CHAPTER V

A BANK BALANCE SHEET

WE have now reached a point at which it is well that we should have before us a typical Bank Balance Sheet, and go seriatim through the items of it, pointing out their meaning, and showing what conclusions can be drawn from them. Now that the large joint-stock banks have agreed upon a common form for their monthly statements, it is easy to combine the different statements into one, and I have therefore drawn up, in the form of Table "B," a composite balance sheet, in which the statements of the "Big Five" banks for the end of February 1926 are averaged.

We will begin with the left-hand side of the balance sheet. The first item, "Capital paid up," forms, in most cases, a part only of the total capital on which the credit of the bank, at least in theory, rests. Generally speaking a bank has a considerable uncalled capital in addition to the amount paid up. But this

TABLE "B"

Composite Balance Sheet

Liabilities.		*Assets.*	
Capital paid-up	£12,232,000	Coin, Bank and Currency Notes and Balances with Bank of England	£34,647,000
Reserve Fund	10,089,000	Balances with and Cheques in course of collection on other Banks in the United Kingdom	8,669,000
Current, Deposit and Other Accounts	295,087,000	Money at Call and Short Notice	19,736,000
Acceptances, Endorsements, etc.	19,089,000	Bills Discounted	40,038,000
		Investments	45,835,000
		Advances to Customers and Other Accounts	158,304,000
		Liabilities of Customers for Acceptances, Endorsements, etc.	19,089,000
		Investments in affiliated Banks	4,949,000
		Bank Premises Account	5,230,000
	£336,497,000		£336,497,000

uncalled capital forms no part of the composite balance sheet. There is, of course, considerable variation between the banks as to the proportion of their unpaid capital to the part paid up. Some of the unpaid capital is also held in the form of "Reserve Capital," which is only callable in the event of liquidation. But generally speaking it may be said that less and less stress has been laid on uncalled capital as the banks have grown in size and have been able to publish large additions to their reserves. The public are rightly convinced of the intrinsic strength of the great banks, and the question of a recourse to uncalled capital has ceased to have any appreciable influence on the credit of a bank, except so far as the market value of its partly paid shares is slightly depreciated by the nominal risk.

The bank must none the less be founded on a solid capital. Half a century ago the shareholders in a bank were full partners, liable up to the whole extent of their personal fortunes for any deficiency in the amount required to pay off the depositors on the liquidation of the bank. It was supposed that nothing short of this would give the security which depositors needed before they would entrust

their money. The principle of limited liability was not legally made applicable to joint-stock banks till 1858; the only exceptions up to that date were the Bank of England and the three oldest Scottish banks, which had been granted the privilege by special Acts or by Royal Charter. And for another twenty years it was regarded as an axiom that unlimited liability was essential for the credit of any ordinary banking company. But the appalling failure of the City of Glasgow Bank in 1878 opened the eyes of investors to the terrible risks which they ran in holding bank shares with unlimited liability. Under that liquidation every shareholder, with the exception of a few very wealthy men, had to surrender all his fortune in order to meet the demands of the depositors; many innocent persons, who might not even know that under some trust they were registered among the owners of a few shares, were reduced to poverty. Bank shares were for a time almost unsaleable, and it became clear that the business of joint-stock banking would be disastrously crippled unless the principle of limited liability were introduced. In a short time every joint-stock bank in the kingdom had taken advantage of the Act of 1858.

Fearful of their credit, the banks in all cases reserved a substantial amount of uncalled liability, and in some cases at least increased their paid-up capital. In fact the banks were at that time generally over-capitalised, and the effect of progressive amalgamations has been on the whole to decrease the proportion of capital to deposits. Before the war the proportion of paid-up capital and published reserves together to deposits stood at a little over 10%. During the war and the consequent inflation deposits rose enormously, while capital was hardly if at all increased, and the proportion fell to about 6%. Since 1921 and deflation the deposits have fallen off, there has been some increase in capital, and the proportion has risen to 7% or 8%. But it is noticeable that the tendency has been to issue new capital in the form of fully paid shares, so that the proportion of uncalled capital has fallen. One big bank indeed has ingeniously contrived to convert its whole capital into fully paid shares, without any obviously bad results. Published reserves, the result of savings from profit in the past, are generally kept about equal to the paid-up capital; and it is, of course, known that all the large banks have large hidden reserves in

the form of contingency funds and the like, though the amount of these is not revealed. Generally speaking it may be said that the present capitalisation of the banks is recognised as sufficient for all practical purposes.

