775	1261	271	99	3282	
1968	6583	4340	2539	268	177	3950	
1969	5634	5663	3594	183	184	3255	
1970	5203	6784	4481	201	262	4107	
1971	5669	7731	4127	273	372	5727	
1972	6216	8324	5191	426	542	1369	6077
1973	6572	9127	8579	394	526	1759	7008
1974	6052	11249	12145	405	592	1369	9404

TABLE B was manufactured from TABLE A given the following assumptions:

- fixed term in the category of personal savings deposits in TABLE A grew at an annual rate of 21% over the 1967-74 period. The totals for fixed term deposits over 1964-66 were calculated by assuming this growth rate would be the same in the earlier period.

The residual was taken to be included in chequable savings deposits as non-chequable savings deposits were not offered by the banks in the 1964-66 period.

- chequable plus non-chequable term deposits as a percentage of total non-personal term and notice deposits were calculated for 1972-74. This percentage was assumed to exist over the 1964-71 period. This allowed a separation of chequable plus non-chequable from fixed term plus bearer term. The chequable plus non-chequable deposits were disaggregated under the assumption that the proportion by year would be the same as for chequable and non-chequable savings deposits.

Chartered banks transaction deposits as reported in TABLE 17 were calculated as the aggregate of chequable and non-chequable savings deposits plus chequable and non-chequable non-personal term and notice deposits plus demand deposits. Chartered bank term deposits as reported in TABLE 15 were calculated as the aggregate of fixed term savings deposits plus bearer term notes plus fixed term from the non-personal term and notice deposit category.

B. Cooperative Banks

Figures in the Bank of Canada Review were only given for total co-operative bank deposits. In order to disaggregate these figures disaggregated data was solicited from the Quebec, Ontario and four western provinces. Using this information, percentages of transaction

and term deposits were calculated for the 1964-74 period and applied to the total deposits data available to get the required breakdown. The data series by province are presented below.

TABLE C

Quebec Caisses Populaire Deposits, 1964-74

(Raw Data (000))

	Transaction		Term
1964		NO DATA	
1965		(1,112.1)	
1966		(1,245.4)	
1967	1,352.6		89.0
1968	1,453.8		121.8
1969		(1,796.5)	
1970		(2,106.8)	
1971	1,802.4		600.8
1972	2,179.3		711.8
1973	2,531.5		936.1
1974	2,754.9		1,306.3

Source: Bureau de la Statistique du Québec, Service des Finances, Statistiques Financierès des Caisses d'Épargne et de Crédit du Québec, issues 1973 and 1974.

TABLE D

Quebec Caisses Populaire Deposits (Adjusted), 1964-74

(Estimated Series (000))

	Transaction	Term	Total
1964	928.2	34.7	962.8
1965	1,063.2	47.8	1,112.1
1966	1,180.7	64.8	1,245.4
1967	1,352.3	89.4	1,441.7
1968	1,454.3	121.3	1,575.6
1969	1,554.0	242.5	1,796.5
1970	1,700.1	406.6	2,106.8
1971	1,802.4	600.8	2,403.1
1972	2,179.3	711.8	2,891.1
1973	2,531.5	936.1	3,467.6
1974	2,754.9	1,306.3	4,061.2

TABLE D was estimated from TABLE C given the following assumptions:

- 1964 total was estimated by using the 1965-74 growth rate and extrapolating one year back.

- 1969-70 term deposits were taken to show linear growth between 1968 and 1971.

- 1964-66 term deposits were assumed to show the same growth rate as experienced 1967-68.

TABLE E

Ontario Credit Union Deposits, 1964-74

(millions of $)

	Transaction	Term	Total
1964	89.3	3.3	92.6
1965	105.4	5.4	110.8
1966	123.5	9.0	132.5
1967	143.7	14.8	158.5
1968	181.9	24.7	206.7
1969	191.9	41.7	233.6
1970	205.7	65.6	271.3
1971	295.5	100.4	395.9
1972	411.2	134.8	545.9
1973	497.5	204.6	702.1
1974	583.3	332.4	915.7

Sources:- 1967-74 data from the Ontario Credit Union League, unpublished data.

- 1964-66 data were estimated assuming that total deposits in that period would have experienced the same growth rate as during the 1967-70 period. After 1970 there was a significant increase in the rate of growth.
- total deposits (1964-66) were disaggregated by assuming that term deposits percentage of the total were growing at the same growth rate as they were during 1967-70. Transaction deposits were taken as the residual.

TABLE F shows the raw data available on Manitoba Credit Union deposits.

TABLE F

Manitoba Credit Union Deposits, 1964-74

(millions of $)

	Liquid(1) Deposits	Term(2) Deposits	Savings(3) Deposits	Share(3) Capital	Total
1964	11.6	-		63.9	75.5
1965	14.9	1.0		72.7	88.7
1966	19.3	2.0		84.5	105.8
1967	21.7	2.7		95.0	119.4
1968	23.8	5.2		100.2	129.2
1969	28.2	7.4		106.8	142.4
1970	28.9	6.1		120.8	155.8
1971	33.2	29.2	144.0	1.0	207.3
1972	44.2	32.7	200.4	1.0	278.3
1973	70.4	49.5	247.4	1.2	368.6
1974	75.4	78.0	285.6	1.4	440.4

(1) Included chequing and other current deposits (savings accounts).

