Fraud in the Development of Victorian British Banking

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Abstract

As the British banking system developed in the Victorian era, one of its major challenges was substantial and endemic fraud among senior managers and directors, closely linked with serious mismanagement. I review the major cases of bank failure due to fraud between 1836 and 1901, and discuss some of the causes and consequences. In a number of cases - particularly the City of Glasgow Bank collapse, the cumulative collapses of 1856-1857, and arguably the Overend Gurney case - fraud and mismanagement seems to have triggered or contributed to large-scale financial crisis. A key factor that led to a reduction in fraud over the era was the general stabilization of the financial sector, in large part due to professionalization of the practice of banking and almagamation across the banking market in the UK. Additionally, some legal changes, including the elimination of unlimited liability, appear to have played a role. After the City of Glasgow Bank's failure in 1878, there is little evidence of systemic problems with fraud in the UK banking system.

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1 Introduction

As the British banking system developed in the Victorian era, one of its major challenges was substantial and endemic fraud among senior managers and directors, closely linked with serious mismanagement. This paper surveys instances of such high-level fraud in the British banking system during the Victorian era, focusing on cases that led to temporary or permanent bank failure (since it was rare that major fraud was discovered except at a point of serious crisis). I look at general patterns and the range of consequences of such cases. Since the problem significantly diminished by 1900, I review some of the likely causes of this diminishment.

In the first 20 years of the Victorian era, 1837 to 1857, there were more than a half-dozen large-scale bank failures due to fraud in England, as well as a number of others in Ireland and Scotland, not to mention fraud-induced failures of smaller banks. In the last 25 years of her reign things were very different. Only two major financial institutions frauds can be seen: the City of Glasgow Bank in 1878, and the collapse of the Liberator Building Society and Balfour companies in 1892. Additionally there were other, lesser cases of bank fraud or mismanagement that led the ailing bank to be purchased by a competitor. But overall the evidence is very strong that fraud and mismanagement in the financial sector had significantly diminished as a problem.

The consequences of fraud varied tremendously, but appear to have been significant throughout. In the case of singleton failures due to fraud, the unlimited liability bank charters that were the modal type during this era tended to inflict major costs on shareholders, frequently bankrupting them. Large bank failures also tended to disrupt trade and the money market, but usually for short periods. Finally, there is strong evidence that fraud contributed substantially to three major crises of the Victorian British financial system; in addition to the well-known case of the City of Glasgow Bank in 1878, fraud appears to have helped transmit the panic of 1857 from the United States to England, and dishonest (but not technically fraudulent) prospectuses played an important role in the Overend Gurney crisis of 1866.

The diminishment in fraud took place over many decades and presumably had a number of causes. From 1825 to 1862 a number of changes were taking place in the legal environment, including the development of the joint-stock bank as a standard corporate entity (before 1826 only a handful of joint stock banks with royal charter were allowed, such as the Bank of England); there appears to have been significant learning among bank managers, shareholders and officers. Related to this was a process of professionalization and standardization of practices across the industry, which a few regulations appear to have helped accelerate. Finally, mergers and acquisitions shifted the banking industry from a large number of small and mid-sized banks to a few extremely large banks by the turn of the century.

One notable pattern is that as bank frauds and failures were becoming less common, so too were unlimited liability banks; by 1885, shortly after the City of Glasgow failure, most of the banks in Great Britain were limited liability[1] and aside from a few small private banks almost none were unlimited liability. While correlation is not causation, there are several pieces of evidence suggesting that in practice unlimited liability exacerbated issues of fraud and mismanagement.

The remainder of the article is structured as follows: Section 2 discusses previous literature on the British banking system, Section 3 gives an overview of the institutional background, looking at developments in corporate and banking law around that period. The core of the paper is Section 4, which reviews the major cases of fraud from 1837 to 1901. Section 5 discusses patterns in the fraud, Section 6 looks at consequences, Section 7 discusses possible reasons for the diminishment of fraud in the late 1800s, and Section 8 concludes.

2 Background

2.1 Banking Failures and Frauds

In the wake of the financial crisis of 2008 there has been an increase in interest in understanding and mitigating financial system vulnerabilities, including a renewed interest in financial crises. A few of the most prominent examples of recent literature would include Gertler and Kiyotaki [2010], Schularick and Taylor [2009], Holmstrom and Tirole [2011] and Brunnermeier and Pedersen [2009]. Kindleberger [1978] discusses the issue of fraud in financial crises, and has a number of examples. Recent years have seen a number of investigations bank collapses and failures of the 1800s in Great Britain. Some examples of this work are Gráda [2012] and Acheson and Turner [2008].

[1] Including a number that were reserve liability, similar to double liablity.

The economic literature on crime in banking and corporations generally is limited. Akerlof et al. [1993] represents the most thorough model available. Some of the academic work on free banking briefly discusses the issue of fraud as part of a discussion of “wildcat banking”, but finds little evidence of serious misbehavior(Rockoff [1974], Briones and Rockoff [2005], White [1990]).

Much of the work in this area is either practical work by accountants and professional fraud investigators, or academic work by sociologists and criminologists. For an example of the first type of work, see Miller [2006], and for the second, the original work is Sutherland [1949].

Additionally, in the past decade historians have begun to pay attention to white collar crime in Victorian Britain, for example Robb [2002] and Taylor [2005].

2.2 The British Financial System to the early 1800s

The British financial system has had a very strong reputation for much of the past 300 years. There is strong evidence that there was a “Financial Revolution” after 1688 which allowed it to finance public debt efficiently and reliably [Bordo and White, 1991]. Hicks argued in 1969 that this Financial Revolution allowed capital to flow to private entrepreneurs efficiently and indeed the British financial system of 1700s and its presumed relationship with the Industrial Revolution has been used as an example of the links between strong finance and growth (see Bencivenga et al. [1995] and Levine [2005]).

Economic historians who study the Industrial Revolution are more cautious about the British financial system before 1870. The British financial system circa 1800 seems to have had strengths in public finance, trade finance and to a lesser extent, in local infrastructure projects such as the canal development companies of the 1700s. Pressnell [1956, p. 75] says “[d]uring the second half of the eighteenth century the English banking system developed as a three-tiered structure consisting of the Bank of England, the rest of the London money market, and the country banks.” The Bank of England and the money market were able to efficiently finance the needs of the British government, and the system as a whole was able to finance both regional and international trade.

However, industrial finance, beyond short-term funding for transactions, was nearly non-existent. The Financial Revolution made government funding much more efficient, but seems if anything to have worsened private financing in the near term, by “crowding out” private investment (Quinn [2001], also Allen [2009]). Joint-stock incorporation was severely limited after the South Sea Bubble of 1720, and the London Stock Exchange in the 1700s dealt mainly with government debt. While there were a large number of private country banks[2] they seem to have been weak; Ashton writes of the late 1700s. "The lives of most private banks were short"(More [1997] and Ashton [1997]).