The next item, "Reserve Fund," is to all intents and purposes part of the capital of the bank. It represents an accumulation of profits which have been earned but not distributed, and which belong to the shareholders, like the "Rest" in the Bank of England returns. It is, of course, within the power of the banks to draw upon the reserve fund in the case of need. Such a thing has been done in the past; instances occurred some thirty years ago, when a great fall took place in the value of Consols, in which many banks had largely invested their reserve funds. But it is exceedingly unlikely that any recourse will be had again to such expedient; all banks have so strengthened themselves by inner reserves that recourse to a published reserve would create an alarm which would seriously damage the credit of a bank in need of it. For all practical purposes, therefore, we take the Paid-up Capital and Reserve Fund in combination as representing the capital of the bank.

It will be seen that these two lines together in the composite balance sheet amount to £22,321,000, or 7·56% of the Current, Deposit and Other Accounts. None of the banks depart widely from this percentage. Barclays, whose capital is fully paid up, compensate for this by showing 8·3%; the others only vary between 7% and 7·86%.

It must not, however, be overlooked that the percentage of capital to deposits is affected by the extent to which the large banks have affiliated other banks to themselves by the purchase of shares. To this practice we shall recur at a later point. But it must be mentioned here that the paid-up capital of the owning bank has to form the foundation for the credit of the affiliated banks as well as its own. If we take into account this addition to the total deposits, the percentage of capital to liabilities to depositors is reduced as follows:

In the case of Barclays Bank	from 8·30% to 7·16%
In the case of Lloyds Bank	from 7·39% to 5·83%
In the case of Midland Bank	from 7·50% to 6·23%
In the case of National Provincial	from 7·86% to 7·05%
In the case of Westminster Bank	from 7·04% to 6·38%

NOTE:—The percentages in the above table are as at end December, 1925, or as near as possible thereto. Capital is taken as "Proprietors' Funds," *i.e.*, Capital, Reserve and Carry Forward.

On the average of all five banks, this means a reduction from 7·61% to 6·48%.

We pass on to the next line, "Current, Deposit and Other Accounts." So far as this is represented by Current and Deposit Accounts, it speaks for itself; it includes the whole liability of the bank to the public, as distinct from its liability to its shareholders. The proportion of current to deposit accounts is a varying one. It varies in different parts of the country and at different times. In Scotland and Ireland the amounts kept on deposit largely exceed those on current account. In England as a rule the contrary is the case, and current accounts are in excess. But this is largely dependent on the bank rate, which controls the deposit rate of interest. When this is high, everyone is inclined to put as much of his spare cash to earn interest on deposits as his banker, or his conscience and sense of duty to his banker, will allow. When the deposit rate goes up to about 3½% or over, there seems to be a notable tendency on the part of deposit accounts to overtake current accounts; and this is one reason why bankers do not look with any favour on a high bank rate.

But "Other" accounts do not thus speak

for themselves. Included in these are sundry items which the banker deliberately abstains from setting out. Prominent among them is the important item of hidden reserves, including whatever provision has been made for bad and doubtful debts, for depreciation of investments and for various funds of the nature of insurance against eventualities which every prudent banker keeps in hand. Moreover, there are wrapped up under this head, to be produced only at the annual stocktaking, the profits which are accumulating during the year. And there are also wrapped up many items of internal bookkeeping, often set off against corresponding items in the "Other Accounts" which follow "Advances to Customers" on the opposite side of the balance sheet. Some of these we shall have to mention presently. It is enough now to point out that when a banker is keeping in hand his cash reserves on a certain percentage of his "Current, Deposit and Other Accounts" he is really keeping a materially larger percentage of his actual liabilities to the public.

