

BANKING

CHAPTER I

WHAT IS A BANK?

IN dealing with such a subject as Banking it would seem desirable that we should begin with a definition, and explain exactly what is meant by the words "Bank" and "Banking." Strange to say, it seems quite impossible to lay down any general definition. The theory and practice of banking have varied from age to age, and still vary from country to country. In most countries banking is carried on under duly codified legislation, and there is little doubt as to the legal definition of a bank. In the United States, for instance, a bank is a corporation holding a bank charter either from the Federal Government, as a "National" Bank, or from a State Government. The functions of an American bank, and the conditions under which they can be exercised,

are laid down by law, and inspectors are appointed by the Governments, whether National or State, who grant the charter, to see that these conditions are strictly observed. The line between banks and other corporations is sharply drawn.

In England, however, no such legal definition exists. Gilbert, in his book on Banking, quotes from a speech in the House of Commons in 1745 the following words: "What is it that we call a Banker? There is in this City a company or corporation called goldsmiths, and most of those called bankers are of that corporation; but so far as I know, there is not a company or corporation called bankers, nor has the business any definition or description either by common law or by statute. By custom we call a man a banker who has an open shop, with proper counters, servants, and books, for receiving other people's money, in order to keep it safe, and return it upon demand; and when any man has opened such a shop, we call him a banker, without inquiring whether any man has given him money to keep."

That statement is, I think, still essentially true. There have been certain negative enactments, as we shall see directly—things

which banks must not do. There are certain protections given to bankers in the course of their business. Curiously enough, though it might seem that the main business of the banks is money-lending, a "money-lender" under the Money-lenders Act must not call himself a banker. On the other hand, it appears that it is open to anybody to take out at Somerset House a certain document known as a "Banker's Licence"; it is only necessary to pay a fee, and no questions are asked as to the character of the business to be carried on under the licence. But there is no legal definition of a bank, unless it be that which appeared in the Finance Act of 1915, to the effect that a bank was a person or corporation "carrying on a *bona-fide* banking business," which recalls the historical definition of an archdeacon.

There is, however, a fairly clear general notion, in England at least at the present time, of what is meant by a bank, and though the margin is not very sharply defined, a bank's area of action is recognised within limits of variation narrow enough to preclude any serious difficulties in practice. In fact there does not seem to be any case in the Courts where a decision has turned upon an

accurate definition, and though it is possible to imagine such a case, it is one which is not very likely to arise. But it is certain that if a definition of a bank were required today, it would be a different definition from any that would be accepted in another country, or that would have been accepted in England even a hundred years ago. To understand this it will be well to look back, not upon the general history of banking, which is excluded by considerations of space, but upon the outlines of the development of English banking during the last century. And it must be understood that "English" banking does not include Scottish banking, which has grown on quite different lines, though the systems of the two countries now approach something like agreement in practice.

At the beginning of the nineteenth century English banking was carried on under three sharply defined systems. In the centre was the Bank of England, a joint-stock bank, working for the profit of its shareholders, but having the sole privilege of carrying on the Government account, and possessing in fact, though not by law, sole right of issue of notes in London. It was protected in its position by a law providing that no corporation con-

sisting of more than six partners might issue promissory notes payable at demand (*i.e.* bank notes) anywhere in England. *This was understood to mean that no joint-stock banking was permitted.

Beyond the London area the country was covered by numerous small private banks which made a profit, and assisted industry, by the issue of their own notes. These had grown up chiefly from the credit of the rich men of the neighbourhood, very often the local brewer or cloth-weaver, whose name stood high on the country market. It was easy and highly profitable for him to make loans to his neighbours, issuing notes which he undertook to pay when presented, so long as he could reckon on a fair delay in presentation. If the notes were accepted as currency and passed from hand to hand in the market, then, so long as they were out, the issuer was receiving interest, probably at what would now be considered a very high rate, on his original loan, and paying none himself. He was employing no capital of his own, and receiving a handsome income merely on the credit of his name.

But by the side of these two banking systems, that of the Bank of England in

London and the private banks of issue outside the London area, there had been growing up another class of banks, the private banks within London itself, who were doing an important business by re-lending, mainly on commercial securities, moneys deposited with them by their customers. These banks had grown out of the London goldsmiths' shops. In the uneasy days of the seventeenth century, these had been bound to make a special study of the safe custody of their own valuable assets, and were ready to offer their services to those of their customers who had either cash or other valuables which they wished kept in greater safety than their own houses could offer. Hence had arisen a custom of depositing with the goldsmiths any cash which was not needed for the moment, to be repaid at some date in the future. It was evident that cash thus deposited could be re-lent at interest, so long as it could be called in by the time when repayment was required; and it was worth the goldsmiths' while to offer a moderate interest on money deposited with them for a fixed time, re-lending it at a higher rate for a corresponding period. As experience grew, it was found that it would be safe to reckon on a certain proportion of

the total deposits being left in practical permanence, at all events while business was running smoothly; it could thus be lent out at interest without regard to any conditions as to the fixing of the period for which deposits were made; in other words, money could be taken on deposit repayable on demand, and yet a certain proportion could be lent for short periods with safety. Thus there came into being the "current account" withdrawable on demand, and following upon this the introduction of the cheque as a transferable instrument. This great discovery, the foundation of modern banking, is not traceable to the genius who invented it. The earliest instance of the use of the word in the New English Dictionary in this sense is dated 1774; but the use of written orders to pay, under the title of "drawn notes," is certainly much earlier.

