

PART I. THE CLEARING BANKS AND THE  
EVOLUTION OF BANK CREDIT IN  
ENGLAND SINCE THE WAR OF  
1914-18

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SECTION ONE

THE DEVELOPMENT OF THE  
CLEARING BANKS

CHAPTER 1. *THE HISTORICAL BACKGROUND*

ON the eve of the last war the fundamental principles upon which both the organization and the functions of the contemporary British banking system are based had already been developed, although the crystallization of the structure in its present form took place only during the last phase and after the war of 1914-18.

*The Economist* Banking Number of Spring 1914, the most detailed source of statistical information, lists forty-three joint-stock banks at the end of 1913, with altogether 5,797 branches and controlling £809 millions deposits. Eight private banks published statements<sup>1</sup> with £27·1 millions deposits. Three of the forty-three joint-stock banks had more than 500 branches. The London City and Midland led with 867 branches and £93·8 millions deposits, Lloyds Bank was second with 679 branches and £91·5 millions deposits, Barclays had 570 branches and £60·8 millions deposits. There were fifteen other banks with over 100 branches.<sup>2</sup>

The great legislative milestones in the evolution of the English clearing banking system lie in the half-century between 1826 and

<sup>1</sup> The classification of *The Economist* is somewhat uncertain, e.g. Baring Bros. and Co., Glyn, Mills and Co. and Coutts and Co. are listed as joint-stock banks. Whilst this classification may be juridically correct, it is not correct from a functionally analytical point of view, as Barings cannot be counted among English banking firms (and even Glyn, Mills only with certain reservations), and the last two should rather be classified as private and not as joint-stock firms. These minor discrepancies do not alter the picture.

<sup>2</sup> It is interesting to note that the National Provincial, though it had £67 millions deposits, only maintained thirty-two branches, despite the fact that it was founded with the explicit intent of developing a widespread system of branches. The London County and Westminster, the third largest in the country as far as total assets and liabilities are concerned, had 342 branches.

1879.<sup>1</sup> The first date marks the removal of the prohibition<sup>2</sup> to establish joint-stock banking companies (with unlimited liability) with more than six members, having the right of issuing banknotes, outside a radius of 65 miles from London.<sup>3</sup> The Bank of England, as a compensation for this limitation of its privileges, received permission to open branches in the provinces. The financial crisis of 1825–6, which was the occasion for this banking reform, also marks the end of the use of rediscounting facilities at the Bank by the private London banks. This change in practice was to have far-reaching effects upon the future organization of the London money market.

The next step was taken in 1833. Joplin,<sup>4</sup> in 1823, called attention to the fact<sup>5</sup> that the charters of the Bank of England did not forbid the establishment of banks having more than six partners, provided the bank did not issue banknotes and restricted its operations to deposit banking. The legal position, however, remained disputed and nobody dared to oppose the Bank so long as the interpretation of the law remained doubtful.<sup>6</sup> The Reform ministry, however, decided to clarify the position. When the Charter came to be renewed in 1833 the Government, in spite of the protests of the Bank, inserted in the Act, which embodies the Charter, a declaratory clause (St. 1833, c. 98) whereby the establishment of non-issuing joint-stock banks was permitted even in London.<sup>7</sup> The London and Westminster started business in 1834, the London Joint Stock in 1836, and the Union and the London and County in 1839. Altogether eighty-seven joint-stock banks

<sup>1</sup> For more exhaustive treatment cf. Andreades, *The History of the Bank of England*; King, *The History of the London Discount Market* (1936); and the important histories of the great joint-stock banks: Crick and Wadsworth, *A Hundred Years of Joint Stock Banking* (1936); Gregory, *Select Statutes, Documents and Reports relating to British Banks, 1832–1928* (1929) and *The Westminster Bank through a Century* (2 vols. 1936); Withers, *National Provincial Bank, 1833–1933* (1933).

<sup>2</sup> 7 Geo. 4, c. 26.

<sup>3</sup> The Charters of the Bank of England (since 1709, redefined in 1742) gave to it a monopoly of banknote issuing, only private firms with less than seven members being exempted. 7 Anne, c. 7 and 15 Geo. 2, c. 15.

<sup>4</sup> Supplementary Observations to the third edition of an *Essay on Banking* (1823).

<sup>5</sup> Afterwards McLeod confirmed this opinion. See *Theory and Practice of Banking*, 3rd ed. (1906), p. 430.

<sup>6</sup> It seems that the Government had obtained confirmation of this view from the law officers, but that did not alter the attitude in the City. Cf. Andreades, *op. cit.* p. 259.

