

CHAPTER VII

THE ACCEPTING HOUSES

WE now pass on to a very important member of the English banking system—the Merchant Bankers or Accepting Houses. They represent a highly specialised development of the financial structure which has grown up, side by side with specialised deposit banking, in the course of the last century. They are almost without exception of foreign origin, but during the century or more through which they have been established in London they have become thoroughly Anglicised. While the great private banking families of London were in the first half of the nineteenth century building up the system of deposit banking, similar banking families on the Continent were gradually being drawn to London by the attraction of the great overseas trade which had been founded, with the growth of the factory system, by English enterprise during the Napoleonic wars. Napoleon's "Continental System" had forced Britain, and her

naval supremacy had enabled her, to win control of all international trade.

During the whole of the seventeenth century it was Holland which held command of the Eastern and Colonial trade. Amsterdam was the entrepôt where the goods of the Indies were warehoused and distributed all over the Continent. Holding the position of a distributing centre, Amsterdam naturally became also the centre of finance for international trade. The Bank of Amsterdam was established in order to set on foot what was practically an international currency. Against deposit of good coins of any currency it was prepared to open accounts in bank money, charging for its services and undertaking to hold in its vaults all the coin deposited with it. It had no power to lend money or discount bills. But all bills in which Amsterdam dealt must be made payable in bank money; and at the same time the receipts of the bank obtained currency, and passed freely from hand to hand. The discounting of bills was in the hands of a certain number of privileged bill brokers, who were the first example of the discount market as distinct from the actual banks.

For nearly two centuries—the Bank of

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Amsterdam was founded in 1609.—Amsterdam remained the great centre of international finance. The money of the Bank of Amsterdam was so convenient for the purposes of international exchanges that bills were drawn on Amsterdam for facility of negotiation, even though the actual goods were not themselves sent for storage in the warehouses of the city. The reputation of the bank stood so high that its receipt for money deposited with it was actually more valued than the coin itself which the receipt represented; for it could be transferred from hand to hand, while the coin deposited, the coin of almost every nation in the world of commerce, was variable in standard, worn, and in any case needed a guarantee of its intrinsic value. This guarantee was given by the receipt of the bank, which could be transferred without the expenses of assay and the like which would be needed if the actual coin were to be given in payment.

But bad times came. During the wars at the end of the eighteenth century Holland was drawn into the flood of Napoleon's enterprise; she had to be at war with England, and her great colonial empire fell into British hands. Her overseas commerce was cut off,

and the warehouses of Amsterdam were drained of the goods against which the bills of her international trade were drawn. Worse than this, it was found that the affairs of the Bank of Amsterdam had been illegally mismanaged. The bank was a State bank, established by the city of Amsterdam, and managed entirely by a Committee of the Town Council. As is always likely to occur where a bank—or other business—is in the hands of those who have been elected to their posts for political reasons, it came out that a succession of dishonest burgomasters had, against the strict rules of the bank's constitution, been lending out the money which should have been held in the vaults as cover for the receipts issued against it. The money had been lent for political purposes—some of it for a municipal money-lending scheme, designed to help the unemployment caused by the war, some of it to the Dutch East Indian Company, which carried great political influence. The revelations shook the credit of the bank to such an extent that about the end of the war period it had to wind up its affairs.

Thus it was that several of the great merchant banking houses of the Continent found it worth their while to transfer their

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international offices to London, which they foresaw was destined to supplant Amsterdam as the pivot of international finance, even before the time when Waterloo once more threw the commerce of the world open to all. The London house of Rothschilds had been opened for some years before they confirmed their position in the City by early information of the result of the battle of Waterloo. The name of Baring had long been familiar, and as early as 1770 Sir Francis Baring, himself of foreign extraction, had founded the house and the family destined to play a brilliant part in the statesmanship as well as the finance of the British Empire. The house he established was in alliance, through the family of Labouchere, with the Hopes of Amsterdam, an English house which had taken a leading part in the banking circles of Holland. Another name which came to London from Frankfort at the very beginning of the century, and like the Barings was destined to rise to political distinction, was that of Goschen. Somewhat later the Selwiders of Hamburg established a house of the first importance in London, while the Hambros brought to London an extensive connection with Scandinavian finance. Other important houses were

of American origin, and kept up a close connection with their allied houses in the United States.