Mokyr [1985] summarized the literature as making several points about the period from the mid-1700s to the early 1800s. Self-finance and loans from friends and relatives were much more important for funding the innovations of the Industrial Revolution. The banking system was very limited and focused on short-term funding of trade and working capital. It may have in this way indirectly helped with capital accumulation but the evidence is mixed. The banks were also highly unstable and may have hurt entrepreneurs as much as they helped. There is no sign that the non-banking formal capital market was much better. There is little evidence of a strong difference, with regard to private financing, between the British financial system and the financial systems of Continental countries.

Other writers are a bit more optimistic, but only just. Kindleberger [1984, p. 93] argues that there were some cases of long-term financing, in part due to failure to pay back short-term loans. Cottrell [2006, p. 210] argues briefly that there were long-term loans which supported the accumulation of fixed capital during the industrial revolution, but both he and Collins and Baker [2003] find most loans, advances or overdrafts were for short periods of 3 to 6 months. Pressnell [1956, Chapter 10] finds that while some industrialists also ran banks (and were able to use the bank to finance their industrial concerns), financing from a bank to an unaffiliated company was usually short-term.

3 Institutional Background

3.1 English Banking and Corporate Law to the early 1800s[3]

The last years of the Georgian period had seen revolutionary changes in banking law. Throughout the 1700s and up to 1826, banking in England was heavily limited by a law of 1709 which

[2]Lipson [1961 (reprint] includes in a footnote on page 245 a remark by an observer in 1793 "the number of banks, even in villages, became an object of general ridicule before the war was thought of."

[3]This section borrows substantially from Cottrell [2006, Chapter 3] and Hunt [1969]

prevented any corporate entity with more than six partners (i.e. a joint-stock company) from issuing paper payable at demand or within six month [Lipson, 1961 (reprint, page 244]. This limited the market for notes to partnerships - the country and City banks - and gave the Bank of England a monopoly on joint-stock banking. In 1826 this monopoly was eliminated for areas more than sixty-five miles from London, and in 1833 it was eliminated across the country.

The same pattern of a restrictive environment set by the early 1700s, with slowly accelerating change in the early 1800s can be seen in corporate law. English corporate law in the early 1800s was awkwardly moving from a pre-industrial model of business structure that had not changed radically from the Renaissance to the world of the modern corporation. The trade-offs between the personal directness and responsibility of the small enterprise on the one hand and the efficiency and scale of the limited liability corporation on the other were complicated, frightening to some, and could be highly controversial.

There were three types of business entities in British law at the beginning of the 1800s - partnerships, unincorporated companies, and full corporations. A partnership was a contract between a small group of individuals, all of whom were liable for the debts of the partnership. Partnerships were by far the most common and familiar type of enterprise structure in England, including among banks (both City and country banks). At the other extreme, full corporations were rare, and could only be created by an individual act of parliament. Corporations were also usually granted a monopoly of some kind (for example, most of the canal development in the 1700s was done by companies incorporated by parliament with monopolies over stretches of canal).

The limitations of the partnership, and the difficulties of gaining full incorporation, led to the unincorporated company: effectively using trust law and some legal grey areas to create something that looked like a duck and quacked like a duck, but was actually a land trust with qualifications.

The Bubble Act passed in 1720 had radically limited the extent of incorporation, and in 1825 it was repealed, slightly easing the process of incorporation. The repeal happened towards the end of the boom of 1824-1825, and the following bust "abated the spirit of enterprise throughout the country" Hunt [1969, p. 56] (although not the development of joint stock banking; see below). By the mid-1830s incorporation had lost some of the suspicion of 1825 and the development of joint-stock banking and railway corporations triggered a boom in incorporation, with 300 companies incorporated in the years 1834-36. Two acts, of 1834 and 1837, made the benefits of incorporation easier to get; the second act gave full incorporation at the discretion of the Board of Trade. The Joint Stock Companies Registration and Regulation Act of 1844 clarified the distinction between partnerships and corporations, and created a straightforward process of incorporation; over the next twelve years 910 companies in England were incorporated under its rules. However, companies incorporated under the act were unlimited liability. It was very commonly believed that unlimited liability, which also held for partnerships, was essential to prevent speculation and irresponsible behavior. At the same time, the practical problems of raising capital required "sleeping partners" whom it was hard to hold fully responsible for corporate actions.

This conflict was finally resolved in a series of laws passed between 1856 to 1862, probably the most rapid shift in the history of English corporate law. Limited liability was granted to joint-stock companies in 1856, banks were added in 1858, and finally in 1862 a full consolidation was passed - "'the *Magna Charta*' of English company law and the written constitution of English joint-stock enterprise" [Hunt, 1969, page 144] - granting limited liability generally.

The situation in Ireland and Scotland was roughly similar. Ireland allowed unlimited liability joint stock banking after 1825. Scottish partnership banks from the 18th century onwards had a legal personality, making them similar to the joint stock banks that only appeared in England after 1826. However, they had small branch networks until the early 1800s, at which point national branch networks began to develop. Despite these differences, across Great Britain by the 1830s the most common form for a new bank was the unlimited liability joint-stock bank [Acheson et al., 2010].

3.2 Background on Bank Liability Regimes

The shift described above, from unlimited liability partnerships to unlimited liability joint stock companies to limited liability joint stock companies, was clearly complicated and took most of the 19th century. The question of how the shift interacted with other developments in banking to influence the tendency to fraud is a complicated one that we will return to at several points. At this point it is helpful to review briefly the perspectives on unlimited vs limited liabilty.

With the exception of a handful of older semi-public banks - specifically the "Bank of England (est. 1694), Bank of Scotland (est. 1695), Royal Bank of Scotland (est. 1727), British Linen Bank (est. 1746), and Bank of Ireland (est. 1783)" [Acheson and Turner, 2008] - all banks, both private and joint stock, were unlimited liability until 1858. Unlimited liability was taken very seriously. Pressnell [1956, page 236] describes the case of Mr. Joyner, a long inactive partner of a bank in Romford that failed in 1825: "He delivered to the bankruptcy commisioners everything he had – including some £32,000[4] – and they returned to him £100 and his pocket watch."

