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Agents, Bills, and Correspondents through the Ages:

An Analytical Reconsideration of the Nature, Scope, and Significance of Correspondent Banking and its Application in Historical Precedence and Selected Case Studies

by

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Dept. of Banking & Finance

Doctor of Philosophy

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Abstract

For the past 700 years, processing payment transactions has largely relied on correspondent banking arrangements. Yet, this critical banking business has been unduly neglected by researchers. Much of the meagre literature on it has failed to provide a consistent definition of correspondent banking that clearly identifies protagonists, possible structures and differences to other forms of representation. Often the invention of correspondent banking is linked to the banking practice of Renaissance Italy. However, correspondent relations are much older. Thus a more comprehensive history of correspondent banking is needed. In addition, there has been a dearth of analytical work on the precise – and multi-faceted – market micro-structure of correspondent banking mechanisms to achieve international fund transfers.

In this thesis, first, the scale of the correspondent banking model, its advantages and risks are laid out within the context of the current regulatory environment. Then the analytical framework, including new classifications and criteria, is developed to examine the nature, scope and significance of correspondent relationships. Based on this, an early history of correspondent banking is offered, which includes ancient and Arabic precedents that are often overlooked. Adopting a historical methodology and making use of important case studies, we contribute to filling the gap in the literature on market microstructure, offering a hitherto missing analysis of the various transaction and interaction modes in correspondent arrangements. This covers the role of agents, bills and other financial instruments used in correspondent transactions. One case study from the late 17th century, based on original archival work, involves the newly founded Bank of England. Established to raise money to fund a war and pay the troops abroad, we show it used international fund remittance methods that had been in operation well before the Bank of England was established – and on several occasions did not act as the principal source of the funds; instead, in key cases foreign correspondents were used. We conclude that a new classification of remittance payments is required that allows for *transaction cycles*, mainly involving bills of exchange and letters of credit.

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Chapter 1 Introduction

"U.S. banks, through the correspondent accounts they provide to foreign banks, have become conduits for dirty money flowing into the American financial system and have, as a result, facilitated illicit enterprises, including drug trafficking and financial fraud."[1]

These are harsh words from the US Senate, describing at the turn of the millennium the effects of a banking method that originated in its modern form in medieval Europe and that prevailed – in many aspects unchanged – until today: correspondent banking.

In the last two decades, one of the oldest banking models (re)earnt unexpected, though rather doubtful, prominence. What caused this? In the aftermath of the horrible attacks on the towers of the World Trade Center on September 11, 2001, policymakers, academia and practitioners in the financial sector were abruptly exposed to shady channels of terror financing. Correspondent banking gained attention as a probable tool for extensive money laundering and financing organized crime and international terrorism. In the following years more and more countries were accused of not offering sufficient supervision and regulatory standards to tackle these risks, and for facilitating pathways for clients of correspondent banks to, for example, evade sanction regimes.

How could a globally fully-established banking method unnoticedly drift into such stormy waters? Why were not adequate (inter)national norms in place to mitigate the dangers of misconduct? All too often, the lack of efficient international rules is based on the inability to find an undisputed definition of the method that needs to be

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[1] Minority Staff of the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs of the United States Senate (2001), p. 1.

regulated. Alternatively, the common denominators are only a reflection of vagueness and imprecision - inviting elusiveness and circumvention of the original intentions.

Superficially, the proper definition of a correspondent bank seems to be a simple undertaking. It could be described as a financial institution that frequently conducts or provides services for another financial institution, which is typically located in another country or market area. Does this fulfil our expectation of a solid intellectual basis for effectual regulation? Barely, as viable and globally enforced standards were not noticeable; and, most likely, they would not have led to the latest scandal-driven reputation of correspondent banking combined with hectic regulatory efforts by lawmakers around the world.

But not only the standing of correspondent banking can be considered as damaged in our days - even the concept is facing sudden and existential challenges. For the past nearly 700 years, processing payment transactions has remained almost inconceivable without correspondent banking arrangements, and significant elements of this type of banking were already developed in ancient times. However, in the wake of the so-called "Fourth Industrial Revolution"[2] that has started to reshape and disrupt a plethora of traditional societal and business structures at an unprecedented pace, we are facing dramatic shifts of influence in the banking sector because of new technologies and the companies driving them. Besides rapid advances in the fields of artificial intelligence, big data analytics and the "Internet of Things", to name a few, it is the invention of the blockchain and so-called distributed open ledgers that could fundamentally rewrite correspondent banking. We may call it one of the most prominent sectors that is not as well understood by practitioners and researchers as it should be, and one of the most threatened by these inventions. Some observers are prompted to ask: "Will Bitcoin Finally Bring Down the House of Medici?".[3] A lack of detailed knowledge of an existing model could possibly lead to significant regulatory deficits regarding a

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[2] This term can be disputed as the latest technological breakthroughs are only marginally connected to a traditional "industrial" understanding.