It is remarkable that, while all the large private deposit bankers of London who rose to importance during the last century have now been absorbed, with one or two exceptions, into the stream of joint-stock banking, the names already mentioned, with a few more, still constitute the aristocracy of the City of London. The name of Merchant Bankers is more accurately descriptive of their work than the title, now usual, of Acceptance Houses. One of them has quite recently amalgamated with a bank doing similar business, and now frankly calls itself Hambros Bank. But they are differentiated from banks proper, in the modern English sense of the word, because they do not do deposit banking, or hold themselves out as taking money on deposit withdrawable on demand by cheque. They do, moreover, at least some of them, import and export goods on their own account. For these reasons they do not claim to be bankers, and do not join the British Bankers' Association, preferring to maintain an organisation of their own, the Accepting Houses' Committee. But they work in fairly close

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alliance with the banks. In particular, their partners frequently sit upon the boards of the joint-stock banks, and of the Bank of England, where their special knowledge of important branches of financial operations gives them a very great influence.

It may be well to give here a brief account of the machinery by which the payment of goods exported from one country to another is carried on. When an exporter puts his goods on board a ship, he receives a bill of lading, which acknowledges the receipt of the goods. This usually has to be accompanied by a policy of insurance on the goods, and an invoice showing their price and total amount, and, according to the uses of some countries, various consular and other certificates for use in the Customs House through which they will have to pass. These are known as the "documents," and the possession of them gives the holder the right to obtain the goods from the ship when discharged and to deal with them as his own.

The terms on which the goods are sold vary, of course, for many reasons. It may be that they are sold for cash on delivery. In this case the exporter draws a sight draft on the purchaser, and hands it, with the documents

attached, to his banker. The banker forwards the draft and documents to his correspondent in the place where the purchaser resides. The correspondent advises the purchaser that he has the documents and will hand them over on payment of the draft. If all is in order, the draft is paid, the documents are given up, and the proceeds of the draft are remitted by the correspondent to the exporter's banker, who credits his customer with the amount, and the whole transaction is closed so far as the exporter is concerned.

But it is highly probable that the purchaser may not have been prepared to buy for cash on receipt of the goods; he may have required credit, in order to enable him to dispose of the goods and collect the proceeds in time to enable him to meet his draft. In that case the exporter will draw a bill on him not at sight, but for the period of credit agreed on, a period which is commonly fixed by the custom of the particular market in which the deal takes place. The most usual terms are sixty days or ninety days' "sight," that is, dating from the time when the bill is presented for acceptance. The exporter will now attach the documents to the bill and forward it through his banker to be presented for acceptance.

He will have further to give instructions whether the documents are to be given up to the customer on acceptance or not. If they are given up, the customer obtains them, and for the currency of the draft the seller is dependent solely upon the credit of the purchaser, for which he has no longer any security in the form of a right to the goods. He may therefore stipulate that the documents are to be held by the correspondent of his banker on his behalf till the draft is paid, in which case he is secured by the power of taking possession of the goods in case of default by the purchaser. In this case the drawee has the option of retiring his acceptance under rebate of interest any time before maturity so that he can sell his goods in block or by instalments as may suit his convenience or circumstances compel. Otherwise he must arrange with the holder of the bill to have the relative goods warehoused on arrival, and the bank in the absence of definite instructions to the contrary will insist on retaining control. When the bill has been taken up the bank will instruct the warehouseman to release the goods or make the necessary delivery.

This, however, is not a very convenient arrangement for the purchaser, who naturally

wishes to have his goods at his own disposal as soon as they are landed, and will be inclined to stipulate in his contract that the documents shall be given up to him as soon as he has accepted the bill drawn upon him, and undertaken thereby to pay at a given date. In this case the seller of the goods has no further lien upon them; he has only the promise to pay. He is thus in a less favourable position than if he were holding the goods in his own possession with power to sell them if the bill is not paid. But in either case he is giving credit to a debtor in a foreign country; and the risks he is thereby running are very considerable. When he gives credit in his own country, his debtor is more or less under his eye; at all events he is in a much better position for watching him and forming an opinion as to his position. And if anything goes wrong abroad, he has to depend for the necessary steps upon those who are acquainted with the laws of the country where his debtor is. If, for instance, there is any dispute about the goods he has sold, he may have to sue in a foreign court; and if he still has them under his control, he may have to sell them under conditions of which he is ignorant. A merchant who sells to many foreign countries

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must, if he is to give credit safely, either confine himself to purchasers of whom he has intimate knowledge and whom he can absolutely trust, or else set up a machinery for watching his debtors in every country to which he sells. Giving credit abroad can therefore be a risky, and even an expensive, proceeding.