Acheson and Turner [2008] (see also Hickson et al. [2005] and Hickson and Turner [2003]) discuss the theoretical background on unlimited liability corporations and compare theory with data from British banking in the 19th century. There are three long-run equilibria with theoretical support. The first equilibrium is one where unlimited liability collapses due to adverse selection. The liability imposes higher costs on high net worth individuals and so they sell the stock, and low net worth individuals buy it. In the end, the unlimited liability provision has no teeth, as the shareholders are so poor they have no assets that can be liquidated in case of bankruptcy. The second equilibrium uses strict wealth requirements to control share purchases, and shares can only be transferred with the permission of all stockholders. Additionally, to prevent an unraveling and collective flight by dumping shares, liability has to be enforced after the sale of shares. A third equilibrium (which Hickson et al. [2005] find in Irish banks in the 19th century) depends on a small group of wealthy owners of the stock to prevent a collapse due to adverse selection; by restricting sale of the stock and maintaining discipline, they prevent the unraveling of the shareholdership.

The third equilibrium is very interesting in the context of 19th century banking. The limited reporting requirements and auditing of the 19th century seem to have led to a significant "insider/outsider" division among shareholders in both the United Kingdom and the United States (regarding the latter, see Lamoreaux [1996]). In some contexts this appears to have worked well, in other contexts it was more problematic.

Other liability structures are possible as well: many state regulatory regimes in the United States used double liability, for example [White, 2011], and France had the *societe en commandite par actions*, which gave directors unlimited liability and shareholders limited liability [Cottrell, 2006]. Both were broached as possibilities in Britain, and something similar to double liability

[4]More than $3 million in 2012.

(reserve liability) was important in the last part of the 19th century.

4 Fraud and Mismanagement During the Victorian Era

Table 1 presents some basic information on major financial institution failures where fraud was implicated, over the course of the Victorian era. As can be seen, there is a substantial change over the period, closely linked with the stability and development of the British financial system generally. In the early years of joint stock banking, to 1847, such failures come fairly regularly. There is then a pause of about a decade, and then a series of collapses across 1855 to 1857 that seem to have been incubated in the boom of the mid-1850s. Three were triggered by the crisis of 1857: the Liverpool Borough Bank, the Western Bank of Scotland, and the Northumberland and Durham District Bank of Newcastle. Another decade later the boom of the British finance companies ends with the famous Overend Gurney crisis, the last major British financial crisis. The last two crises listed are more isolated. The City of Glasgow Bank failure in 1878 was probably the single greatest bank failure in British history but inflicted relatively minor damage on the system. The Liberator Building Society lost roughly £3.5 million deposited with it by British working men but likewise had few direct links to the financial system.

Table 1: Major Failures of British Banks and Finance Companies in the Victorian Era Where Fraud Was Implicated

Year	Name	Main Office	Losses ('000s £)
1836	Northern and Central Bank	Manchester	443
1839	Manchester and Liverpool[a]	Manchester	375
	Imperial	Manchester	Not clear
1840	Commercial Bank of England	Manchester	500
1841	Marylebone Bank	London	20
1842	Bank of Manchester	Manchester	800
1847	Royal Liverpool Joint Stock Bank	Liverpool	400
1855	Strahan, Paul and Bates	London	700
1856	Tipperary Joint Stock Bank	Tipperary	500
	Royal British Bank	London	350
1857	London and Eastern Banking Corporation	London	290
	Liverpool Borough Bank	Liverpool	1,000
	Western Bank of Scotland	Glasgow	3,000
	Northumberland and Durham District Bank of Newcastle	Newcastle	1,000
1866	Overend Gurney	London	3,000
1878	City of Glasgow Bank	Glasgow	5,200
1892	Liberator Building Society	London	3,500

A summary list of major collapses of banks or other financial institutions from 1836 to 1901 where fraud was implicated. Estimated losses are by author based on shareholder meeting discussions and newspaper reports, with the exception of Overend Gurney (based on lawsuit), City of Glasgow [Collins and Baker, 2003] and Liberator Building Society [Robb, 2002].

[a]May not have involved fraud/mismanagement; case is of interest in that a large dividend was passed at the same meeting loss was announced

It is worthwhile to begin by reviewing in detail the collapse of the Northern and Central Bank over December 1836 and January 1837 on the eve of the Victorian era. While the bank is probably not representative of all banks, and especially not the best banks, it gives some sense of the range of problems the worst banks had.

4.1 The Northern and Central Bank

On the morning of the 28th of November 1836, Thomas Evans arrived in London by the mail coach[5]. Evans was manager of the Northern and Central Bank, a newly formed joint-stock bank with a main office in Manchester and a number of branches in Lancashire. Evans carried a bag

[5]The narrative of Mr. Evans' arrival in London is taken largely from his testimony before the House of Commons' Committee on Joint Stock Bank on March 7, 1837, as reported in the November 15, 1387 issue of the Manchester Guardian.

with roughly £108,000 in notes and securities; including £91,000 of bills, £5,200 of Bank of England notes, and about £9,000 in American securities; which he was taking to the London office of the Northern and Central Bank. A distance of over 150 years makes it difficult to adjust for inflation, but the equivalent value in 2010 would be at least $10 million and arguably $150 million[6].

The remittance would enable the bank's London office to honor bank bills that appeared in London. In the newspaper coverage of the time, and in Evans' testimony before parliament, there is no clear reason for such a large remittance. Evans in his testimony before the committee on joint-stock banks mentioned a "scarcity of money" in the fall of 1836, and indeed interest rates had moved up over that period[7]. While there was no public awareness of a problem with the Northern and Central Bank, it appears to have been facing a number of issues. As Evans testified, "my mind was very much engaged at the time up on the state of things generally."

Evans then took a cab from the post office building to St. Paul's coffee house, where he was to meet one of the directors of the bank, Benjamin Braidley, and where both would be staying in London. Upon entering the coffee house Evans later testified "I discovered in two minutes that I had not got my bag, and I immediately ran out into the street, and followed the cab ...but without success."

The moment where Mr. Evans came running back into the street, hoping to retrieve £108,000 of urgently needed notes and securities, marks the beginning of the end of the Northern and Central Bank. Although the bag was recovered by the next morning, Evans and Benjamin Braidley believed that the Northern and Central Bank "was so much discredited" that it required an emergency loan from the Bank of England to survive.[8] As the Bank of England began to assist the Northern and Central, a shocking amount of mismanagement and fraud was disclosed.

The day after the loss of the parcel, November 29th, the Bank of England agreed to lend £500,000 to the Northern and Central, based on statements from Evans and Braidley that deposits net of cash came to £380,000. By mid-December it emerged that in fact deposits and

[6]The figure of $10 million is based on absolute purchasing power. An estimate based on relative purchasing power, that is, relative to per capita GDP, would be somewhere around $150 million. http://www.measuringworth.com

[7]NBER Macrohistory: XIII. Interest Rates, both the London Open Market Rate of Discount (m13016) and the Bank of England Minimum Rate of Discount (m13013) show an increase in interest rates from 4% to 5-5.5% from June 1836 to December 1836.