<sup>7</sup> Two other important reforms made banknotes legal tender and exempted the banks from the operations of the usury laws.

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were formed in the first seven years after the Act.<sup>1</sup> The Bank of England did not give up its opposition to these new banks in which it saw dangerous competitors. On the basis of antiquated laws of the most varied character a vendetta was carried on in Parliament and in the Courts which was as acrimonious as it was unsuccessful.<sup>2</sup> The Bank also refused open drawing (let alone discount) accounts<sup>3</sup>

TABLE I. THE BANKING SYSTEM AS OPERATING IN ENGLAND AND WALES IN 1844\*  
(Amounts are stated in £000's)

	Number	Branches	Capital and reserve	Note circulation	Deposits
Bank of England (7 Sept.)	1	12	18,118	20,176	12,275
London banks:					
Private	63	None	?	Nil	27,000†
Joint-stock	5	45‡	2,244	Nil	7,984
Provincial banks:					
Private:					
Issuing	208				
Non-issuing	65				
	273	71	?	{ 5,153	? ?
Joint-stock:					
Issuing	72				
Non-issuing	28				
	100	441	7,244§	{ 3,478	? ?

\* Crick and Wadsworth, op. cit. p. 22.  
† Estimate by Joplin, *Currency Reform: not Depreciation* (1844).  
‡ Of which thirty-six were accounted for by the London and County Bank.  
§ Forty-eight banks did not give figures, and this amount represents capital only of the remainder.  
NOTE. London branches of foreign and colonial banks are not included in this table.

for joint-stock banks.<sup>4</sup> The private bankers, on their part, refused to permit them to participate in the daily clearing which increased the efficiency, and reduced the cost, of dealing with the cheque payments of customers, which began to be the most important function of banking firms. The joint-stock banks countered these attacks as well as they could and secured deposits by granting attractive rates of interest. Between 1825-6 and 1841-2 the number

<sup>1</sup> King, op. cit.; Gilbart, *A Record of the Proceedings*, etc. (1847).  
<sup>2</sup> Cf. Crick and Wadsworth, op. cit. and Gregory, op. cit. discussion on the Westminster Bank Act, on the difficulty of suing by joint-stock companies, the problem of stockholders, the formula of accepting bills, etc.  
<sup>3</sup> Until 1841. Cf. Gregory, op. cit., also Gilbart, *History, Principles, and Practice of Banking* (1922).  
<sup>4</sup> Cf. Part II, ch. 8, on the importance of this development for the structure of the money market.

of private banks diminished from 554 to 311, partly by continued failures but also by amalgamation, and 118 joint-stock banks survived at the end of the period.

The rapid increase in the provision of banking facilities and the speculative excesses with which it was accompanied led to severe crises, and numerous banking failures occurred. In 1844 the Government decided upon a thorough reorganization of the basis of banking; the result was, as far as the Bank of England was concerned, the Act of 1844,<sup>1</sup> the so-called Peel's Act. Its regulations need not be repeated here. Joint-stock banking was regulated in a second Act.<sup>2</sup> The excesses of the immediate past resulted in a strong reaction. Consequently the principles of this Act were oppressive. The establishment of new joint-stock banks was made almost impossible.<sup>3</sup> In fact only three joint-stock banks were established in the period 1844–54, and only ten until the law of 1857 relaxed the provisions of the 1844 law.<sup>4</sup> The almost complete freedom from new competition enabled the existing joint-stock banks to consolidate their position. The deposits of the London joint-stock banks increased from £8,850,774 in 1847 to £43,100,724 in 1857.<sup>5</sup> It is significant that the private banks could not hold their own. Of 208 private banks authorized to issue notes and existing in 1844, only 157 remained at the time when the new Act was passed.<sup>6</sup>

This intermediate period saw the final victory of the joint-stock banks over the London Clearing House controlled by the private bankers who refused to admit new members. Gilbart, as manager of the Westminster Bank, first applied for admission in 1834—almost immediately after he began negotiations with the Bank of

<sup>1</sup> 7 and 8 Vict. c. 32.

<sup>2</sup> 7 and 8 Vict. c. 113. In addition to the prohibition of the establishment of any new banks of issue and the limitation of the power of issue of existing banks, private and provincial joint-stock, both of which measures were already embodied in the Charter Act.

<sup>3</sup> They could be established only by Letters Patent for the maximum term of 20 years. This procedure necessitated the presentation of a petition to the Crown and a hearing before a Committee of the Privy Council. Minimum capital was to be £150,000. There were further stringent restrictions.

