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Title: The Banking Network and Foreign Exchange Business of the British and  
American Giant Banks in the early Twentieth Century

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## I. Introduction

The aim of this study is to examine two main topics. The first is the foreign exchange business of London clearing banks before 1914, during an era in which the pound sterling was the key currency of international exchange and trade. The second is the formation of a correspondent banking network in New York before the US dollars became the currency vital for international trades and transactions. This paper concentrates upon the concrete case studies of activities of foreign branches of London City and Midland Bank (hereafter "Midland Bank") and the National City Bank of New York (hereafter "City Bank"). These banks had three characteristics in common. Firstly, each of them was the largest bank in their home country, the UK and US respectively. Secondly, foreign branches of both were established at the same period. Thirdly, the chairmen of both banks were eager to promote international business.

As is well known, some UK and US banks founded foreign branches and commenced foreign exchange business in the late nineteenth to the early twentieth century. However, there are few studies of internal banking records<sup>1)</sup>. This paper, therefore, investigates the foreign exchange transactions of Midland Bank, and the campaign to gain foreign correspondent banks and a correspondent banking business by City Bank through the analysis of such internal records. By introducing hitherto unreported facts, the historical significance of these developments will be considered.

## II. The Banking Network and Foreign Exchange Business of British Giant Banks

As is well known, the London Clearing House was the largest centre of international financial settlements in the world, prior to 1914. Foreign banks and British overseas banks, however, were not allowed to join the house. As a result, such banks had to create correspondent accounts and deposit money in pound sterling with one of London clearing banks. These London banks were called "London agents" or "London bankers". Table 1 displays the number of foreign correspondent banks linked with each of major London clearing banks, --the so called "Big Five" and the Union of London and Smiths Bank, --and their geographic distributions. The table shows a large variance in the correspondent banking activities among the major clearing banks. This paper focuses on those banks having a comparatively large number of correspondent banks. Table 1 also shows that some of major clearing banks had forged a large number of correspondent links with European

and North American banks.

The international transactions among banks were paid in London using bills in pound sterling. Nevertheless, some London clearing banks founded foreign branches (departments or offices) in London and commenced foreign currency exchange business from the early twentieth century. This paper draws attention to the fact that such offices were created by Martins Bank in 1893, Lloyds Bank in 1898, Midland Bank in 1904 and London County Bank in 1907. Among these, the 'Foreign Exchange Office' of Midland Bank may be taken as a representative example.

The main business of the "Foreign Exchange Office" of Midland Bank was commercial credits and transactions including loans, discounted bills and acceptances to traders and correspondent banks. Furthermore, the office dealt with foreign currency business. Not only Midland Bank but other banks' foreign branches also issued foreign currency drafts and purchased foreign bills<sup>2)</sup>. Conventional wisdom has it that, as most international transactions were paid in pound sterling, British importers and exporters did not need foreign currency drafts nor demand them from their trade banks including Clearing Banks. On the other hand, since foreign traders, both importers and exporters, had to pay and receive using sterling bills, they exchanged their domestic currency to (or from) the sterling. As the result, it is generally claimed that "the bulk of the foreign exchange business arising out of British overseas business trade was conducted in foreign centres rather than in London"<sup>3)</sup>. It is worthy of note, therefore that, contrary to this common view, that London clearing banks had commenced trading in foreign currencies before 1914.

Relatedly, Lloyds Bank purchased foreign domicile bills equivalent to half a million pounds, a figure which had increased fivefold, in the year, 1910-1911. The amount was 12.5% of the total amount of bills discounted by the London head office of the bank. Lloyds Bank held them to maturity, because foreign domicile bills were not discounted by London discount houses and not negotiated in the London bill market<sup>4)</sup>.

Through its foreign branch, Midland Bank opened deposit or current accounts in foreign currencies in foreign banks in their respective locales in 1908-1912. It had more than 150 accounts, composed of more than 100 in Europe, mainly Germany and France, 25 in US, 15 in Russia, and 7 in Middle and South America. This paper can confirm that by using such accounts, Midland Bank dealt with foreign currencies including swap and finance transactions in French francs, German marks, and US dollars<sup>5)</sup>. For example, Midland Bank deposited 300,000-400,000 US dollars in New York in City Bank<sup>6)</sup>. The Colonial and Foreign Department of Lloyds Bank also had such foreign currency balances in the hands of continental banks in 1911. Generally, in a case of a correspondent contract between a giant bank in the key currency country and a bank in other countries, an account was opened only

at the side of the bank in the key currency country. It was not an exception, therefore, in London in the early twentieth century, that even though both a London clearing bank and a foreign bank became 'agents' for each other, that an account be opened only in London with all transactions between them being settled and financed in London. It had been argued that in the era when the pound sterling was the key currency of international traded and exchange, British Banks did not need to have foreign currency deposits in foreign countries<sup>7)</sup>. It is, therefore a notable discovery that, in fact, major London clearing banks founded foreign branches holding considerable foreign currency deposits in Europe, America and other countries.