[8]Bank of England statement to the committee on joint-stock banks, published *Manchester Guardian* Nov 22 1837.

hence liabilities were much greater than that, and by early February 1837 the Bank of England had lent over 1.3 million pounds to the Northern and Central.

Over December 1836 and early 1837 there proceeded a steady iterative process of discovery, whereby the confusion and inaccuracy of the previous statements of the Northern and Central precipitated a further investigation by the Bank of England's representatives (two directors had been sent to Manchester in December 1836), which then uncovered further inaccuracy. By the time the Bank of England gave an official statement to the Committee on Joint Stock Banks in March 1837, a wide range of problems had been found[9].

After the initial difficulty in getting an accurate summary of the Northern and Central balance sheet more problems were discovered, beginning with (as the Bank of England reported):

> [T]he great proportion of shareholders among the debtors. Of 52 accounts due at Manchester, the balances of which exceed £2,000 each, 35 are due by shareholders; and of 29 principal debtors at Liverpool, 21 are shareholders; and when...the directors of the Bank of England desired that a committee of inspection should be appointed from the shareholders not being debtors, or in any way connected with the directors, it was stated that it would be difficult, if not impossible, to form such a committee.

There were also very poor lending controls generally. There were cases of branch managers who lent to clients thousands of pounds beyond levels set by the directors. The Sheffield branch had "received a class of paper hitherto unknown to bankers, viz. bills drawn up on America," and tens of thousands of pounds had been given out in England based on bills and agreements tied to a bank in Philadelphia. In commercial world of the time, it was unlikely that such bills would be repaid.

The Bank of England's representatives then came across serious defalcation and fraudulence. The bank's directors were systematically falsifying the public books, making it appear that they had paid in capital that they hadn't, hiding sales of shares by listing third parties as the owners and paying dividends out of non-existent profits. The Bank of England commented:

> After these discoveries the directors of the Bank of England determined not to

[9] The following discussion is based on the statement.

> leave the affairs of the Northern and Central Bank in the uncontrolled administration of the existing board. They, therefore, endeavored to find some of the larger shareholders qualified to act as a committee of inspection. In this much difficulty was experienced.

Eventually they found four who were suited for the role. They also required that the bank cease operations until the debt to the Bank of England was repaid[10] .

The challenges of the outsider shareholders and the debtors of the Northern and Central Bank were still far from resolved. It emerged that £443,000 were owed to the Northern and Central Bank by its own shareholders, and under the law of the time, it was legally impossible for the bank or any of its individual shareholders to sue the debtor shareholders (this was changed within the year).

The bank's business was purchased by the National Provincial Bank [Sykes, 1926, page 13] and, impressively, the Bank of England was repaid by the end of January 1838[11].

The opening discussion of the failure of the Northern and Central Bank gives some sense of the dynamic in the cases up to 1847. The most interesting pattern in these cases is the vast proportion of them that occur in Lancashire. A quick survey of Table 1 shows that with the exception of the fairly small Marylebone Bank, all of the scandals up to 1855 were banks based in Lancashire, and a large number of the collapses after were as well. The Lancashire banking system was notoriously weak, possibly because of a small regional base [Kindleberger, 1984, page 93], a dependence on bills vs notes [Pressnell, 1956, page 19], or a late boom in banking in the 1820s and after [Cottrell, 2006, page 25]. Whatever the causes, there seems to have been a systematic weakness in the region, as even contemporaries observed.

On October 25, 1839, the *Times* City column laconically mentions "[a]nother meeting was held last week at Manchester of the unfortunate shareholders and claimants of the Imperial Bank, the affairs of which, not uncommon with joint-stock banking mishaps there, increase in confusion at each successive meeting, and the assets diminish in amount from the exhibit of the first balance-sheet." At a meeting of shareholders for the Bank of Manchester on October 15, 1842 (then collapsing due to losses of £800,000) a shareholder name Grieg stood up and said

[10] This last provision is discussed generally, but a specific reference can be found in the *Manchester Guardian*'s report on January 25th 1837 of the shareholder's meeting on January 23rd.

[11] *Manchester Guardian*, January 31, 1838.

> Now, I say there never was a greater abuse of any word in the English language, than the word "bank." We have had in this town the "Northern and Central" squander. We have had the "Imperial" squander. We have had the "Commercial" squander. We have had the "Manchester and Liverpool" squander and as if the town had not been sufficiently disgraced, we are called together this day to testify to the "Manchester" squander, which, though last, is, I am sorry to say, not the least.

On October 18, 1842, the *Times* reprinted an editorial from the *Manchester Chronicle* about the Bank of Manchester which wrote "let any one realize this single fact - that manufacturing establishments have been deliberately created and carried on with borrowed money to such an extent as to involve the loss - the absolute dissipation - of 1,500,000 *l.* within 10 years, in a single district, and then ask himself what must have been the consequence of such a state of things?"

4.2 The 1850s

The general boom of the early 1850s appears to have led to a substantial amount of fraud. There are four bank scandals the two years before the crisis of 1857 - Strahan Paul and Bates (1855), Tipperary Joint Stock Bank (1856), the Royal British Bank (1856) and the London and Eastern Banking Corporation (1857). Total losses for all four sum to over £2 million, and each of the first three, as a percent of contemporaneous GDP, was of the same magnitude as the Madoff scandal in 2009.

The first scandal, Strahan, Paul and Bates, was a highly respected bank that had experienced large losses. In what seems to have been a last-ditch attempt to recover those losses the bankers attempted to sell some of the securities that clients had deposited (Evans [1859], Robb [2002]).

The second scandal, Tipperary Joint Stock Bank, involved undiluted fraud on the part of the director, John Sadleir. He had used "almost the entire funds" of the Tipperary Bank in speculation in German and California mining concerns, had a personal overdraft of £200,000 and was indebted to the bank for more than £346,000, and the full nature of the amounts involved in forgery by Sadleir were never calculated. He committed suicide that year (Evans [1859], Robb [2002], Bradford [1951]).

The third scandal was the Royal British Bank failure. A manager and two directors of the bank had lent out the bank's funds, unsecured and without informing the other directors, to themselves and their friends, and had falsified balance sheets to cover this. The loans themselves were not criminal, which gives some sense of the state of banking law and practice at the time, but the falsification was. All three individuals responsible were given short prison sentences, and several other directors were as well [Taylor, 2005].

The last scandal before the panic of 1857 began was the collapse of the London and Eastern Banking Corporation in March, where money went directly from the paid-in capital to a number of directors, including £237,000 to Colonel Peter Waugh. On April 3, 1857, the Times Money Market and City Intelligence column included a terse note that Waugh had "retired with his family to the continent."