There remains to be considered the line "Acceptances, Endorsements, etc.," which must be taken into account with an equal

"contra" item on the other side of the balance sheet. With the meaning of the acceptance proper we shall have to deal presently; they are an all-important factor in the financing of overseas trade, and are the one means left to the banks by which they can "create credit"; the joint-stock banks in England having long lost the privilege of issuing bank-notes payable to bearer on demand.

As two "contra" accounts do not affect the ultimate balance of the balance sheet, it is evident that they are inserted only for the purpose of giving information. But it must be said that, under present arrangements, they give as little information as possible and very few deductions of any interest can be drawn from them.

In his speech at the Annual Meeting of the Midland Bank Limited on January 25, 1924, Mr. McKenna, in dealing with this particular item in the balance sheet, said:

"The impression that trade is improving is confirmed at first sight by the notable increase in our acceptances and engagements on account of customers, but here I must warn you against a hasty conclusion. Our acceptances and engagements now stand at

£36,552,607 as compared with £25,862,341 at the end of 1922, but the greater part of this increase is due to a rise in engagements resulting from the growing volume of business in forward exchange. . . . As it is our invariable custom to protect ourselves against loss by a compensating purchase or sale, it is necessary for book-keeping purposes to include under our engagements two entries in respect of a single transaction."

The practice of the Midland Bank referred to above in Mr. McKenna's speech is not, however, common to all the members of the "Big Five," the more general method being to take into account the difference only (if there be any) between the Bank's Forward Purchases and its Forward Sales, such difference being reflected in the balance sheet by an increase or decrease in cash, against a corresponding increase in one or other of the following items:

(*a*) "Current Deposit, and Other Accounts"—where Forward Purchases exceed Sales;
(*b*) "Advances, etc."—where Forward Sales exceed Purchases;

the total of Acceptances, Endorsements, etc. not being in any way affected.

There has been no agreement between the banks as to the composition of this item—Acceptances, Endorsements, etc.—and in fact very great differences in practice are known to exist. The existence of differing methods of accountancy—that relating to Forward Exchange Contracts, to mention one item—renders impossible, as will have been seen above, any true comparison between the figures published by the various joint-stock banks.

Here it may be stated that a "spot" operation in Foreign Exchange is the purchase or sale of foreign currency for delivery at once (*i.e.* "on the spot"). A "forward" operation is a purchase or sale of foreign currency for delivery at or within an agreed future time, the rate at which it is carried out being fixed at the time the arrangement is entered into. It is not proposed to enter at any length into the nature and volume of the "spot" and "forward" Foreign Exchange business of the banks; it must suffice to say that Forward Contracts in Foreign Exchange have been developed largely since the war, as a consequence of the varying value of currencies not resting on a gold basis; they provide a means by which both exporters

and importers can assure themselves against the fluctuations of Foreign Exchange. A bank is always prepared to sell or buy for its customers either "spot" exchange or "forward" exchange, covering itself by corresponding purchases or sales which may be "spot" or "forward" transactions, thus relieving itself of any risk in exchange rates.

There are other items of smaller importance affecting this line of the balance sheet—namely, Letters of Credit, Confirmed Credits, etc., etc.—to which conditions of space preclude further reference.

We now turn to the other side of the account. The first line is "Coin, Bank and Currency Notes, and Balances with the Bank of England." This represents the cash reserve which the banks hold in hand to meet the demands of their customers. It is reckoned as a percentage of the bank's liabilities to the public. The amount in the balance sheet before us, £34,647,000, is about 11·74% of the Current, Deposit and Other Accounts, though, as we have seen, it is a somewhat larger percentage of the portion of this last item which really represents liabilities to the public. The percentage is an average, as the banks have no uniform rule, and while

most of them only aim at keeping 10%, one of them publishes a ratio of about 15%.

