

## HISTORY AND EVOLUTION OF ENGLAND BANKING SYSTEM

R.M.D.H Rathnayake<sup>1</sup>

### Abstract

Banking in the United Kingdom can be considered to have started in the Kingdom of England in the 17th century. The first activity in what later came to be known as banking was by goldsmiths who, after the dissolution of English monasteries by Henry VIII, began to accumulate significant stocks of gold. The Bank of England has a longstanding interest in the structure of the financial system. System structure can affect financial stability through influencing the cost and availability of the financial services on which households and businesses depend. The country's banking sector consists of more than 340 commercial banks, with the Bank of England, which is the economy's central bank, at the apex. Since the 1970s, the U.K government has implemented a number of banking sector reforms - in order to safeguard and improve the banking sector. By any standard, the U.K. currently has one of the most developed banking systems in world. The country has enjoyed a substantial bank-based financial sector development over the years, and its institutional framework has also grown stronger. However, like any other financial system, the U.K. banking system still faces wide-ranging challenges, such as less than adequate disclosure standards, contagion risk from the euro zone, squeezed interest margin and uncertainties caused by changes in regulatory regimes.

This article tracks the history evolution of a core component of the banking system in the United Kingdom, the banking sector, describing how technology has transformed the economics of banking, and how deregulation in the 1970s and 1980s freed banks to take advantage of new opportunities through globalization and financial innovation.

**Key Words:** Banking System, History, Evolution, United Kingdom

---

<sup>1</sup> B. A (Special) in Economics, Second Year, hansirathnayakermd@gmail.com

## **Introduction.**

The origins of England banking system can be found in the activities of the London goldsmith-bankers during the period 1650 to 1700. London goldsmith-bankers initiated and developed the basic principles of accepting deposits on which interest was paid, made loans from the funds supplied by such deposits, issued their own promissory notes (or banknotes) and allowed depositors to access their accounts by use of ‘drawn notes’

This article has illustrated the significant changes in the structure of the UK financial system over recent decades. During the 17th century, goldsmiths began to offer banking services to aristocrats and merchants. They accepted gold deposits in return for receipts that acted like modern-day cheques or banknotes. Having gained a reputation for being reliable lenders and custodians of wealth, they gradually extended their services. The private banking sector was born. Some of its pioneers survived to become some of the famous financial brands we know today.

## **Historical evolution of British banking system**

Banking in the United Kingdom can be considered to have started in the Kingdom of England in the 17th century. The first activity in what later came to be known as banking was by goldsmiths who, after the dissolution of English monasteries by Henry VIII, began to accumulate significant stocks of gold. The Bank of England has a longstanding interest in the structure of the financial system. System structure can affect financial stability through influencing the cost and availability of the financial services on which households and businesses depend.

Over the course of the nineteenth century the British banking system was also transformed. In the first half of the century England was a country populated by numerous small banks. Until 1825 when joint-stock banking was permitted for the first time, apart from the Bank of England itself, other English banks had been restricted to small partnerships. To the extent that these banks are ‘too important to fail’, private incentives are distorted and resources misallocated (Haldane, 2010). Acknowledging this, efforts are under way both domestically and internationally to address the risks associated with too important to fail institutions.

By the First World War the British banking system had become the envy of the world, able to withstand the financial crises that afflicted many other countries. (Geoffrey, 1993) That did not mean that none of these larger banks failed for some did, such as the City of Glasgow Bank in 1878, but the system as a whole was able to cope with that. Individual bank failure can never be eliminated in a competitive banking system.

The British banking system then withstood the effects of two world wars and the global financial crisis of 1929-1932 (Sayers, 1971). The one British bank that experienced serious difficulties at that time was Williams and Deacons, as it focused on lending to the depressed Lancashire cotton textile industry. It was absorbed by the Royal Bank of Scotland at the invitation of the Bank of England. This reputation for stability then continued after the Second World War. Even the secondary banking crisis of 1974 left the large British banks unscathed and thus able to participate in a rescue organized by the Bank of England.

Since 2007, the British banking system has been reverting to the model that served it well in the past. Oversight of banks lies, once again, with a Bank of England now conscious that stability cannot be taken for granted. The de-mutualized building societies have all disappeared. The Spanish Bank, Santander, absorbed the Abbey National, Alliance and Leicester and the retail activities of Bradford and Bingley, while Northern Rock has been acquired by Virgin Money. The result leaves Britain with a few very large banks. Each of these is different. Santander is a subsidiary of a Spanish Bank managed from an office complex just outside Madrid. It is building up a large UK retail operation. Lloyds/HBOS is a very large UK retail bank, and is being forced to sell branches so as to reduce market dominance. The government owns 40 per cent of it following its rescue. Barclays has converted itself into a universal bank, combining commercial and investment banking, through the purchase of the Wall Street business of Lehman Brothers after its failure. HSBC is a global bank with a largely Asian focus and is run jointly from London and Hong Kong. Standard Chartered is a London-based bank whose business is entirely in emerging economies.