<sup>4</sup> Cf. Crick and Wadsworth, *op. cit.* pp. 27 and 293. It is interesting that two of these banks failed within a decade of their establishment (*ibid.*).

<sup>5</sup> King, *op. cit.* p. 184, 1858 Committee Report. It seems that this increase was due more to the spread of the banking habit than to the attraction of the clients of other banks (*Minutes, Qu.* 1138).

<sup>6</sup> Select Committee on Bank Act, 1857, App. 21. The number of private banks participating in the London Clearing House was thirty-nine in 1834 (Matthews, *Bankers' Clearing House* (1921), p. 13). By 1853 this had been reduced to twenty-five.

England—and renewed his application in 1836 and 1840. All these were refused. The joint-stock bankers thereupon elaborated plans to establish a new clearing house in which the Bank of England was to participate.<sup>1</sup> This plan was vetoed by the Bank of England. It was later disinterred, but the clearing house in 1854 admitted six joint-stock banks. Up to the outbreak of the last war eleven more<sup>2</sup> were admitted at varying intervals. A country cheque clearing was started in 1858 on the basis of plans elaborated by Lord Avebury (then Mr J. Lubbock) in order to satisfy the country bankers, who resorted to the same method of pressure as the London joint-stock bankers, and threatened the establishment of their own clearing house.<sup>3</sup> The cheque, which even in 1832 was only of minor importance—except perhaps in London<sup>4</sup>—became established as the normal method of payment. The clearest proof for this is that the Bank Charter Act of 1844 which penalized the amalgamation of joint-stock banks (both among themselves and with private banks) by the loss of the privilege of note issue did not prevent such amalgamations even in this early period. This change in the method of payment decided nearly all subsequent developments in commercial banking in the United Kingdom.

The joint-stock bank had further obstacles to surmount. The most irksome restrictions were swept away in 1857. The Act of that year<sup>5</sup> repealed the provisions of the Joint Stock Bank Act of 1844, retaining only the provision concerning the denomination of bank shares. The minimum of £100 was reaffirmed. The right of note issue was not restored, but the permissible number of partners in the case of private banks was raised from six to ten.

The limited liability principle which was accepted for companies other than banks in the previous year was granted to banks only in 1858.<sup>6</sup> All joint-stock banks had to re-register under this law. A further measure facilitating the establishment and amalgamation of joint-stock banks was the Companies Act of 1862, which unified the legal regulations of all companies. This removed

<sup>1</sup> Gregory, *op. cit.* vol. 1, pp. 169 et seq.

<sup>2</sup> Matthews, *op. cit.* p. 26. The last admission prior to the 1914–18 War was that of the London and Provincial Bank (1914). Lloyds, Parrs, and the Midland were also admitted on amalgamation with members of the Clearing House. There has been only one further admission, the District Bank, on amalgamation with the non-member Manchester and County Bank.

<sup>3</sup> The Metropolitan Clearing (1907) was the last to be organized. The number of branches in the London area was then not less than 350. Matthews, *op. cit.*

<sup>4</sup> Cf. Crick and Wadsworth, *op. cit.* p. 23.

<sup>5</sup> 20 and 21 Vict. c. 49.

<sup>6</sup> 21 and 22 Vict. c. 91.

the minimum limit on bank shares. For some time the older banks did not avail themselves of the possibility of registering under the new Act as limited companies. They were deterred partly by the fear that a limitation of liability would impair confidence, partly by the obligation to publish balance sheets. But in the prosperous era prior to 1872 many new banking ventures were established.<sup>1</sup> At the same time the amalgamation movement was decidedly speeded up.<sup>2</sup> Private bankers feeling the severity of competition not merely gave up their individuality but began to amalgamate themselves. The most outstanding of these amalgamations took place under the leadership of the firm of Lloyds and Co., Birmingham Old Bank.

The consolidation of the legal basis of joint-stock banking was the direct consequence of one of the worst failures of British banking history. In October 1878 the City of Glasgow Bank closed its doors. It was one of the largest of the Scottish banks. It had 133 branches, 1,200 proprietors, over £8 millions of deposits, and a note circulation of £800,000.<sup>3</sup> The actual losses accumulated in a long period of speculative excesses and fraud amounted to not less than £6 millions. The unlimited liability of the proprietors involved calls amounting to £2,750 per share of £100. The effect of this failure on the value of all bank shares was ruinous, though the Acts of 1857–8 which permitted registration of banks as unlimited companies (hitherto they were legally partnerships) reduced to one year, from the previous period of three years, the liability attached to the ownership after the transfer of shares.