The background of the decision to offer foreign exchange services was "prompted by the capture of an increasing volume of London foreign business by European Banks". London branches of foreign banks, such as Credit Lyonnais and Dresdner Bank challenged the traditional dominant position of London merchant bankers in overseas business. Not only merchant bankers but also, for example leading Big-Five bankers such as Edward Holden, who later became the chairman of Midland Bank, "feared that the foreign banks might use their foreign exchange services to invade the ordinary business of the major commercial banks". Another reason why Holden made a decision to enter the foreign exchange business is given below<sup>8)</sup>.

Holden visited the US in 1904. The trip "profoundly influenced his attitude to foreign business"<sup>9)</sup>. He tried to open Midland Bank's branches in New York and Chicago, but this attempt had to be given up on the grounds of restrictions placed by American banking law. In place of foreign American-based branches, he was eager to have correspondent contracts with major banks in US and offered to carry out various business transactions with them. Holden thought National City Bank of New York was the most important bank among US banks. The following section investigates City Bank's correspondent business and its struggle toward internationalization in the City of New York in the face of banking restrictions, prior to 1914, when the US dollar was not yet the key currency.

### III. The Campaign for Obtaining New Correspondent Banks by City Bank

National City Bank of New York was famous for being the first and most active bank among US national banks to promote internationalization. The bank was the largest in US in the early twentieth century and its scale was the same as that of the Midland Bank, the biggest of major London clearing banks. City Bank founded a "Foreign Department" in 1897, due to the rapid growth of its foreign exchange business along with expansion of the US overseas trade. Not only City Bank but about 100 national and state banks in US formed similar overseas business arms by 1913, even though national banks were restricted in their

international activities by US banking law. At that time, they were prohibited from opening branches in foreign countries and from accepting foreign bills<sup>10</sup>. These restrictions forced them to depend upon doing business via American trust banks, such as Guaranty Trust or London agents.

Meanwhile, foreign banks including those from UK were prevented from opening branch in New York by state law. They were restricted to founding agents who were not to accept deposits nor lend to their customers<sup>11</sup>. On the other hand, following the increase of US overseas trades, there was increasing demand for foreign exchange in US dollars. Under such circumstances, both US national banks and foreign ones formed correspondent contracts to circumvent such these restrictions. There were a number of advantages to such contracts for national banks such as City Bank. All they needed was to open an account and maintain sufficient balance to make payment via receipts. This was a simple and inexpensive way to carry out foreign transactions and to avoid local competition with foreign banks. Foreign banks could enjoy the same benefits as well in New York. In this way, the restriction by US banking laws, prior to 1913, caused City Bank to set a high value on its international correspondent banking business.

It was an easy task for City Bank, the largest and most trustable bank in the US, to expand its correspondent banking network abroad. The bank opened correspondent accounts in foreign banks all over the world. The number of these accounts reached 132 in 1912<sup>12</sup>. City Bank had engaged in a large scale campaign to gain new correspondent foreign banks from the end of 1910 to early of 1911. City Bank sent letters to foreign banks with which it did not have correspondent contracts to suggest opening accounts in the bank in New York. According to a letter from John Gardin, the chief manager of the Foreign Department of City Bank to Frank Vanderlip, the chairman of the bank on February 14, 1911, "We are carrying on our campaign for new business in a steady and systematic manner, which has been productive of good result. We have secured fifty-one new accounts since October 3, 1910, among which are some very large and wealthy institutions of Europe"<sup>13</sup>. Just before starting the campaign on 30<sup>th</sup> June 1910, the bank had 301 overseas correspondent banks. In 1912, after the end of the campaign, the number achieved was more than 400<sup>14</sup>.

A considerable number of the new correspondent banks were located in Europe and South America<sup>15</sup>. The number of correspondent banks with City Bank had increased to a level more than three times greater than that of major London clearing banks<sup>16</sup>. It is an astonishing fact that City Bank had managed to achieve a number of foreign correspondent banks greater than that of giant clearing banks in the key currency country, UK, even in the face of the many restrictions and handicaps faced by US national banks. US national banks

were not allowed to finance overseas trade such as acceptance business in New York and furthermore, a US central banking system including clearing and discounting bills had yet to be established.