As the Panic of 1857 spread to the Northeast United States in October [Calomiris and Schweikart, 1991], a number of finance and trading firms collapsed (*London Times*, November 10, 1857) which then triggered the collapse of first the Liverpool Borough Bank and then the Western Bank of Scotland, and finally the suspension (temporary) of the City of Glasgow Bank. The UK Treasury then issued a letter on November 12 temporarily suspending the Bank Charter Act of 1844, allowing the Bank of England to issue notes beyond the Act's limits and hence act as a lender of last resort.

There were three banks where fraud and mismanagement were rife: The Liverpool Borough Bank, the Western Bank of Scotland and the Northumberland and Durham. A parliamentary report in 1858 (cited by Robb [2002]) accused all three of gross mismanagement, false reports and paying dividends to create an illusion of profit. Liverpool Bank had endorsed from £700,000 to £1,000,000 worth of bills with "no negotiable validity at all." Western Bank of Scotland was considered so troubled that other Edinburgh banks broke from their usual practice of supporting troubled banks and insisted that it be closed. The Northumberland and Durham Bank gave a loan of £1 million, without meaningful security, to a single iron company [Thomas, 1934].

Beyond the problems with these banks, there seems to have been an endemic problem of credit fraud across the British financial system and other parts of Northern Europe. The *London Times* repeatedly discussed issues with fraud through November and December of 1857. For instance, the Money Market and City Intelligence column of November 4, 1857 writes:

> In several instances houses which have lately suspended and submitted their activ-

> ities to creditors have been discovered to have followed the practice of fabricating commercial paper....The character of the offense was exhibited in its most despicable light in the case reported a fortnight back of Sadgrove and Ragg where...boys in the establishment were trained to forgery and imposture by being regularly employed in the manufacture of fraudulent acceptances. But these people were altogether of an inferior class and out of the mercantile circle. The analogous facts lately exhibited have been among individuals who held a good place on 'Change and a position generally in which any misdeeds must compromise the British name. In one case within the present week it has transpired that bills were regularly created between one house and another for a trifling commission, with a full knowledge on the part of the acceptor that they represented no business operation whatever.... Some of the knot of Glasgow failures also, which were announced about the middle of last month, are understood to have revealed a combination in this direction of a most gigantic kind, and it is alleged that when the affairs of the Liverpool Borough Bank shall be investigated the public will be still further enlightened on the magnitude of such proceedings.

The column on November 26, 1857 gives more detail on frauds in Glasgow and Newcastle. On December 21st it accused the Western Bank of Scotland of £2 million in losses due to "advances to swindling shippers" and points as well to the Liverpool Borough Bank and the Northumberland and Durham. The *Times* is generally very critical of joint-stock companies and "stock-jobbing" [Hunt, 1969, page 35] but its accusations are supported with instances from Bankruptcy Court cases. That there was a general problem is reinforced by the *Economist*, whose leader on January 2, 1858 discussed the problems of fraud, listing the three problem banks and then stating "[f]ictitious paper has been at the root of all the most flagrant cases of insolvency in the home trade; – fictitious paper, conducted upon a scale and a system hitherto entirely unknown, and in many cases under circumstances which raised so strongly the presumption of fraud, if not of forgery, that it is difficult to believe that those who negotiated it were not aware of its real character."

It thus appears that the transmission mechanism of the Panic of 1857 to Britain was a large system of fraudulent credit transactions between firms in the United States and the United

Kingdom.

4.3 Overend Gurney

The Overend Gurney collapse is famous as the event that triggered the panic of 1866 (Bordo [2003], Flandreau and Ugolini). Overend Gurney was one of the largest discount houses and was one of the two top firms in this area by the 1840s. It had an extremely high reputation, but between 1855 and 1866 the firm appears to have seriously loosened its standards. King and Gregory [1972, pages 245-256], gives a very full description of the process by which an insider, D. W. Chapman, hired Edward Watkin Edwards as an outside advisor, who both paid and recieved kickbacks as part of his role of linking borrowers with the company. By 1860 the discount business brought in £200,000 a year, but the firm was losing £500,000 a year net. The company came to possess a range of assets that had previously been collateral for bills, including two fleets of ships that had belonged to merchant clients[12].

The company was floated as a limited liability concern in 1865, with prospectuses that hid existing debts. The technical defense of this under the law of the time is that this was not fraud since it did not state falsehoods but simply left out inconvenient truths - such as millions of pounds of debts [Hunt, 1969, page 153n]; indeed, the official history of Barclays informs us that this was "perfectly legal" at the time [Ackrill and Hannah, 2001].

The company failed in 1866, precipitating a general financial crisis. Shareholders of the newly floated company brought criminal charges against the directors, accusing them of defrauding shareholders of £3 million. A verdict of not guilty was returned in 10 minutes. (see Robb [2002], Flandreau and Ugolini, Ackrill and Hannah [2001],Ref [1870], Hunt [1969], King and Gregory [1972] for more details).

One reason the Overend Gurney collapse led to a general crisis is that the 1860s had seen the

[12] Powell [1915] gives a story of George Rae, a highly respected banker who did more than anyone else to professionalize the field of banking in Britain, visiting Overend Gunrey before the collapse:

> 'As you are here, Mr. Rae,' said the partner in Overend's, showing him some Liverpool bills, 'I should like to know what you think of these people.' Rae shook his head ominously at some large acceptances by a man he knew to be very weak. The partner then showed him another acceptance, which Rae said was worse than the first, and a third, which was worse than either. Without the slightest hesitation, but yet in a quite casual manner, Rae, on leaving, said, 'By the way, if you have no particular use for that deposit of [Rae's bank], I think it would be convenient for us to have it.'

development of a number of finance companies based on the French model of the *Credit Mobilier* (Hunt [1969, page 147], Kindleberger [1978, page 105-106]) which appears to have led to the development of a general credit bubble.

4.4 City of Glasgow Bank

The last major failure of a British bank in the 19th century was the collapse of the City of Glasgow Bank in 1878 with false statements in the balance sheets totaling £6.6 million. There is considerable evidence of misbehavior by the top management and directors. In addition to having a limited stake in the company, with only 1% of the share, several directors borrowed hundreds of thousands of pounds from the bank. The manager and four of its directors were given prison sentences, for either falsifying balance sheets or publishing balance sheets they knew to be false and given sentences from 8 to 18 months. The collapse destroyed many of its shareholders: "Calls totalling £2,759 per £100 share were made; only 254 of the 1,819 shareholders remained solvent when the affairs of the bank were finally wound up" (see Tyson [1974]).