Since 2007 each of these banks has adopted a strategy to meet the challenges and exploit the opportunities present in a rapidly changing

world. For some a strong focus on UK retail banking is seen as the model to follow, while others have taken the route of global expansion. With hindsight it is clear that, in the 10 years before 2007, a number of British banks had adopted business models (Geoffrey, 1993) that could only be successful in an environment of continuous economic growth and credit expansion. Such an environment could not be sustained indefinitely and when it ended these business models were exposed as deeply flawed. We can summarize evolution of England banking system under five decades.

1. 17th Century
2. 18th century
3. 19th century
4. 20th century
5. 21st century (Current situation in England Banking System)

### **17th Century**

Many goldsmiths were associated with The Crown but, following seizure of gold held at the Royal Mint in the Tower of London by Charles I, they extended their services to gentry and aristocracy as the Royal Mint was no longer considered a safe place to keep gold. Goldsmiths came to be known as ‘keepers of running cash’ and they accepted gold in exchange for a receipt as well as accepting written instructions to pay back, even to third parties. This instruction was the forerunner to the modern banknote or cheque. Around 1650, a cloth merchant, Thomas Smith opened the first provincial bank in Nottingham.

During 1694 the Bank of England was founded. The Governor and Company of the Bank of Scotland was established by an Act of the Parliament of Scotland on 17 July 1695, the Act for erecting a Bank in Scotland, opening for business in February 1696.

### **18th century**

During this period, services offered by banks increased. Clearing facilities, security investments and overdraft protections were introduced. An Act of Parliament in 1708 restricted banks with more than six partners from issuing bank notes. This had the effect of keeping private banks as small partnerships. Joint stock investment companies were already well established,

but joint stock banks did not become well established until the following century.

The Industrial Revolution and growing international trade increased the number of banks, especially in London. These new "merchant banks" facilitated trade growth, profiting from England's emerging dominance in seaborne shipping. Two immigrant families, Rothschild and Baring, established merchant banking firms in London in the late 18th century and came to dominate world banking in the next century.

### **19th century**

On 23 October 1826 a new joint stock bank, Lancaster Banking Company, was formed. However earlier that year the Bristol Old bank had converted from a private to a joint stock bank, making it the first joint stock bank. This was quickly followed by other institutions such as the Manchester & Liverpool District Banking Company and the National Provincial Bank. The National Provincial was the first bank to be considered a truly national bank with twenty branches across England and Wales.

In 1844 the government introduced the Bank Charter Act to regulate the issuing of bank notes. Two banking collapses, one in 1866 and another in 1878 caused significant reputation damage but in consequence record keeping and accounting improved. The resulting new organizations became huge bureaucracies with a board of directors, general manager, secretary and an army of accounting clerks.

### **20th century**

With the outbreak of war banking flourished and the so-called "Big Five" commenced a series of takeovers and mergers. These banks, Westminster, Provincial, Barclays, Lloyds and Midland were eventually reined in by government control.

Between the wars, there was a decline to match the general depression of the time. But the banks fought back by taking action to recruit less wealthy customers and by introducing small saving schemes.

## **The beginnings of branch banking**

The country's banking sector consists of more than 340 commercial banks, with the Bank of England, which is the economy's central bank, at the apex. Joint-stock banks began to open more branches, a system which seemed likely to provide a more stable structure and one more suited to the needs of the now advanced Industrial Revolution. However, the branches needed to be controlled from Head Office, which was to prove difficult with poor communications and lack of skilled men.

The problem was best described by Mr. Robert Paul in 1826, when addressing Parliament: "that branches were accompanied with so much hazard, required such constant watching and inspection, and involved us altogether in such a degree of superintendence that, upon the whole, my general impression is that the branches are not the most advantageous part of our business

In 1833, an Act of Parliament permitted joint-stock banks in London, and confirmed the legality of cheques drawn on them. The use of cheques made for more rapid commercial transactions. Access to the London Bankers Clearing House was still denied to joint-stock banks until 1854. Further restrictions were imposed in September of 1844 by an Act "to regulate the Joint-Stock Banks in England". This applied to the establishment of new joint-stock banks, which now needed Charters, and were given a maximum term of twenty years and a minimum nominal capital of 100,000.

The second half of the nineteenth century was an age of British industrial and commercial supremacy, which called for an expansion of the services provided by the established banks. For example, the London and Manchester Bank had four branches in 1850, and seven by 1865.

Limited liability now enjoyed by other business companies had not yet become a recognized attribute of banking companies. The final solution was found in the Act of 1879, which provided new legislative principle of "Reserved Liability". This was the difference between the nominal and paid-up values of shares, this being callable only in event of the company being wound-up. One result of this change was to make obligatory the annual publication of bank balance sheets. This furthered the amalgamation process by revealing the financial position of provincial banks.