Initial deposits made at the opening of accounts in City Bank by foreign banks were generally of small amounts. Only seven among thirty-eight new correspondent banks, created, in the period from October 1910 to January 1911, deposited over US\$ 10,000 with City Bank. The aims of the banks that had large US dollar deposits in City Bank at the opening of accounts may have been to facilitate traveler's services and immigrant's remittances or to prepare for future expansion of trades in US dollars in New York. But such banks were as a whole a minority. Some banks deposited only a few dollars. Further, "several of them termed 'non-deposit correspondent banks' only deposited securities for safekeeping, agreeing the regular commission charge" by making no dollar deposits whatsoever.<sup>17)</sup> Due to the fact only a tiny proportion of international trade payments were made in US dollars in the early twentieth century, most foreign banks opened accounts with small dollar deposits as a kind of gesture of goodwill initially simply in compliance with request by City Bank. Although the balances of these accounts were small at their opening, the total balance of such accounts in City Bank in New York marked a drastic increase, of three to fourfold, within the decade, prior to 1914. The figure initially, US \$ 6 million in 1905, reached US \$ 22.7 million in June 1914, on the eve of the first world war<sup>18)</sup>. The increase in New York balances held by foreign banks may reflect the increase in international payments in US dollars.

The main foreign correspondent banks for City Bank were Midland Bank, Deutsche Bank and Hong Kong and Shanghai Bank. Unfortunately, there were few extant banking records on correspondent business in either New York or overseas. It could only be confirmed by internal documents that Midland Bank had large balances over US \$ 300,000-400,000 and that both Midland Bank and Deutsche Bank made brokerage loans to brokers in the New York stock exchange market. Deutsche Bank succeeded in this business, whereas on the other hand, Midland Bank failed to make a profit due to the intense competition. It could also be confirmed that there were vast interbank exchange dealings between City Bank and French commercial banks, such as Banque de Paris et des Pays Bas, Credit Lyonnais, Societe Generale, and the Comptoir national d'escompte de Paris<sup>19)</sup>. Judging from the figures which shows a large number of short-term transfers in Table 2 and 3, it would appear that City Bank was an active participant in interest and exchange arbitrage.

On 15<sup>th</sup> November 1906, Holden sent a letter to Gardin to reject the drawing of American financial bills on the London market, reproached him with the following words, "You are sending me the rubbish to negotiate on our (London) Market. You are getting me a bad name

in the Market, and you are doing a bad thing for yourselves. ...The Bills in depot which we had consist of the rubbish of the Market, that is the Finance Bills, which everybody is talking about now"<sup>20</sup>). Felix Schuster, the chairman of Union of London and Smiths Bank, also rejected the bank accepting of American finance bills<sup>21</sup>). It alleged that UK financial institutions accepted American financial bills in vast amount in the early twentieth century, however, the statements above by the chairmen of major London clearing banks gives sufficient contradiction to such allegations. "They have carefully avoiding accepting any bills which were open to the suspicion of being created either for purpose of fostering speculation or of withdrawing gold for London Market"<sup>22</sup>). These statements confirm Midland Bank and Lloyds Bank accepted not financial bills but mainly rather raw cotton bills drawing from the US<sup>23</sup>). This suggests that there is still room for discussion regarding the degree to which UK financial institutions were eager to accept American financial bills.

#### IV. Conclusion

This research reveals two main aspects of the international banking system at the beginning of the twentieth century. Firstly, Midland Bank had a large number of foreign currency deposit accounts all over the world, mainly in countries in Europe and North America, and engaged extensively in foreign currency business transactions, prior to 1914, while in the era in which the pound sterling was still the key currency of international trade and exchange. Secondly, in the same period, when the US dollars was not yet the key currency, City Bank undertook an assiduous campaign to obtain foreign correspondent banks, and expanded its correspondent banking network successfully. These facts were not only previously unknown, but also of historical importance in showing how the foundations of international banking networks and foreign exchange business were built up by giant banks in London and New York in the golden age of the pound sterling.