Hence the necessity for a class of experts who specialise in foreign credits. They make it their business to have representatives abroad whose function is to know all about the principal importers and exporters of their country, and to watch every change in the financial conditions around them. This is the function which was taken up by the Accepting Houses, and of which they had for long almost a monopoly. They had, as we have seen, in many cases old family connections with Continental countries, and for a century or more they were engaged in extending their connections. They possess to-day the experience and the accumulated information of several generations who have been engaged in the same business. And they are thus prepared to offer their services to the exporters and importers of all countries. They relieve the exporter from his risk by giving the assistance which the importer needs. The

exporter draws his bill not on the customer who buys his goods, but on the house which undertakes to accept on behalf of the purchaser. The standing of the chief Accepting Houses is such that their undertaking to pay over the amount by a given date enables the exporter to sell his bill at any time at a fine rate of discount, thus reaping the benefit of the difference between the buying rate for gilt-edged paper and an ordinary trade bill, the acceptor of which may perhaps be but little known and whose name may not command unquestioned credit in the exporter's market.

The method of procedure under this system will then be as follows: The exporter, in making his contract of sale with the purchaser, *i.e.* the importer, will stipulate that payment is to be made by means of a credit to be opened in his favour by a house of high standing. Evidence that the credit is actually arranged must be supplied by the furnishing of a Letter of Credit or otherwise. The exporter will also, if he is in a position to do so, stipulate that the credit is to be "confirmed," *i.e.* irrevocable. If this is not done, and the exporter has to rely only on an "unconfirmed" credit, he may find, after he has shipped the goods

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and forwarded the documents, that acceptance is refused, on the ground that the credit has been cancelled. It may have been cancelled by the importer, who for some reason or other may wish to get out of his bargain, or even possibly by the Accepting House itself, who may have good reason for withdrawing the credit, although such a contingency is rather remote. The confirmed credit, however, is the only one on which the exporter can absolutely rely for payment; this, once granted, cannot be modified or cancelled without his consent.

Before granting the credit the Accepting House will, as a rule, stipulate for some sort of security. They may, for instance, insist that they hold the documents until the relative acceptance has been fully provided for. On the other hand, they may agree to surrender them at once against other collateral, the extent of which will be dependent on the standing of the importer. In the former instance, retirement under rebate will always be permitted, and this facility is not infrequently availed of upon arrival of the goods. An undertaking to place the Accepting House in funds at least three days before the maturity of any bill that they may be called upon to

accept is also often required. Thus so long as the importer remains solvent they are never actually out of funds; what they have done is to guarantee that the purchaser will pay a sum of money at the expiration of the agreed term; and on the strength of this guarantee the drawer is able to obtain his money at once. He can go to his banker, exhibit the Letter of Credit which authorises him to draw his bill, and his banker will thereupon buy it from him for cash down, less, of course, an amount for interest during its currency and for any expenses which may be incurred in collecting it. His banker will proceed to forward the bill to his London correspondent, who has to obtain acceptance of it, and who will then hold it till maturity or re-discount it as may suit his convenience. When the bill has once been created and bought by a banker, it becomes a negotiable instrument which can be transferred from hand to hand by endorsement, each endorser undertaking the liability for repayment to the person to whom he passes it on; and thus the bill may be used for remittance from one financial centre to another, till it is at last presented for payment to the acceptor at the due date.

It is by the circulation of bills of this nature

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that all international payments, whether for goods or services, are in normal times carried out. A very large amount, in the aggregate probably some hundreds of millions of pounds sterling, is always afloat in bills drawn on London. There are in addition bills drawn on other financial and commercial centres; but none of them approach London in amount. Since the war the Americans have done something to make a rival centre of New York; but the plant of custom is one of slow growth. The acceptance of bills was for long forbidden to American banks, and it is only recently that the custom has grown up of accepting dollar bills and employing them for international payments—chiefly for settlement between the American countries other than the United States, and New York. Some progress was made in the replacement of the £ by the \$ while the £ was at a discount in the exchange; but since the resumption of the gold standard in London a check has been put upon the process.

This is a rough outline of the practice of the Accepting Houses with regard to their commercial clients in foreign countries. It will be seen that it implies an accumulated fund of experience and tact such as explains well

enough the fact that the chief part of the business should be concentrated in the hands of comparatively few firms of large resources, old-standing foreign connections, and an unbroken tradition of sagacity and integrity. It is easy to see why it comes about that the Americans, keen men of business though they are, have found so much difficulty in making New York an accepting centre to rival London.