The ratio is, in fact, purely arbitrary. It was fixed only when, after the war, the common form of monthly return was decided on. In the days before the war this item of cash was combined with the next, "Balances with and Cheques in course of Collection on other Banks in the United Kingdom." This item is almost, but not quite, cash. It is almost cash, because the bulk of it will, in fact, be turned into cash in the course of a day or two; but it is not quite cash, because it includes a certain number of cheques sent for collection which may be dishonoured, and also because cash with another bank in the United Kingdom is not in all cases quite the same thing as cash with the Bank of England. So in settling the common form of return it was considered better to keep the item of cash distinct. The percentage, whether 10% or 15%, was fixed upon, I believe, as the sort of thing that the public might fairly expect of the banks; it was a matter of self-respect that the banks should sacrifice so much of their profits.

It is, in fact, much more than is required for the ordinary working of a bank, and it is

fairly notorious that in practice it is by no means universally adhered to day by day. The floating balances of a bank are divided between the balance at the Bank of England and money at call on the discount market in a proportion which is continually varying, according to the calls made upon the till—calls which to a large extent cannot be foreseen. The balance of cash as shown in the monthly return is, by agreement, the average of the amounts shown in the weekly balance sheets of the respective banks. All that the managers of the banks have to do is to see that these weekly amounts average about the percentage of the current accounts and deposits at which the bank aims. So long as this average is kept up, the amounts from day to day of balance at the Bank of England and money at call in the market may fluctuate according to the requirements of the moment.

It will be seen that the banks make a large sacrifice of profit in thus keeping idle so large a cash reserve. In our composite balance sheet the sum of £34,647,000 would be worth at least 3% on an average, if employed in the usual channels, or one million a year, equal to a dividend of 8% on a total capital of something over £12.000.000. But at

least half of the cash balance is needed for the daily purposes of the till; the other half, say a dividend of 4% on their capital, is what the banks pay for the purpose of keeping up appearances.

It is commonly said that this line represents the banks' first line of defence in case of a crisis. This is only partially true. Reference to the Bank of England returns already set out will show what is the actual course of events in a crisis like that of July–August 1914; and it is hardly likely that a more severe one will be experienced for a long time to come. The increase in "Other Deposits" during those days of stress shows that the banks did not, in fact, draw upon their balances at the Bank of England; on the contrary, they increased them. And the increase, on the other side of the bank return, in "Other Securities," shows that it was by putting the market "into the bank" that they thus satisfied the demands of their customers while increasing their balances at the Bank of England. In other words, the first line of defence of the banks in that memorable crisis lay not in their cash balances but in their Money at Call and Short Notice, and to a large but unknown extent in the "run off"

of short bills, of only a few days' currency, which they held under the head of Bills Discounted.

As then this cash reserve is quite arbitrary in amount, and even to a certain extent fictitious—for it in no wise represents a minimum which is constantly maintained—it is hardly worth while to devote much attention to the curious fallacy which would make this percentage the basis of our whole banking system, as the foundation on which the whole power of the banks to "create credit" rests. It has already been sufficiently pointed out that the banks have, except to a limited amount by their acceptances, no power to create credit; they can only direct the use of credit which is created by quite another means. All that this percentage represents is a limitation of the power of the banks to give credit; evidently the more of their resources they lock up in reserves, the less is their power of lending. The fixed limit to the banks' power of lending is the amount of the resources placed at their disposal by depositors, together with so much of their capital and accumulated profits as is not fixed in business equipment, buildings and the like.