The City of Glasgow collapse led to the end of unlimited liability banks in Britain. George Rae wrote: " Men began to ask themselves, whether it was not an act of insanity, to continue owners of a description of property, the holding of which had brought even wealthy men to the ground, and hundreds of the well-todo to privation or beggary, with as little warning as an earthquake gives." Immediately after the collapse the 1879 Company Act was passed allowing all unlimited liability banks to convert to limited liability. By 1884 only nine small unlimited liability banks were left [Acheson and Turner, 2008].

4.5 After the City of Glasgow

There is no doubt that fraud both large and small continued after the City of Glasgow, but it seems to have been rarer and more contained. In cases where major fraud occurred, mergers with healthy banks were frequently arranged and appear to have prevented major collapses. Sykes [1926] writes of the Union Bank of Birmingham, which discovered a major fraud in 1883:

"The deception was discovered on the Monday, but by Wednesday an almagamation had been arranged" with the Birmingham and Midland Bank.

The Liberator Building Society which collapsed in 1892 is a case of clearcut fraud, a company that was founded apparently purely to funnel money from the lower middle-class into a group of allied companies with interlocking directorships. Roughly £3.5 million solicited from members, the vast majority of which was lent on risky large-scale building projects [Robb, 2002].

4.6 The "Tip of the Iceberg"?

The cases listed above cover most if not all of the documented cases of high-level fraud in banks in Britain in this time period. However, knowledgeable observers believed that fraud was common, and that publicized cases were only the tip of the iceberg. In 1857, after a particularly bad series of failures, *The Economist* wrote:

> When a bank fails, if it be a private partnership, it always turns out that some of the parties have wasted the depositors' money in speculations, altogether extraneous from the business of the bank, or in a long course of extravagant living; - if a joint-stock concern, in nine cases out of ten the directors have abused their trust, and have made money of the shareholders and depositors subservient only to their own uses.

The justice pronouncing sentence on the directors of the Royal British Bank (who were given prison terms, more below) admitted that their dishonesty and self-dealing were "common practice" [Robb, 2002].

5 *Modi Operandi*

The most famous economics article on fraudulent businesses, Akerlof et al. [1993], describes a process of "looting", where the government guarantees the bankruptcy costs of the institution, thus providing the owners with incentives to choose investment projects with a maximum short-term payoff, regardless of the longterm consequences (which are borne by the government). Only a few of the scandals of the Victorian era go to the extremes of the "looting" model: a few that might qualify would be the Bank of Manchester, Tipperary Joint Stock Bank and the London and Eastern Banking Corporation. In each case large amounts of money were extracted by the inside directors (to the loss of both depositors and shareholders) in a very short period, such that there seems to be little or no hope of the company continuing as a going concern.

The Bank of Manchester collapse was blamed on the managing director, Edmund Burdekin, who disappeared. It's not clear if he was fully responsible and successfully escaped, or if he was partically responsible, and he and his accomplices used his departure and scapegoating to allow all of them to avoid blame.[13]

In the case of Tipperary Bank the culprit John Sadleir does not seem to have had a realistic hope of escaping the collapse or its consequences, and in the event he took his own life. This case should perhaps be chalked up to "idiosyncratic preferences."

The directors of the London and Eastern Banking Corporation had extracted the full value of paid-in capital within two years of its founding. They appear to have successfully exploited the rules to escape consequences. In the Money Market and City Intelligence column of September 30, 1857, the *London Times* wrote:

> The London and Eastern directors adroitly contrived to prevent a public exposure of their acts until they had made an arrangement with a powerful institution [the Oriental Bank Corporation] to take charge of their liabilities in a manner that would lessen the ruinous costs of an ordinary winding up. They could thus say to the shareholders, 'We have misappropriated every farthing of your paid-up capital of 250,000 *l.*, and have incurred debts which will perhaps demand 250,000 *l.* in addition. But you have a few assets which may diminish the loss....Take your choice therefore. Disturb this arrangement by bringing the affair into the law courts, and...you will lose nearly the whole.'

Most of the other cases appear to be hybrid combinations of vanity, knavery and foolishness In the case of Strahan, Paul and Bates, the bank appears to have been run legimately for generations, but then attempted to cover up growing busines problems. The majority of cases appear to have followed in the tradition of the Northern and Central Bank, whereby poor controls and self-dealing were covered up with false accounts and dividends paid from capital. In most of the cases there seems to have been a small group of insiders who held the account books and

[13]The *London Times* on October 11, 12, 15, 17, and 18th, 1842 discuss some of the issues.

falsified them as needed to make the bank more appealing to shareholders.

The collapse of the Liverpool Borough Bank provides some illumination. The directors of this bank regularly published false accounts and authorized dividends in periods of loss. One director named Dixon appears to have made an effort to discharge his responsibilities. In a shareholders meeting in 1858, covered in the *London Times* March 9 1858, he said he had been the youngest member of the Board, "and found it was a custom for all the 'outside' directors, that is, all except the managing committee, to be kept in the dark with regard to the most important proceedings" and speculated that this was common across a number of joint stock banks. In quoting him, the *London Times* lamented that he was probably correct. In lawsuits that followed the collapse[14] he defended himself as someone who pushed back against the senior directors, although his defense is somewhat weakened by the admitted fact that after speaking up to the senior directors, he then followed their guidance completely.

The fates of the perpetrators were wildly variable. John Sadleir may be unique in that he took his life. A large number went to prison, including key directors of Strahan, Paul and Bates, the City of Glasgow and the Royal British Bank. Some were ruined (Braidley of the Northern and Central Bank appears to have been). Others fled, apparently successfully, including Burdekin of the Bank of Manchester, and Waugh of the London and Eastern Banking Corporation. Some seem to have exploited the gaps in the legal code and the difficulties in proving wrongdoing and avoided any serious consequences without having to leave Britain.

6 Consequences

In the most extreme cases the frauds either directly led to or greatly exacerbated systemic crises. The Panic of 1857 appears to have been transmitted to the United Kingdom, at least in part, due to the collapse of fraudulent credit agreements. The Overend Gurney collapse is universally acknowledged to have led to the crisis of 1866. Given that there was no legal finding of fraud in the case, it should be put in its own category, but there is no doubt that opacity and dishonesty were critical to its failure and the subsequent crisis.

While not as extreme as the crises of 1857 and 1866, the failure of the City of Glasgow Bank

[14] Discussed for example in the *London Times* August 28, 1858, November 5, 1858 and January 29, 1859.

triggered runs on a number of banks and led to the failures of six banks in England and Wales. Additionally there was a large-scale liquidity crisis, with the circulation of Bank of England notes increasing 20% and the reserve falling to 28% of liabilities. Unemployment rose to 11.4%, but by the spring of 1879 there seems to have been a full recovery (Collins and Baker [2003, page 91-93], Morgan [1943, page 200]).