In 1826, Lord Liverpool declared that "the solid and more extensive banks could not fail in time to expel the smaller and weaker" (Dissanayake, 2000). This was to become true as many of the old private and small joint-stock banks were unable to meet the demands of the growing industrial nation; since they were lacking in a branch network to bring in deposits to meet demand, and so were forced to sell out. The reason for the improvement of the branch system was the removal of legislative obstacles, the growing dominance of the cheque, the completion of the railways and the development of the telegraph. The Bank of England charter 1709-1825 established that private joint-stock banks would be illegal:

"For any political body or corporation whatsoever elected or to be elected other than the said Governor and Company of the Bank of England for or other persons whatsoever united or to be united in covenant or partnership, exceeding the number of six persons, in that part of the United Kingdom called England, to borrow, owe or take up any sum or sums of money on their bills or notes payable on demand, or any less time than six months from the borrowing therefore."

## **The functions and organization of the bank of england**

### **1. The Bank's role as bankers**

In their capacity as bankers the Bank provide a wide range of services analogous to those offered by commercial banks to their customers. The Bank's main customers are the Government, the commercial banks, and overseas central banks and international organizations though there remains a small amount of private and commercial business.

#### 1.1 Bankers to the Government Government's

Main accounts are held with the Bank. A large number of subsidiary accounts are kept with the commercial banks, because the Bank have few branches outside London. But wherever government revenue may be collected initially throughout the country.

#### 1.2 The bankers' bank

The Bank of England are bankers to the commercial banks and, as described later act as lender of last resort to the discount houses, and thus to the whole

banking system. Nearly all the domestic commercial banks have an account with the Bank, as do the discount houses and accepting houses and a few of the overseas banks in London-making nearly one hundred in all.

### 1.3 Bankers to other central banks

The Bank have about ninety central banks accounts for overseas and for such bodies as the International Monetary Fund. The International Bank for Reconstruction and Development, the International Development Association and the Bank for International Settlements. Many central banks particularly those in the sterling area hold the bulk of their external reserves in London and others keep substantial working balances in sterling. Most of these funds are placed with the Bank which may arrange and advice upon their investment.

## **2. Agent for the Government**

The Bank act as agent for the Government in administering exchange control; a staff of about 340 is currently engaged on this work one quarter of the peak figure reached in the early 1950's. The Bank also administer the voluntary arrangements introduced in May 1966 to limit investment in the more developed countries of the sterling area. In addition, they manage, on behalf of the Treasury, the Exchange Equalization Account, which holds the official reserves of gold and foreign exchange.

### 2.1 Exchange control

The chief object of exchange is to protect and conserve the gold and foreign exchange reserves. The legal basis for exchange control is the Exchange Control Act 1947 and statutory instruments issued under this Act. Exchange control is not applied to transactions between U.K.

### 2.2 The Bank's operations in the markets

By their market operations-and. through their various contacts, in other ways-the Bank seek to implement the Government's monetary policy. In the money market. The amount of Treasury bills offered each week at the tender is usually fixed



### 2.3 Financial advice

Daily operations in the money, gilt-edged and foreign exchange markets provide the Bank with the technical knowledge of, and practical experience in, these markets which together contribute greatly to the Bank's ability to give financial advice.

#### **Current situation in England banking system**

This article has traced the development of British banking from its origins to the present day. Looking ahead it is interesting to speculate on the future changes of banking, as a service industry, to meet the requirements of society. Over the past twenty years, extensive changes have taken place in the departmental organization of the Bank and, within many of the departments, in the work of the various offices. These changes have not reflected any basic change in the Bank's functions-although they have been partly associated with a wider interpretation of those functions. Essentially, changes in organization have been necessary because of the introduction of new techniques, designed to enable the Bank to operate more effectively; the transfer of work from one department to another, with the aim of greater efficiency; and the impact upon the Bank: of changes in other institutions. Two world wars had little effect of the banking structure of the country. The amalgamations at the end of the First World War were the culmination of the long process of structural development. A massive branch banking system had grown out of the piecemeal development of the past.

Like their predecessors of hundred years ago, today's bankers seek to extend their business in every possible aspect, developing expertise in foreign exchange, finance of foreign trade and trustee and executor work. Within their own system a very high degree of mechanization has occurred; all branches now having a computer linked to a vast network for time saving, greater efficiency and speed.

The credit card system, first introduced in 1966 from a well-established American tradition, has now been undertaken by all the major banks and may prove to be an innovation with far reaching effects. Cash dispensers, cheque cards and budget accounts are other recent services offered to aid the convenience of the customer, while the more recent Euro-cheque system

enables a traveler in Europe to cash his down British cheque in the currency of the country where he is staying.