The creation of credit is, it must again be said, in the hands not of the joint-stock banks, but of the Bank of England acting as the agent of the Government. We have seen that the great creation of credit necessary in an acute crisis does not show itself either in the cash reserves of the joint-stock banks, which are slightly increased indeed, but to no great extent, or in their deposits, which remained about steady during the crucial weeks in July and August 1914. But the reserve of the Bank of England, and its proportion to liabilities, showed the full extent of the squeeze; the gold and notes in the Banking Department fell with great rapidity, while the increase in Other Securities showed the startling advance in loans. Since then the measure of the power of the joint-stock banks to lend, that is, the amount of their deposits, has been dependent on the Government requirements resulting in the expansion or contraction of credit, as controlled by the Treasury Note issue, by Ways and Means Advances, and by Treasury Bills; the banks have followed the expansion or contraction of their deposits thus brought about by contracting or expanding their cash reserves in proportion. But the amount of their re-

serves is not the cause, but the effect, of their ability to give credit.

On the next line, "Balances with and Cheques in course of Collection on other Banks in the United Kingdom" we have already touched, and there is little more to be said about it. The bulk of it consists of cheques which are on their way to the country, including Scotland and Ireland, and of which the vast majority will be collected and turned into cash in the course of at most three or four days. This item is what American bankers call "the float." It is, of course, much more important in the United States, where it takes four or five days to present in San Francisco a cheque forwarded from New York, than in the United Kingdom, where a cheque can be conveyed anywhere in twenty-four hours. It will be noted that cheques on banks abroad are not included here; of course they are not to be considered as equivalent to cash.

Before we leave these lines of the cash reserves, a word may be said on the mechanism by which the balance is controlled. We have seen that it is impossible to keep the balance really steady. The large clearing banks are the bankers not only of the large

country, Scottish, Irish and Overseas banks, but of the large financial houses of the City, including the great accepting houses, with whom we shall presently have to deal, and through whose hands no inconsiderable part of the floating money of the country passes. The balances which they keep with their London bankers vary very greatly; but they are subjected to heavy calls from their customers which cannot be foreseen, except within very wide limits. Their balances are held with the London banks at call, and though there is an honourable understanding that any large demands on them shall be advised beforehand as far as possible, yet the unexpected must needs continually happen. The manager who has the highly responsible task of " keeping the till " at the Head Office of his bank starts his day with an estimate of his probable receipts and outgoings for the day, and has to work to it in arranging in the morning the amounts which he can put out at call or short notice, or which he will have to call in in order to keep his balance right. But he is liable to many unexpected calls in the course of the day, some of which may even come from the branches of his own bank. Hence it happens that by the evening

he may find himself out in his estimates by as much as some millions, either in excess or default. If he is short, he has to rely on his balance at the Bank of England; if he is over, he has to bear the loss of interest on the balance till he can get it out. But there is a certain compensatory force at work. The bill brokers and the "money brokers" of the Stock Exchange are always on the look-out to find where money is available to complete their balance for the day; for of course it is not the bankers only who may find their estimates wrong. And at about the close of business hours there is a system of inquiry for "night money," lent to be repaid next morning. By this means a good deal is done to equalise the task of balancing up for the day. This money is, of course, lent at a very low rate; the banker will quote at times as low a rate for the night as 1% p. a., rather than make nothing at all on an excess of several millions.

Yet even so he must look to a very large fluctuation in his daily cash balance, represented, of course, mainly by his balance at the Bank of England. This he has to report daily to his Directors; if they notice any considerable excess or shortage in it, they will ask questions as to the condition of the

market, and thus watch the general tendencies on which their immediate policy must depend. But they have further to keep their eyes not only on the ease or tightness of the market for the day; the balance at the Bank of England for last night is a largely accidental amount. They have laid before them privately a weekly balance sheet, in which these daily variations are smoothed out, and the Bank of England balance must be then fixed as nearly as possible at such an amount as will give them the figure which they have fixed on as sufficient to provide, with till money and other cash assets in their possession, the proportion of cash to liabilities which they ought to hold. This weekly figure is further smoothed out in the monthly balance sheet which is issued to the public. Here the "Cash in hand and at the Bank of England" is the average of the weekly balances which have been before them privately.