To meet this situation fresh legislation was passed in 1879. This made possible a division of the unpaid banking capital into two parts. One part was callable at the discretion of the directors. The other was 'reserved' to be called only in the event of liquidation. This provision greatly increased the credit standing of firms which availed themselves of it. To do so they had to become companies under the law and were obliged to publish their balance sheets. Many of them did so. Between 1880 and 1882 most joint-stock banks registered as limited liability companies with a simultaneous increase of their capital—in most cases the increase was not paid up, but 'reserved'. Those provincial banks which did not

<sup>1</sup> Especially so-called 'International Banks'. Cf. Crick and Wadsworth, *op. cit.* p. 33 and Baster, *The International Banks* (1929).

<sup>2</sup> A notable amalgamation was that of Jones, Loyd and Co. with the London and Westminster Bank in 1864, which shows the growing importance and prestige of joint-stock banks. Lord Overstone was one of the greatest opponents and harshest critics of joint-stock banking.

<sup>3</sup> Crick and Wadsworth, *op. cit.* pp. 396–8.



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follow suit and continued to withhold the publication of their balance sheets, began to lose in influence and popularity. The general effect of the legislation was to cause some consolidation of the banking system. The position in 1884 appeared as shown in Table II. It is seen from this table that the majority of English banks at this period were predominantly local in character. But those which had gone beyond the limits of their own localities were already surpassing all others in size.

TABLE II. THE BANKING SYSTEM AS OPERATING IN ENGLAND AND WALES IN 1884\*  
(Amounts are stated in £000's)

	Number	Branches	Capital and reserve	Note circulation	Deposits
Bank of England (24 Sept.)	1	11	18,295	25,102	29,372
London banks:					
Private	35	10	?	Nil	68,000†
Joint-stock	21	52	18,147	Nil	76,654
London and provincial banks:					
Joint-stock	6	517	9,000	Nil	69,738
Provincial banks:					
Private:					
Issuing 100		330	?	1,439	78,561†
Non-issuing 72		103	?	Nil	
Joint-stock:	172				
Issuing 45		523	15,749	1,541	54,456
Non-issuing 46		529	18,728	Nil	80,887
	91				

\* Crick and Wadsworth, op. cit. p. 34.  
† Estimates: the private banks did not publish balance sheets, while eleven provincial joint-stock banks did not give full figures.

The further development, given the growing predominance of the cheque as a means of payment and the repeal of restrictive legislation, could not be in doubt.<sup>1</sup> The advantages of ever-wider branch banking under these circumstances were so manifest that the impetus to concentration became irresistible. These advantages are, first, the speedy and cheap clearing of cheques which is expensive for a local bank which has to maintain agents in the clearing centre. Once a bank can clear cheaply and quickly it can attract deposits by offering, instead of a cash interest payment, the service of administering a drawing account; secondly, the direct

<sup>1</sup> The replacement of the bill of exchange as a means of internal finance by the overdraft had the same influence.

pooling of surpluses in certain areas and their transfer to those requiring credit with consequential economies in cash reserves; thirdly, the wider (not only geographically) and therefore better distribution of individual credit risks (even the more general risks resulting from the influence of the business cycle can be better distributed, as no bank will be exclusively interested in the riskier sphere of capital goods production); fourthly, the reduction of general overhead costs (reduction in uneconomic branches, cutting the duplication of agents) and the standardization of operations; fifthly, superiority of service resulting from the possibility of utilizing the advantages of a wide division of labour by employing experts whose services, though often retained at the head office, are available to all clients. It is true that the method of employing corresponding banks in main centres and of obtaining (or sending) bills for rediscount to such centres eliminates many of the technical drawbacks of the unit system. But it cannot compete from the combined point of view of profitability and safety with the branch banking system.<sup>1</sup> Table III shows the development of the amalgamation movement after 1890 and demonstrates how the 1914 position was reached.

The amalgamation movement enabled successful provincial banks such as the Midland and Lloyds to establish connections in areas in which they were not represented and also to obtain a place in the clearing house<sup>2</sup> by absorbing a London bank which was already a member. In one instance (Barclays Bank, 1896) several private banking firms amalgamated in order to be able to compete successfully with the large joint-stock banks. Only banks in the Lancashire area resisted for a long time any attempts at amalgamation.<sup>3</sup> While this process of consolidation was continuing there was also a considerable amount of expansion by the opening of new branches. These increased from 1,195 in 1858 to 2,113 in 1881 and 5,797 by the end of 1913. The general character of the amalgamations can be seen in Table III.

*The Amalgamations after 1914. The Treasury Minute.* In the first years of the war the movement slackened only to gather new impetus in 1917 and 1918. The number of small local banks was already

<sup>1</sup> Cf. Sykes, *The Present Position of English Joint Stock Banking* (1928).