In lesser cases there seem to have been local effects. As information on the Northern and Central Bank's problems became more and more serious in the last week of 1836, the *London Times*' Money Market and City Intelligence column described general uneasiness that affected the entire money market. When the Bank of Manchester foundered in 1842 the *Times* gave a report from Manchester[15] saying that "in every branch of the Manchester trade here...a complete cessation is visible to all...In London we are pleased to hear that the country houses have been extremely busy, but so alarmed are they at the stoppage of the Bank of Manchester, that they dare not order Manchester goods." The collapse of the Royal Bank of Liverpool in 1847 led to a report on October 19 of "a most gloomy apprehension in commercial circles" and on October 21 "[a]spect of affairs to-day is still most gloomy." There are few visible movements in the price of consols or interest in such cases, however.[16]

In effectively every case the collapse was very destructive for shareholders who were either too honest or too slow to escape their debts. The most extreme examples are from Scotland. The City of Glasgow failure's impact was discussed above. The collapse of the Western Bank in 1857 led to a relief fund for its shareholders and depositors. On January 28, 1858 the Times mentioned in passing reports of insanity and death, or flight, among the shareholders of the Western Bank. On September 9, 1858 the Times discussed the fact that the fund, then nearly £9,000, was completely insufficient to assist "the mass of existing misery" and observed that many of the victims were "beyond help," describing the case of a retired merchant who died "of a broken heart" after "the whole of his ample fortune [had] been swallowed up by the Western Bank of Scotland." [17]

[15]October 17, 1842

[16]On a happier note, the *London Times*, always suspicious of speculation, claimed on September 18, 1858 that business in Manchester was better than ever, thanks to the collapse of the Liverpool Borough Bank, and the attendant loss of credit for speculators.

[17]The suffering brought on by the Scottish bank collapses tended to bring out the disapproval of the English papers. A particularly aggressive *Manchester Guardian* editorial of October 11, 1858 wonders at the Scottish character, and approvingly references a description of Glasgow as a "whisky-drinking joint-stock-bank-breaking town."

In some cases the bank or institution was purchased by another concern. If the bank was "wound-up" it would frequently take years; the Commercial Bank of England held its final shareholders meeting in 1852, more than a decade after it collapsed.

One benefit following from the collapses is the lessons that other institutions took from them. Collins and Baker [2003] show that English banks significantly reduced their risk exposure in the wake of the City of Glasgow, increasing liquid assets (but also reducing lending). Loopholes in existing corporate law were first seen and then mitigated in the wake of frauds; until the law was changed, the "outside" shareholders of the Northern and Central Bank had no way to sue the "inside" shareholders for their failure to pay their share of the capital calls.

7 Diminishment

What are the causes of the overall decline in fraud in the banking and financial system through the middle and later 19th century? One group of causes seems obvious - a general increase in stability stemming from an increase in experience and sophistication among joint-stock bank management and a larger size and professionalization of the banks that existed (the "fittest" that survived, as it were). Regulation arguably helped, although there were not major shifts after 1862. The change from unlimited to limited liability seems to have actually helped matters.

7.1 Stability

The increase in stability (or if you prefer, decrease in instability) seems certain. Sykes [1926, page 98] estimates that from 1825 to 1915, 387 private banks were merged into other banks, and 165 simply failed (2 survived). For joint stock banks over the same period, he estimates 220 disappeared, of which 167 were merged into other banks, and 53 failed (13 survived). The evidence suggests that the rate of failure was particularly high in the earlier periods, and the rate of amalgamation higher in later periods. Sykes [1926] writes on page 109 that there only a very small number of amalgamations from 1825-75. From [Hunt, 1969], page 157, we get data from 1844 to 1868, when there were 291 banking and finance companies formed, of which only 49 survived to 1868 - an 84% attrition rate, compared with 56% attrition for all joint-stock companies in the same period . Even taking into account the substantial amalgamation during this period, with an average of over 2 bank mergers per year from 1844-61, and over four bank mergers per year from 1862 to 1889 [Sykes, 1926, page 31], it still seems likely that nearly 200 of these banking and finance companies went down as failures.

The twin processes of failure and amalgamation led to a small group of very large banks by 1901. In 1835-36 407 private banks and 100 joint stock banks were registered in England [Hunt, 1969, p. 79n, no data on branches] . By 1850, in England and Wales there were 426 banks with 1094 branches (including both private and joint stock banks. By 1900, the year before Victoria's death the number of banks had fallen to 164 (roughly equal proportions of private and joint stock) but the number of branches had expanded to 4,570 (almost all belonging to joint stock banks) [Pressnell, 1956, table 10.5 p. 275], and the five largest banks had 27.7% of the deposits, each having more than 30 times as many deposits as the Northern and Central Bank [Collins and Baker, 2003, table 6.1 p. 109].

The deposits increased roughly in line with the growth in branches. Pressnell [1956, table 10.4 p. 275] shows deposits in England and Wales going from an average of £107 million in 1848-52 to £366 million in 1873-7 and £664 million in 1898-1902. Scotland grew as well but at a slower rate from £35 million in 1848-52 to £105 million in 1898-1902.

This expansion in size was combined with more systematic internal controls and training of staff.

In the 1870s, formal training in banking expanded. The Gilbart Lectureship in Banking was established at King's College, London, and the Institute of Bankers was founded in 1879. Accounting seems to have become more formal during this period as well [Robb, 2002]. Collins and Baker [2003, pages 153-156] quote extensively from a 1907 manual on the change in the banking career path:

> A bank was at one time, not very distant from the present, considered a harbour of refuge for the young man who did not care to face the rough and tumble of ordinary commercial life, and who lacked the means or opportunity of entering one of the learned professions. The duties were light, the prospect was certain if not brilliant, and the stigma which at one time attached to trade was avoided. But times have considerably changed since then....The most successful man, at all events in the lower ranks of his profession, is the one who can get through a

> lot of work with the fewest possible mistakes. Thoroughness is the first thing to aim at...The first thing which every bank clerk should aim at is the cultivation of a legible and neat style of handwriting, and of figure formation.

Another quotation Collins and Baker [2003, page 156] from the memoir of someone who started as a clerk at Barclays in 1900 gives more evidence of the careful and more restrictive management of the late Victorian era:

> In those days it was eight years before the junior clerk was entrusted with a ledger, ten perhaps before he was allowed at the counter...I did try to invent new ways of sealing letters and stamping envelopes, and was severely sat on for my pains. The type of Victorian who laboriously won his way to a post of authority in the bank from the lowest rung, could never see why a junior who succeeded him should escape the same treadmill.