It will then be understood that the monthly figure of Cash in hand and at the Bank of England is the average of balances which during the period may have varied very widely. In particular there will have been large variations between the two items of "Cash in hand" and "Money at call and

short notice." What the monthly balance does show is the fact that even where money has for a time been transferred from cash to short notice, it has always been in so readily available a form that it can be called in and returned to cash at least once a week.

Having thus set aside and sterilised the amount of cash which he looks on as the foundation of stability, the banker then has to consider how he is to employ that part of the money entrusted to him which he can safely lend out for longer or shorter periods. Evidently a considerable portion of it can only be lent for short periods in a manner which will assure rapid availability in case of need. It is impossible for a banker to foresee the calls which may be made upon him in the course of the next few days, and he must have some means by which he can supply his balance at the Bank in case of a sudden call upon his resources. This short money will to some extent represent the amounts which he holds upon time deposits running for various periods, from a few days up to two or three months. Of course he can feel confident that not all of these will be called in at once. Banking is after all on the whole a very steady business, and the variations in the amounts

receivable and payable, if taken in the gross, are only slight over short periods. But still a reservoir of short loans is very essential to cover all probable variations.

By "short money" the banker usually means loans running at periods of from one to fourteen days. The item stands in the balance sheet as "Money at Call and Short Notice." It consists chiefly of two parts—money lent to the bill-brokers at call or seven days' notice, and money lent on the Stock Exchange "for the settlement," that is, to enable brokers and jobbers to take up stock in the intervals between the fortnightly settlements.

The question of loans on the Stock Exchange can be dismissed very shortly. The settlements take place usually every fortnight, occasionally with an interval of three weeks. The uses to which these loans are put by the members of the Stock Exchange, and the mysteries of "contango" and the "carry-over" in general need not concern us here, the more so as an excellent account of the Stock Exchange and its mode of doing business has already appeared in another volume of this series. What concerns the banker is firstly the security he gets for the money he lends, and secondly its ready availability for repay-

ment at the settlement. In both respects Stock Exchange loans are of the highest class —the Stock Exchange is a close corporation keeping strict discipline over its members.

The only general exception to their ready realisation that has occurred, I think, within living memory was at the outbreak of the war, when the Stock Exchange was closed for a considerable period, and fortnightly settlements were not resumed till after the legal termination of the war. Stock Exchange loans were thus "frozen" like so many other loans, and by arrangement with the Government the bankers agreed to carry them till the legislature unlocked them.

With the manner in which the other part of the Money at Call and Short Notice is lent, and the general part which it plays in the banking system, we shall have to deal more at length when we come to the money market as a whole, and no more need be said here. So too with the very important item of Bills Discounted. But here we must pause for a moment to point out one ambiguity which occurs under this head. There is no distinction made between Treasury bills and commercial bills—between money lent on bills to finance the Government, and money advanced

to assist commerce. This is a matter on which a bank manager keeps a watchful eye, as affording a valuable indication of the course of commerce on the one hand, and of Government finance on the other. The two elements are entirely distinct, and there does not seem much reason why the information on which the bank manager sets so much store should not be communicated to the public. At present the only index of the course of trade afforded by the bank balance sheets is the item of Advances to Customers. Here, of course, it is possible to judge roughly how far trade is active by noting the demands for loans; but this information would be still more useful if the course of the import and export trades could be traced in the amount of bills on the market. As it is, this is entirely masked by the issues of Treasury bills, which depend on the needs of the Treasury and have at most a very indirect connection with commerce and industry. It must be confessed, therefore, that this item is not very informative. Not only does it make it impossible to see which way trade is moving; but it veils the amount which each bank holds of what is really a very important defence in time of need; for in real urgency a bank could always

realise its holding of Treasury bills by taking them to the Bank of England, which could not refuse to discount them if asked. That, however, is a remote contingency.