(2) Term deposits started to be reported separately only from 1965. Before 1965, they were reported as part of share capital.

(3) Before legislative changes in 1970 reduced the share capital per member to a one $5 share, members were free to buy as many shares as they wished. After 1970 the majority of share capital deposits were transferred and reported as savings deposits.

Source: Manitoba Department of Co-operative Development, Administrative and Credit Unions Branch, Unpublished data.

TABLE G was estimated from TABLE F using the following assumptions:

- there was some confusion as to whether the columns categorized as savings deposits and share capital would best fit into the transaction or term deposit market. For this reason and since an accurate distribution was desired more than an accurate absolute estimate, this data was ignored.

- 1964 term deposits were estimated as being the same percentage of term deposits plus share capital as they were in 1965.

TABLE G

Manitoba Credit Union Deposits (Adjusted), 1964-74

(millions of $)

	Transaction	Term	Total
1964	11.6	0.9	12.5
1965	14.9	1.0	15.9
1966	19.3	2.0	21.3
1967	21.7	2.7	24.4
1968	23.8	5.2	28.9
1969	28.2	7.4	35.6
1970	28.9	6.1	35.0
1971	33.2	29.2	62.4
1972	44.2	32.7	76.9
1973	70.4	49.5	119.9
1974	75.4	78.0	153.4

TABLE H

Saskatchewan Credit Union Deposits, 1964-74

(millions of $)

	Transaction	Term	Total
1964	29.2	-	29.2
1965	34.1	0.2	34.3
1966	41.1	17.7	58.9
1967	47.6	36.2	83.8
1968	55.9	55.1	111.0
1969	64.2	73.3	137.5
1970	83.4	89.6	173.0
1971	107.6	124.5	232.1
1972	145.0	171.4	316.5
1973	210.7	216.9	427.6
1974	287.5	288.3	575.8

Source: Saskatchewan Department of Co-operation and Co-operative Development, Administration and Research Services Branch, unpublished data.

TABLE I shows the raw data available on Alberta Credit Union deposits:

TABLE I

Alberta Credit Union Deposits, 1964-74

(millions of $)

<table>
<tr><th></th><th>Current</th><th>Term</th><th>Total</th></tr>
<tr><td>1964</td><td colspan="2">3.2</td><td>3.2</td></tr>
<tr><td>1965</td><td colspan="2">5.5</td><td>5.5</td></tr>
<tr><td>1966</td><td>4.6</td><td>4.6</td><td>9.2</td></tr>
<tr><td>1967</td><td>5.6</td><td>8.9</td><td>14.5</td></tr>
<tr><td>1968</td><td>7.6</td><td>15.3</td><td>23.0</td></tr>
<tr><td>1969</td><td>9.3</td><td>26.5</td><td>35.8</td></tr>
<tr><td>1970</td><td>13.2</td><td>36.6</td><td>49.9</td></tr>
<tr><td>1971</td><td>16.2</td><td>67.7</td><td>83.9</td></tr>
<tr><td>1972</td><td>27.8</td><td>98.9</td><td>126.7</td></tr>
<tr><td>1973</td><td>36.9</td><td>146.6</td><td>183.5</td></tr>
<tr><td>1974</td><td>45.5</td><td>203.8</td><td>249.2</td></tr>
</table>

Source: Alberta Department of Agriculture, Co-operative Activities and Credit Union Branch, <u>Consolidated Balance Sheet Report for Alberta Credit Unions</u>, Issues 1964-74.

TABLE J was estimated from TABLE I using the following assumptions:

- to estimate term deposits for 1964-65 it was assumed that as a percentage of the total they would grow at the same rate as in the 1966-69 period. Transaction deposits were taken as the residual.

TABLE J

Alberta Credit Union Deposits (Adjusted), 1964-74

(millions of $)

	Transaction	Term	Total
1964	2.0	1.2	3.2
1965	3.1	2.4	5.5
1966	4.6	4.6	9.2
1967	5.6	8.9	14.5
1968	7.6	15.3	23.0
1969	9.3	26.5	35.8
1970	13.2	36.6	49.9
1971	16.2	67.7	83.9
1972	27.8	98.9	126.7
1973	36.9	146.6	183.5
1974	45.5	203.8	249.2

TABLE K

British Columbia Credit Union Deposits, 1964-74

(millions of $)

	Transaction	Term	Total
1964	7.7	7.4	15.0
1965	11.6	11.2	22.8
1966	17.1	17.5	34.6
1967	26.5	25.0	51.4
1968	39.1	39.4	78.5
1969	56.9	52.7	109.6
1970	75.9	77.3	153.2
1971	137.3	128.4	265.8
1972	219.3	204.6	423.9
1973	292.0	401.6	693.6
1974	330.0	550.8	880.7

Source: 1966-74 data from British Columbia Central Credit Union, unpublished data.