<sup>2</sup> The National Provincial Bank decided in 1866 to relinquish the privilege of note issue rather than lack a London office. It was admitted to the clearing.

<sup>3</sup> The contemplated amalgamation of the Manchester and Liverpool District with Lloyds in 1904 and of the Lancashire and Yorkshire Bank with Parrs in 1910 had to be abandoned.



TABLE III. BANK AMALGAMATIONS:\* ENGLAND AND WALES

Years	Private with private	Joint-stock absorbs private	Joint-stock with joint-stock	Private absorbs joint-stock	Total
1826-1843	23	93	6	—	122
1844-1861	11	23	10	—	44
1862-1889	31	66	40	1	138
1890-1902	37	64	51	1	153
1903-1924	1	36	58	—	95
Total	103	282	165	2	552

\* Sykes, *The Amalgamation Movement in English Banking*, 1825-1924 (1926).

negligible. Amalgamation now embraced large branch systems. Two reasons were given for this new type of amalgamation.<sup>1</sup> The first was that the amalgamation of large existing systems secured an extension of their areas with the consequent gain in safety, efficiency and economy of operations.<sup>2</sup> The second argument used was that the increase in the size of industrial units necessitated an increase in the banks, for otherwise they would be unable to accommodate these new large firms.<sup>3</sup> The most important of these amalgamations were those of Lloyds with the Capital and Counties Bank Ltd.; the London City and Midland Bank Ltd. with the London Joint Stock Bank; the London County and Westminster Bank with Parrs Bank Ltd.; and the National Provincial Bank of England (which up to that moment had not taken part in this type of

TABLE IV. BANKING AMALGAMATIONS  
(Approximate figures for 1918)

	London branches	Provincial branches (excluding sub-branches and including only one branch in each place)	Foreign agencies held
(a) National Provincial	26	251	31
Union of London and Smith's	31	78	150
(b) London County and Westminster	110	180	400
Parrs	35	160	35
(c) London City and Midland	107	419	850
London Joint Stock	41	109	70

<sup>1</sup> Cf. *Report of the Treasury Committee on Bank Amalgamations*, Cd. 9052-1918.

<sup>2</sup> Cf. Goodenough, *M.E.* Qu. 780 and Pease, *ibid.* Qu. 2054-6.

<sup>3</sup> Cf. Goodenough, *M.E.* Qu. 780-9 and Pease, *ibid.* Qu. 2038-40. A third reason was, in all probability, the mere attraction of size which secures international prestige. The expansion of the German joint-stock banks stimulated the British race in amalgamations.

expansion) with the Union of London and Smith's Bank Ltd. The object and result of these transactions is best demonstrated by a table published by the Treasury Committee (Table IV). The number of banks of the first magnitude was reduced to five. They controlled nearly two-thirds of all banking resources of the country.

This spate of amalgamations caused serious perturbation,<sup>1</sup> and demands were voiced to curb by legislation any further concentration in banking. The Committee appointed by the Treasury concluded that the arguments raised against further amalgamations were on the whole justified, whilst the two reasons (cf. above) brought forward in favour of further concentration were losing force as the amalgamation movement proceeded. No further diversification and spreading of the banking area was possible except in the case of a few remaining banks. Amalgamations between the big institutions would rather tend to reduce competition to an undesirable extent. Nor could it be claimed that further amalgamation was necessary in order to be able to accommodate industry. The Committee mentioned (1) that the further shrinkage of the ratio of capital to liabilities was undesirable and pointed out that amalgamations tended to result in a writing down of the combined capital of the amalgamating institutions, and (2) that the dangers of reduced competition could not be considered negligible. This was especially the case with respect to the money market which depended for its existence on a free supply of short loans obtained under competitive conditions. There was, furthermore, the added risk that with the reduction of the number of first-class acceptors the limits within which both the Bank of England and foreign purchasers would be willing to take acceptances granted by the amalgamated bank would have to be restricted. (3) Finally, they pointed out that the political repercussions of the concentration of banking in the hand of a few banks would be undesirable. They therefore recommended that further amalgamations, joint directorates or any steps altering the status of banks, should be made dependent by an Act of Parliament on the joint approval of the Treasury and the Board of Trade. The departments should consider favourably schemes whose effect did not consist mainly in reducing competition. The legislation proposed has never been passed, but otherwise the conclusions of the Committee were accepted. Instead of legislative regulation 'various

<sup>1</sup> There was intermittent criticism before, cf. *The Economist*, 4 August 1914.