But this is not the whole of the accepting business which is done in London. There are abroad many quite good firms who do not enjoy what may be called an international credit; they are not of the high standing which would tempt the London Accepting Houses to do business with them direct. But they are known to their own banker abroad; and when they require a credit established, it is very usual for them to go to their own bankers, and ask that a credit may be opened in London for their account. The foreign bank, being satisfied as to their customers' position, will thereupon write to its London bankers, and arrange for the opening of a "third party" credit for account of their clients, and the London bank, being satisfied as to the position of the foreign bank, will advise the credit on the strength of their customers' standing and

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on the account they maintain. Most of the chief foreign banks have, in fact, important credits running which are chiefly, and often solely, operated upon in this manner. This, of course, is not quite so cheap to the foreign bank's client, who has to pay a double commission, but the best of the foreign banks, particularly perhaps the American, do business on so large a scale and are of such undoubted standing that the competition between the London banks for their accounts is very keen, and very low rates are quoted to them for acceptance facilities; so that in some cases it happens that the ultimate charge for the credit is not more on this plan than in direct transactions between the foreign merchant and an Accepting House.

The accepting business has been much more in the hands of the banks since the war than it was before. When war broke out, the first result of it was to make illegal the collection of debts from an enemy. The Accepting Houses all had large sums coming due to them from the Continent, particularly from Germany, to provide for running acceptances up to three and sometimes six months. These sums they were forbidden to receive, though their foreign debtors were willing and able to

pay. It was very rightly felt that as the State forbade collection, the State ought to step in and protect the credit of the Accepting Houses. One of the first steps of the Government, therefore, was to provide that the acceptances of these houses, as they came due, should be taken up by the Bank of England, and, in the phrase of the day, "put into cold storage." This very wise step enabled the Accepting Houses to carry on their business; but it was naturally much crippled, and it became the practice for foreign banks to call for the acceptance of an English joint-stock bank before they would buy bills on London. At the same time there was a tendency to restrict the term of credit, and the ninety days period was largely abandoned in favour of the "sight credit." This was the natural outcome of inflation, which made all merchants and manufacturers flush of money; bank balances were greatly increased, and it was more profitable to pay cash than to pay the interest on a credit. Thus it became a common practice to forward documents attached to a draft at sight, to be handed over to the importer of the goods as soon as the draft was paid.

The war has also had another notable result. Up to 1914 the large German banks

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had offices in London which they employed largely for the purpose of giving their acceptances a London domicile, enabling them to be freely discounted on the London market—a striking evidence of the predominance of London. They brought to London and held there large balances which they employed on the market, as a reserve against their liabilities here, and their position was a very strong one. At the outbreak of the war they were, of course, placed under a sequestrator and their London business was liquidated; in the case of the best of them their liabilities were fully discharged. But their active business had been brought to an end, and it was not till the new treaty with Germany in the beginning of 1925 that they were given power to reopen in London. Of that permission they do not seem to be in a hurry to avail themselves; and in the present shortness of capital in Germany it is evident that they can use their resources more profitably at home than in England. The result is that the financing of German foreign trade has, at least for the present, passed chiefly to those of the great Accepting Houses who have always had special connections with Germany; and it may be conjectured that they are at present

in a stronger position in international trade than they have ever been.

One or two of the large French banks, and some American banks, also have London offices in which they do a banking business in competition with the London banks and Merchant Bankers. Their presence, however, is not resented. The bankers of London generally take the view that the presence of foreign bankers tends only to bring business and to emphasise the supremacy of London in finance; the bigger the market, they hold, the more profit is there to be made. When foreign bankers are once established in London, it is less likely that they will allow their financing to be decoyed away to other centres.

The Merchant Bankers of London also fulfil another function of the highest importance. They are the financial advisers of most foreign Governments, and issue their loans here. Naturally when loans are brought out under the auspices of our own Government, such as the recent loans sanctioned by the League of Nations to Austria and Hungary, or, under the Dawes Commission, to Germany, the Bank of England takes the lead. But almost all the other foreign loans issued in London have been brought out either by

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Merchant Bankers themselves, or by syndicates, in the case of large issues, of which they have formed a part.' With these may be included also a very important series of municipal loans for the chief cities of the Continent. In virtue of this power of issue the Merchant Bankers of London have had an excellent influence in keeping some of the lesser powers of the world in the path of financial honesty.

It may be further added that the business of the Merchant Bankers is foreign business in the strict sense; it has never extended much in the confines of the British Empire. Here the financing of exports and imports is carried on by the Overseas and Colonial banks. The financing of trade to and from India and China is in the hands of a few large banks which are commonly known as the "Exchange banks" par excellence. Some of them have their Head Office in London, others in India or China. But all are firmly established alike in London and in the chief seats of their activities across the seas. They have grown up with the business which they have to finance. The large merchants, like the banks, are strongly represented on both sides of the water; the fact that on both sides they share

a common nationality has rendered unnecessary the services of a middleman such as are needed outside the limits of the Empire. The Exchange banks are always ready to buy good commercial bills at the finest market rates; they know intimately the character of the firms with whom they are dealing, whether in India or at home. The bills which they buy in India or China are practically all on London; they are sent home and re-discounted freely on the London market.