"Investments." It will be seen that the average under this head is just about 15% of the liabilities to the public. But the proportion varies considerably between the different banks, from 9·2% to 20%. The investments are almost entirely in Government stocks, with an infusion of other gilt-edged securities. At one time they were mostly in Consols or long-dated stocks; but since the war the number of Government issues of medium or short-dated securities has enormously increased, and a large part of the banks' investments have lately been in the form of National War Bonds, Treasury Bonds, and the like. As these near their maturity the Government has to induce the holders to convert into longer terms. Thus the tendency is for holdings in Conversion Loan and the like to take the place of medium-dated bonds.

This item is thus still under the influence of war finance. When the large war loans were issued, the banks agreed to subscribe large amounts, in a fixed ratio to their deposits,

and the proportion of investments thus swelled to quite abnormal figures. Some of the banks' subscriptions were made with an undertaking to the Chancellor of the Exchequer that they should not be sold till the market price had advanced to a considerable premium. Thus for a time investments were not only unduly swelled, but were unsaleable, and the banks took a risk which in ordinary times would have been considered quite beyond the limits of prudence. But the progress of inflation, by greatly increasing the deposits in the banks, reduced this undue proportion; and the rise in the price of Government stocks which followed the end of the war and rapid deflation made it easy for the banks to reduce their holdings at a good profit. Now the proportion is not very different from what it was before the war.

The investments of a bank are a very useful place for a moderate amount of loose funds. They give a fixed income, which tends to steady profits, and in ordinary times they are easily saleable. But they cannot be regarded as a safe resource in a crisis; in times of panic there are no buyers. At the end of July 1914 the Stock Exchange was actually closed, and all investments were absolutely "frozen."

Investments are therefore only a degree more liquid than Advances to Customers, and are treated by bankers as on a similar footing. When the demand for loans falls off, the banker puts his money into Government stocks, and when the demand for loans increases, he meets it in the first place by selling his investments.

This tendency was very marked in the six months from December 1924 to May 1925; the following figures will illustrate the movement. In December 1924 the aggregate deposits of the Clearing Banks (less National Bank) were £1,655,940,000. By May 1925 this had fallen to £1,597,965,000, a drop of about £58,000,000. During this period Advances had increased by about £37,000,000, from £811,214,000 to £848,638,000. In order to meet this increase the amount of investments had been reduced by about £29,000,000, from £303,199,000 to £274,363,000. Discounts had also been reduced from £234,400,000 to £200,096,000, indicating that Treasury bills had been allowed to run off in order to supply funds. Thus the increase of accommodation under the head of Advances had been obtained by reduction of advances to the Government under the two heads of

Treasury bills and permanent investments in Government stock.

But there is a danger latent in the employment of bank funds in long-dated gilt-edged securities which must not be forgotten. The capital value of such stocks varies with the general rate of interest on capital; and in time of depression when there is little demand for money, and rates fall, the market price of stocks rises. Such a period of stagnation occurred after the Baring crisis in 1890, when Consols, then bearing 2¾% interest, gradually rose to over 111 in 1896. The rise of prices of securities reflected the slackness of the demand for loans for industrial purposes, owing to the stagnation of trade, and the bank rate for a long time stood at its lowest level, 2%. Thus banking profits were difficult to earn, and there was a great temptation to banks to invest in securities whose capacity of appreciation seemed unlimited. But the demand for money created by the South African War, and the great increase in trade activity which followed it, sent the value of gilt-edged securities down with alarming rapidity. For several years up to 1914 banks had to provide large sums annually to write down their investments. More than one important

institution, of the Savings Bank class, whose Directors believed that in investing in Consols they were following a most conservative and prudent course, found themselves in difficulties, and in some cases liquidation, with all its consequent distress to the small investor, was inevitable. When the war was over, and confidence returned, while deflation was raising the value of all fixed investments, the price of gilt-edged stocks rose rapidly. The banks recovered the large sums they had put aside towards writing down their stocks, which had largely been converted, as we have seen, into shorter dated securities, where depreciation could not take place. These recoveries in value formed a most valuable addition to those hidden reserves against depreciation which render the banks to a great extent immune from such risks in future. But bankers have had a sharp lesson, which will not soon be forgotten; and it may be taken as certain that they will be shy of committing themselves to investment in any securities which are not protected either by a fixed and not too distant term for redemption, or by a very effective sinking fund.