Whatever the date of the introduction of the cheque, the important point for us is that by the opening of the nineteenth century there had grown up in London round the Bank of England a powerful body of private banks, the descendants of the goldsmiths, who were attracting deposits from their customers, and using them for the financing of trade in the

City by discounting trade bills, making advances upon goods in the course of sale, lending upon easily realisable securities such as those dealt in on the Stock Exchange and venturing a certain proportion on such less liquid security as deeds of premises. They had, in fact, developed the system of deposit banking as we know it. The history of English banking for the next hundred years is summed up in the extension of this system to joint-stock banks, and the absorption by them of the private banks—a process which is now complete, for all practical purposes, so far as the country is concerned, and almost complete in London.

The monopoly of joint-stock banking claimed, and long enforced, by the Bank of England was based upon the following provision in the Charter of 1708: “During the continuance of the said corporation of the Governor and Company of the Bank of England, it shall not be lawful for any body politic or corporate whatsoever, created or to be created (other than the said Governor and Company of the Bank of England), or for any other persons whatsoever, united or to be united in covenants or partnership, *exceeding the number of six persons*, in that part of Great Britain called England, to borrow, owe, or

take up any sum or sums of money on their bills or notes, payable at demand, or at a less time than six months from the borrowing thereof."

In 1708, and for long afterwards, it was supposed that no bank could carry on business successfully unless it had the right to issue notes; and this clause in the Charter was always understood to confer on the Bank a monopoly of joint-stock banking in England. But by the early years of the nineteenth century it was proved, by the practical experience of the private banks of London, that deposit banking, without any right of note issue, was feasible and profitable. The London banks worked in alliance, instead of competition, with the Bank of England, and did not issue notes, though such of them as had not more than six partners possessed the legal right to do so. Still it was not, apparently, till 1822 that attention was directed to the fact that the clause in the Charter left it open to a joint-stock company to carry on a banking business so long as they did not issue notes. The Bank of England protested, but public opinion was aroused by the disastrous panic and the collapse of small country banks in 1825; and in 1826 a bill was passed which expressly

allowed banks having more than six partners to carry on business in England at a greater distance from London than sixty-five miles, provided they had no establishment as bankers in London. They must not issue notes at a place within sixty-five miles of London, nor draw any bills on London for a less amount than £50. In other words, joint-stock banks might be established in the country, with powers of issue; but, whatever might be the true reading of the Bank Charter, no legislative sanction was given to the establishment of any joint-stock banks in London itself or its neighbourhood. That did not come till 1833, when the renewal of the Bank's Charter was accompanied with a clause which recited that whereas it was intended that the Bank of England should continue to hold all the exclusive privileges of banking conferred by previous Acts, and whereas doubts had arisen as to the construction of such Acts, and it was expedient that such doubts should be removed, it was enacted that "any body politic or corporate, or society or company or partnership, although consisting of more than six persons, may carry on the trade or business of banking in London, or within sixty-five miles thereof, provided that (they) do not

borrow owe or take up in England, any sum or sums of money on their Bills or notes payable on demand or at any less time than six months from the borrowing thereof."

The Act of 1833 was followed early in 1834 by the establishment first of the London and Westminster Bank, and then by that of the London and County Banking Company. The former was established with the intention that it should confine itself to London, while the latter took as its area the sixty-five-mile radius, covering the home counties. The country joint-stock banks, however, had a start of some years, and it may be mentioned that of the existing "Big Five" only one, the Westminster Bank, had its origin in London, and all the others came to London from the provinces—the Midland Bank and Lloyds Bank from Birmingham, the National Provincial, whose first branch was at Gloucester, and Barclays Bank by an amalgamation of numerous private banks in the eastern counties, owned mostly by Quaker families generally connected by marriage. It may be noticed too that the present year 1926 marks the centenary of the legal establishment of joint-stock banking in England outside the pale of the privilege of the Bank of England.

The Bank of England received the intruders with a very bad grace, and every legal obstacle was put in their way. The private bankers of London joined in the ban, and for a long time refused the joint-stock banks admission to the Clearing House. It was largely due to the determination and genius of Mr. J. W. Gilbert, the manager of the London and Westminster Bank, that the victory was ultimately won. Mr. Gilbert celebrated a striking triumph when the London and Westminster Bank bought up the business of Jones, Loyd & Co., the bank of their chief opponent in the past, the famous private banker Lord Overstone.

The distinction between London and country banking naturally arose from the fact that the earliest country banks possessed the right of note issue, uncontrolled by any legal restrictions; it was not until Peel's Bank Act of 1844 that this right was restricted, and provision made for its gradual extinction. The country banks which came to London had to surrender it; but the fact that many of them found it worth their while to do so is evidence of the supplanting of issue banking by deposit banking, which has been completed only within the last ten years by the final

extinction in England of the note issues of English banks other than the Bank of England, which, under this Act of 1844, remains the only bank in England issuing its notes payable to bearer on demand.

It is now possible to give a definition of English banking, and to define a bank in terms of its deposit business. We can say that a bank is a person or corporation which holds itself out to receive from the public deposits payable on demand by cheque. This does not express more than one part of the business of a bank; but it does express the characteristic by which a bank is, to the common apprehension of the public, distinguished from other financial institutions. But it must be repeated that the definition only holds good for Great Britain, including Ireland as well as Scotland, and perhaps for the United States. But it would not be applicable on the Continent, where the use of the cheque is too little developed to be regarded in any sense as a fundamental part of the operation of a bank; and a definition would rather be sought from the discounting of bills and the giving of monetary credits.