#### Notes

- 1) Clark, W.(1974),*London As a World Financial Centre-How its Market Work*, London; Jones, G.,(1982), "Lombard Street on the Riviera: The British Clearing Banks and Europe 1900-1960", *Business History*, vol.24,no.2; Atkin, J.(2005), *The Foreign Exchange Market of London*, London; Michie, R.(2012), "The City of London as a centre for International Banking; The Asian Dimension in the Nineteenth and Twentieth Centuries", Nishimura, S., Suzuki, T. and Michie, R ed. *The Origins of international Banking in Asia The Nineteenth and Twentieth Century*, Oxford University Press.
- 2) HSBC Group Archives ,Midland Bank,UK0863/0002,Advert inc. shipping department, Ward, Lock and Co., Limited illustrated guide book published about The London City and

Midland Bank,1913.

- 3) Atkin, J.(2005), *The Foreign Exchange* ,pp.5-23
- 4) Lloyds Bank Group Archives, HO/CA/Acc.5,Weekly Liabilities and Assets Ledger, 1911; Lloyds, HO/D/Inv.5, Minutes of Investment Committee, 15 April 1910.
- 5)HSBC, Midland Bank,UK0293/0009,Arrangement book, Foreign Branch Office, Foreign Currency Accounts, register of banking arrangements,indexed,1908-1917; Rare Book & Manuscript Library, Colombia University, Vanderlip Paper, Part A: Correspondence-Incoming,VP, A43, J.E. Gardin, March 7, 1911.
- 6) Lloyds, HO/D/Inv.5, Minutes of Investment Committee, 15 and 22 Sept. 1911.
- 7) Bloomfield,A.(1959), *Monetary Policy under the International Gold Standard, 1880-1914*,New York.
- 8) Holmes and Green (1986) , *Midland 150 years of banking business*, London, pp.133-134.;*Bankers Magazine* (London),LXXI,1901,pp.376-389; *Journal of Institute of Bankers*,XXXII,1911,pp.435-461.
- 9) Holmes and Green (1986) , *Midland 150 years*, pp.133-134.;H HSBC Group Archives, Records of Managing Director(Holden Edward) 292/35, Midland Bank head office, Letter Book, E.H. Holden indexed., 25 April, 1906.
- 10) Mayer, "The Origins of the American Banking Empire in Latin America : Frank A. Vanderlip and the National City Bank," *Journal of Interamerican Studies and World Affairs*, 1973,Vol.15, No.1, p.63.
- 11) New York State, *Annual Report of the Superintendent of Banks*,1911,p.14.
- 12) H. Cleveland and T. Huertas , *Citibank, 1812-1970*, New York,1985, pp.43-44.
- 13) VP, A43, J.E. Gardin, Feb. 14, 1911.
- 14) VP, A43, J.E. Gardin, Sept. 14, 1911; Cleveland, *Citibank*, p.83.
- 15) VP, A43, J.E. Gardin, Feb. 2, 1911.
- 16) Cf. Table 1.
- 17) VP, A43, J.E. Gardin, Feb. 2, 1911.
- 18) Cleveland, *Citibank*, pp.83, 349.
- 19) VP, A43, J.E. Gardin, May 24, 1911.
- 20) HSBC, Midland Bank, UK0292/0037, letter book, E. H. Holden,15 Nov. 1906,p.167.
- 21) *Bankers Magazine* (London),LXXIII,1907,p.469.
- 22) *Bankers Magazine* (London),LXXIII,1907,p.469.
- 23) *Bankers Magazine* (London),LXXVII,1907,p.222; *Bankers Magazine* (London), LXXXIX,1910,p.231;Lloyds Bank Group Archives, Lloyds Bank, 'Annual Meeting',1901; Lloyds, HO/D/Inv.5, Minutes of Investment Committee,30 June and 22 Dec. 1911.

Table 1: The Number and Location of Correspondence Banks of the Big Five and Union Bank in 1910

	North America	Central & South America	Europe	Asia	Africa	Other	Total
Barclays	5	1	7	1	1	5	20
Lloyds	14	0	9	2	2	0	27
Midland	46	13	51	3	1	3	117
Westminster	19	14	70	0	1	1	105
Nat. Prov.	6	2	6	2	0	1	17
Union	51	10	69	5	1	1	137
<b>Total</b>	<b>141</b>	<b>40</b>	<b>212</b>	<b>13</b>	<b>6</b>	<b>11</b>	<b>423</b>

Barclays: Barclays Bank, Lloyds: Lloyds Bank, Midland: London City and Midland Bank, Westminster: London County and Westminster Bank, Nat. Prov.: National Provincial Bank, Union: Union of London and Smiths Bank.

Source: *Banking Almanac*, 1911

\*Table 2 and Table 3 will be distributed on the day