The use of professional auditors was an important shift. The numerous acts regulating incorporation from 1844 to 1862 changed tack on the use of audits several times. The Act of 1844 required it, but the later acts, particularly 1856 and 1862, dropped it as a requirement but retained it as a choice. The Fraudulent Trustees Act of 1862 made it illegal to deliberately circulate false accounts with an intent to deceive or defraud, and thus provided increased pressure for audits, which appear to have been general by 1870. With this came an increasing professionalization of the role of auditors and accountants generally. One expert writing in 1857 advised directors to avoid "*dilettanti* auditors" and the Economist observed in 1866 that "acountants were becoming a profession like lawyers." In the wake of the City of Glasgow collapse compulsory and independent audits were legislated (Hunt [1969, pages 140-142], but for a more skeptical view, see Walker [1998]).

7.2 Unlimited Liability

In addition, the legal institutions that undergirded the banking sector had shifted significantly. As discussed at the beginning, in 1837, with the exception of five "semi-public" banks, every bank in Great Britain, either private or joint-stock, was unlimited liability. Limited liability first became available to English banks in 1858 and by the 1870s there were 42 limited liability banks in England and one in Ireland. After the City of Glasgow failure the Companies Act of 1879 was passed, which allowed for reserve liability (similar to the idea of double liability). By 1885 there were only a few small unlimited liability banks left in England [Acheson and Turner, 2008].

Both commmon sense and economic models would predict that the greater risks of unlimited liability would give shareholders a strong incentive to monitor bank management and avoid large-scale fraud, while limited liability limits and possibly eliminates such incentives. It is therefore striking that the stability of British banking increased over a period where unlimited liability disappeared. Closer examination suggests that this pattern is not simply a spurious correlation, but in fact is due to fundamental problems with implementing unlimited liability in practice.

Some of the problems are predicted by theory. As discussed in the background section, one important issue is preventing shareholders from dumping the stock in case of collapse. At the very onset of the joint stock banking era this generated serious problems. The October 25, 1839 Money Market and City Intelligence column of the *Times* observed that the Imperial Bank had only 132 registered shareholders at that time, while the original list was 657; there seems to have been a great deal of stock trading that was not carefully registered. This problem does not crop up as much later on and it seems likely that registration was tightened.

A more serious problem is adverse selection. One of the equilibria discussed above is an "unravelling" where low net worth shareholders buy up the shares, leaving the unlimited liability moot. This issue was something contemporaries were very sensitive to. For example, a September 18, 1856 editorial in the *London Times* on the Royal British Bank reviews the list of shareholders and comments:

> The "Royal British Bank" [sic] has entrapped 28 spinsters, but only 10 widows. Then, mixed with the general throng, come butlers, household servant male and female, clerks, small shopkeepers of all kinds, publichouse keepers, artists, and 'gents'. In short, we find ourselves among a class of small people of all sorts, who, we know, live entirely outside of the great commercial world, are wholly unacquainted with trade on a large scale, and to whom, therefore, all the machinery of this great world of business and all its proceedings are as simple mysteries as if they were matters of another world....Cast your eye over this list, and see what a column and a-half [sic] of securities substantially comes to. Here are, in the

> first place, 67 "gents," 28 spinsters, and 10 widows, dispersed over all the towns and counties of England. Here is a pretty intricate and manifold legal machinery which you put into motion! Imagine bringing down the full arm of the law upon countinghouse clerks, hucksters, small shopkeepers, menservants and maidservants, spinsters, widows, and "gents," dispersed over the whole of England! It is obvious that such a security exists in name rather than in substance, and that when you have pleased yourself with the show it makes upon paper you have got the principal part of it. It will be found that the real responsibility – all that is worth calling such – lies, after all, in a few good names out of the whole list.

In these discussions of the net worth we can also see (in addition to class snobbery) a concern that adverse selection might not just eliminate investors with money, but investors with sense. A *London Times* editorial of March 26, 1859 discusses such a scenario explicitly, arguing that only a small minority of capitalists dared to become involved in unlimited liability concerns.

A further problem with unlimited liability in practice was that, while it might eliminate moral hazard issues with the shareholders, in many instances it worsened moral hazard with regard to the debtors of the company, who were inclined to suppose themselves completely insured in the case of bankruptcy. On January 28, 1858 the *Times* argued that "[w]hen the credit of [an unlimited liability] bank was...questioned...the names of these [wealthy] gentlemen were always paraded to allay any thought of vigilance" and on March 26, 1859 argued that unlimited liability "provided...companies...with excessive credit, and inoculated them with corresponding ideas of extravagance." Another observer argued that "the credit of a partnership of limited liability will be limited also" and not governed by "a vague estimate of property supposed to exist independently of the business" [Hunt, 1969, page 129].

The root issue appears to be that the unlimited liability structure depended critically on a core group of capable, wealthy, responsible, cooperative insiders. If the inside circle was responsible, as in the cases described in Hickson and Turner [2003], than an outsider could do well. But for any of the collapsing joint stock banks described here, the outsiders suffered badly, even to the point of insanity or death. For an outsider shareholder (of any level of wealth) buying a share in an unlimited liability bank was like buying a lottery ticket, albeit one with at least as much downside as upside. It was this opacity and randomness that seems likely, more than anything else, to have led to the gradual extinction of the structure.

8 Conclusion

I have reviewed the issue of high-level fraud across the British financial system in the Victorian era, focusing particularly on joint-stock banking in England, but looking at a range of institutions of the period, across the United Kingdom.

Fraud at the high levels of financial institution management appears to have been a major issue across the period, with serious consequences for shareholders, depositors and the general public. The early years of joint stock banking were particularly problematic, with particular problems during the boom years of the 1850, and in the Lancashire region.

Evolutionary change in the culture and experience of bank management seems to have been critically important. Regulatory changes made some difference, and the development of limited liability in place of unlimited liability appears to have played a role.

The review of fraud in this era offers a few lessons for financial regulation in our time.

First, radical changes in legal structures can create instability that may take decades to resolve. There appears to be a learning process in the early Victorian era as bankers and bank shareholders came to understand the new joint stock bank structure. The process of learning took at least from 1826 to 1857, and arguably until 1879.

Second, the uneven performance of unlimited liability presents a cautionary tale about financial institution structure; both theoretical and practical arguments supported the use of unlimited liability, but in practice it seems at best to have been moot, and more likely destabilising.

Finally, the role of culture and common expectations in supporting stable operations should not be overlooked. One of the most important changes of the last part of the Victorian era is the development of a professional banking and accounting culture.

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