1964-65 data estimated based on the following assumptions:

- 1964-65 term deposits were assumed to be the same percentage of the total as during 1966-72, a period over which the percentage was relatively stable.
- 1964-65 total deposits were assumed to grow at same rate as during 1966-72.
- 1964-65 transaction deposits were taken as the residual.

TABLE L

Aggregate Cooperative Bank Deposits for Ontario, Quebec and Western Provinces, 1964-74

(millions of $, percentages in brackets)

	Transaction	Term	Total
1964	1067.9 (95.7)	47.5 (4.3)	1115.4
1965	1233.3 (94.8)	68.1 (5.2)	1301.4
1966	1386.4 (92.3)	115.6 (7.7)	1502.0
1967	1597.4 (90.0)	176.9 (10.0)	1774.3
1968	1762.7 (87.1)	261.0 (12.9)	2023.7
1969	1904.4 (81.1)	444.0 (18.9)	2348.4
1970	2107.4 (75.6)	681.8 (24.4)	2789.2
1971	2392.1 (69.5)	1051.0 (30.5)	3443.1
1972	3027.0 (69.1)	1354.1 (30.9)	4381.1
1973	3639.1 (65.0)	1955.3 (35.0)	5594.4
1974	4076.5 (59.6)	2759.6 (40.4)	6836.1

Source: TABLES D, E, G, H, J and K.

Cooperative bank deposits were disaggregated by applying the above percentages by year and deposit type to the totals as reported in the *Bank of Canada Review*.

C. Quebec Savings Banks

Total deposits only were available for the Quebec Savings Banks. The disaggregation into transaction and term deposits was assumed to be identical to that of the Quebec cooperative banks (see Table D).

D. Trust Companies

Transaction deposits were taken as equal to non-chequable savings deposits plus chequable savings deposits. Term deposits were taken as equal to term deposits plus guaranteed investment certificates with less than 5 years to maturity.

E. Mortgage Loan Companies

Transaction deposits were taken as equal to non-chequable savings deposits plus chequable savings deposits. Term deposits were taken as equal to term deposits plus mortgage company notes plus debentures with less than 5 years to maturity.

TABLE 15: Term Deposit Market; Five and Eight Firm Concentration Ratios, 1966 and 1974.

TABLE 17: Transaction Deposit Market; Five Firm Concentration Ratios, 1966 and 1974.

Data on demand deposits for the individual chartered banks is available in the Canada Gazette. Other institutions were not examined. Cooperative banks are the only significant competition in the market and they are too decentralized for any large amount to be concentrated in any one individual institution.

Data on savings and term deposits are aggregated together and reported as personal and non-personal deposits. The following method was used to estimate the savings deposit share of these totals:

Let P_i = personal deposits for each of the i banks.

N_i = non-personal deposits for each of the i banks.

$P_{s,i}$ = personal savings deposits (chequable and non-chequable).

$P_{t,i}$ = personal fixed term deposits.

$N_{s,i}$ = non-personal savings (chequable and non-chequable).

$N_{s,i}$ = non-personal bearer term notes plus fixed term deposits.

$P_{s,i} = A_i P_i$, where A_i equals the percentage of ith bank personal deposits held in savings accounts.

$N_{s,i} = B_i N_i$, where B_i equals the percentage of ith bank

non-personal deposits held in savings accounts.

Assume A_i = Ax and B_i = Bx for all i, where Ax and Bx are the average for all banks, that is;

$$\frac{\sum_i P_{si}}{\sum_i P_i} = Ax \quad ; \quad \frac{\sum_i N_{si}}{\sum_i N_i} = Bx$$

Ax and Bx for a given year can be calculated from TABLE B this appendix.

Then P_{si} = Ax P_i and N_{si} = Bx N_i for each bank.

Let S_i = Psi + Nsi where Si is the estimated holdings of savings deposits of the ith bank.

To get total transaction deposits of the ith chartered bank add Si + Di where Di = that bank's demand deposits.

In table 17, calculate Ti = Pti + Nti where Ti is the estimated holdings of term deposits of the ith bank. The calculations would be made similar to the estimations of individual bank savings deposits above.

Trust company data was also examined for individual institutions in the Financial Post, Survey of Industrials. Deposits and certificates were reported in aggregate. Deposits plus certificates less than 5 years were calculated as percentage of all deposits plus certificates

for trust companies as a whole (see Bank of Canada Review). Call this percentage Cx. Then deposits plus certificates less than 5 years for the ith trust company will equal CxD_i, where D_i equals total deposits plus certificates for the ith trust.

Similarly, term deposit totals for each Mortgage loan company, (equal to term deposits plus debentures less than 5 years plus mortgage company notes) can be calculated. Total deposits of the ith loan company are reported in the Financial Post, Survey of Industrials. The average that term deposits plus debentures less than 5 years plus mortgage company notes are of total deposits for mortgage loan companies as a whole can be calculated from Bank of Canada Review.

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