Over the past 40 years the size of the UK banking system has grown dramatically and under plausible assumptions it could continue to grow rapidly. This article examines a number of issues related to the size of the UK banking system, including why it is so big and what empirical evidence tells us about the relationship between banking system size and financial stability.

Currently banks in the United Kingdom have refined their services with most offering very similar services being distinguished only by offering different interest rates. Indeed, a very recent trend has been to not advertise interest rates as this avoids the banks having to offer such advertised rates to at least 60% of their customers. In March 2014, Bank of England launched our three-year Strategic Plan to transform the way they work. The plan established a renewed mission for the Bank: 'promoting the good of the people of the United Kingdom by maintaining monetary and financial stability'.

In 2006 the Office of Fair Trading found that the banks were exploiting penalty bank charges on credit cards and has suggested that banks restrict such penalty to a maximum of 12 UK pounds. Penalty charges or Liquidated damages are illegal in UK contract law unless they represent the real cost of a breach of contract incurred through an unauthorized overdraft level or bounced cheque.

The Financial Services (Banking Reform) Act 2013 is calls for a paradigmatic shift toward the principle adopted by the US of risk averse strategies. This manifests itself in the form of "ring-fencing" retail banks to protect consumers and by creating requirements for certain amounts of capital to be retained to act as a buffer against market instability. This reform is set to support the strengthening economy and is a response to the 2008 financial crisis.

As of 11 October 2008, the British banks have short-term liabilities equal to 156% of GDP or 368% of the British national debt, while the average leverage ratio (assets/net worth) is 24 to 1. Over the past 40 years (2014) the banking system in the UK has experienced a 'dramatic shift' with total assets increasing from 100% of GDP to 450%, and it is 'plausible that the UK banking system will continue to grow rapidly', due to its probable 'comparative advantage' in international banking services, with the pre-

eminence of London as a financial center traceable to the 18th and 19th centuries. In 2014, the FCA revealed that 29 firms had applied for authorization to become banks. As of Dec 2015, a number of new banking licenses have been secured, e.g. by Atom Bank and Tandem bank.

### **Biggest UK Banks – Breakdown by Asset Size**

Below is the listing of this year's top UK banks by asset size.

<b>Banks</b>	<b>Total Assets in Billions*</b>
HSBC Holdings	\$2,634.14
Barclays PLC	\$2,634.14
Royal Bank of Scotland Group	\$1,635.93
Lloyds Banking Group	\$1,333.99
Standard Chartered PLC	\$725.914

\* Asset size as of 2015

**Source:** ([www.advisoryhq.com/top-5-uk](http://www.advisoryhq.com/top-5-uk))

The statistics table below shows a trending bar chart of the total assets of the top 5 biggest UK banks. The chart shows each British bank's total assets during the first half of the last couple of years.

## Summery

This article has traced the development of British banking from its origins to the present day. The Bank of England has a longstanding interest in the structure of the financial system. The country's banking sector consists of more than 340 commercial banks, with the Bank of England, which is the economy's central bank, at the apex. Looking ahead it is interesting to speculate on the future changes of banking, as a service industry, to meet the requirements of society. Like their predecessors of hundred years ago, today's bankers seek to extend their business in every possible aspect, developing expertise in foreign exchange, finance of foreign trade and trustee and executor work. Within their own system a very high degree of mechanization has occurred; all branches now having a computer linked to a vast network for time saving, greater efficiency and speed. This article has illustrated the significant changes in the structure of the UK financial system over recent decades. During the 17th century, goldsmiths began to offer banking services to aristocrats and merchants. By any standard, the U.K. currently has one of the most developed banking systems in world.

## References

Gilbody J (1988), *"The UK Monetary and Financial System"*, by rout ledge 11 New Fetter Lane, London EC4P 4EE.

Sayers R.S (1958) *"Modern Banking"*, 4th edition, Oxford at The Clarendon Press.

Sayers R.S (1971) *"Central Banking after Bagehot"* Oxford University Press, Amen House, London.

Dissanayake S (2000) *"A Concise Economic History of Britain"* Ariya Printers (PVT)LTD, 13 A, Kotugodella Veediya, Kandy.

Geoffrey J. (1993) *"British Multinational Banking 1830-1990"* Bookcraft Ltd, Midsomer Norton, Bath

Chaudhri B.K. (1976), *"Practical Banking"* Konark Publishers PVT LTD, A-149, Main Vikas Marg, Delhi

Benford, J, Berry, S, Nikolov, K, Robson, M and Young, C (2009),

'*Quantitative easing*', Bank of England Quarterly Bulletin, Vol. 49

Hancock, M (2005), "*Divisia Money Bank of England Quarterly*" Bulletin, Spring.

<http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2015/q201.pdf><http://www.tradingeconomics.com/sri-lanka/gdp-growth>