The heading of "Advances to Customers and Other Accounts" is important enough to

be reserved to a separate chapter; and the "Liability of Customers for Acceptances, Endorsements, etc." we have already discussed on the other side of the balance sheet. With the remaining items we must deal in very summary fashion. The introduction into the assets of a separate heading to cover the investments of a bank in other banks which it controls by holding the majority or the whole of the shares is quite recent. The practice of thus holding other bank shares is, in fact, a product of the war, and of the fact that the amalgamations of the large banks had reached a point at which central control became difficult. So long as the operations of a bank were confined to England, where banking law and practice were uniform, it was possible to centralise the management in a head office in London. But when it was desired to extend the business of the bank to Scotland and Ireland, not only were the laws and the practice in many respects different, but there was a highly laudable national pride involved, and it was difficult to absorb and abolish an institution which had behind it an honourable name and high repute, in order to merge it in one whose name was half foreign and whose head office was far away

from any access by its customers. Thus it was that when the Scottish and Irish banks were in some cases drawn into the sphere of London banks, by the offer of an exchange of shares on terms so favourable that the existing shareholders could not wisely refuse them, policy suggested that the banks should continue to work under their old names and local management; their shares were held by the London bank, but kept alive, and their Directors were continued in office, working under such supervision as was deemed necessary, the London bank only holding in hand the power, in the last resort, to enforce their wishes by the right which shareholders have to dismiss Directors or officials whom they do not approve. In thus taking over the ultimate control of a large business, the holding bank does not indeed make itself liable to the depositors for their deposits. But it cannot be denied that there is a certain moral responsibility incurred by the holding bank. When the new form of monthly balance sheet was under discussion, it was felt that this consideration took such holdings out of the rank of ordinary investments held by the bank merely for the sake of the interest upon them; and it was very properly agreed that they

should be set out in a way which would show the amount and nature of the holding, and any uncalled liability on the shares. All creditors of the bank were thus fully advised of these outside commitments. It may be added that it seems only right that every shareholder of the bank should have proper knowledge of the position of these subordinate holdings by access to the balance sheet of each bank owned.

The first purchases of Irish banks took place during the war; the Scottish affiliations followed soon after. But the appeals which were publicly made to British banks to show more enterprise, and to take up the international banking which had once been mainly in the hands of the German banks, led to a considerable expansion of business on the Continent in 1919 and the following years. Some of the banks set up foreign branches of their own, others combined for the purpose; others held off from such outside ventures, and contented themselves with closer relations, short of purchase, with important Continental banks. Others purchased controlling interests on a large scale in various Colonial and Overseas banks. It is not possible at present to express an opinion on

the wisdom of this policy, which so far is only on its trial; but many important observers regard it not without apprehension.

The item of "Bank Premises" needs even less comment. They are, as has already been pointed out, an essential condition of existence for the bank, and must be regarded as a necessary investment of its capital. The business of all the large banks has grown with extreme rapidity since the war, and for them, as, for the community, the housing question has been acute. The large sums which stand in the various balance sheets of the banks represent only a part of what has been spent; for all the banks make a practice of writing down drastically the actual cost of the buildings. This is necessary because continual expansion makes necessary continual remodelling and rebuilding. Moreover, it is evident that no bank can expect to realise from an ordinary sale anything like the whole of what has been spent on such expensive provisions as strong-rooms and other special needs of a bank. And it may be added that a bank regards its premises as a most valuable advertisement Competition between the large banks is particularly keen in this direction; and the result is that the banks are

now not only the chief builders in the most important streets of every town and almost every village, but they are most anxious to do their best for the adornment of the towns, and the choice of architects and the approval of designs are matters of anxious consideration in every bank board-room. And it is not, I think, an exaggeration to say that the designs for new bank buildings are very nearly the most important part of the exhibits in the Architecture Room at Burlington House from year to year.