[3] Morehead (2015).

substituting (or parallel) method.

Despite its size and undisputed importance, the banking literature has all too often treated the field of correspondent relationships like an orchid. In some cases, it would have just been a small analytical step from an impressive body of research on the history of financial markets to encompass the central roots of correspondent banking.

Take the findings of the eminent historian de Roover (1944) as an example.

> "The Italians especially were clever in replacing specie by other devices in the settlement of debts. Their ability in this respect much impressed foreign observers [...] A French Satirist, in the fifteenth century, marveled at the ability of the Italians to do business without money. In dealing with them, he said, one never sees or touches any money; all they need to do business is paper, pen and ink."[4]

Notably, a doyen of banking history does not mention correspondent banking. Still, he describes decisive elements like the underlying bookkeeping methods and specie-less settlement.

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Research on correspondent arrangements is characterised by remarkable terminological chaos, not only regarding its definition. With this thesis we try to counter such unsatisfactory results. As a first step, we strive to overcome the negative consequences of obvious confusion by thoroughly exploring the large scale of the correspondent banking model, its risks and advantages and current regulatory developments.[5] For centuries (and until today), terms like "agents", "branches", and "correspondents" were mistaken or used synonymously. As indicated above, a clarification is also essential for existing and future

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[4] De Roover (1944), p. 381.

[5] See below, Chapter 3 1.

regulatory efforts that are repeatedly built on vague or even misleading definitions.

Therefore, we don't limit ourselves to merely developing a new *system of factors of correspondent relationships* as a precondition for our wider-ranging *parameters for the identification of correspondent arrangements*: we also offer the necessary additions to the existing lists of risks and disadvantages of this banking method (geographical, geopolitical, technological and reputational risks). It needs to be mentioned that "cross-cutting risk clusters" (societal, economic, geopolitical, technological, and environmental risks) have also been overlooked by researchers so far.

An in-depth look into the regulatory specifics of correspondent banking exposes this method as a primary example of the aim and cause of a *private-public regulatory hybrid*, where (inter)national public-sector regulation is accompanied by a remarkable amount of self-regulation through the industry.

In order to achieve an overdue and concise classification, former and existing forms of correspondent relationships need to be clearly distinguished from any other type of inter- and multinational banking, respectively, from alternative forms of representation for financial institutions abroad.[6] On the national level of some jurisdictions (and major economies like India and Brazil), we also have to differentiate correspondent banking from so-called "banking correspondents". We will introduce a more fitting terminology of the latter, namely "business correspondents".

The second pillar of our examination of modern correspondent banking is based on an ostensibly trivial assumption: any new perspective and definition of correspondent relationships have to be compared with the broad spectrum of existing descriptions, mirroring the usage in the academic and practical world of banking and finance. This also requires a closer look at accounting methods and a critical view on the "dogma" that

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[6] Chapter 3 2.

correspondent relationships necessarily need a vostro/nostro account relationship.[7] In addition, as correspondent banking does not occur solely between commercial banks, we evaluate which parties can be involved in a correspondent banking arrangement.[8]

We accordingly establish a concept of *first-* to *third-order correspondents and respondents*, depending on their degree of services offered, their accounting methods, and whether they hold a banking license. Consequently, central banks, the CLS Bank, the Bank for International Settlements (BIS), or even clearing houses can be and are parties in correspondent arrangements. Lastly, correspondent relationships throughout history are unthinkable without functioning clearing and settlement procedures. By developing *criteria for clearing, settlement, and payment systems*, we show that even certain payment systems can be parties in a correspondent relationship.

As we demonstrate that a correspondent (banking) relationship does not necessarily need a bank on the correspondent's and/or respondent's side, the majority of all definitions related to this method are flawed; some of them can even be perceived as completely incorrect. Specifically, in the light of technological innovations, a "bank-only" approach bears the risk of a growing number of loopholes in the regulatory landscape. Thus, we suggest a definition that does not concentrate solely on correspondent "banks" any longer, but uses the term "institutions" instead, as correspondent banking relationships are traditionally liaisons between financial institutions. In addition, we recommend an alternative terminology to *correspondent banking* and consider the expression *correspondent relationship* or *arrangement* as less deluding.

Overall, our differentiated view has the potential to contribute to the appropriate design of international financial regulations, which currently seem to be mainly ad hoc. A consequential call for international standards and a coherent regulatory landscape that lead to predictable compliance costs and also imply those players that are important for a functioning and affordable international payments network has to be based on a systematic

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7 Chapter 3 3. and 3 4.

8 Chapter 3 5.

and essential categorization of correspondent relationships – an effort that shapes the first main part and focus of our thesis (Chapter 3).

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The second major part of this thesis (Chapter 4) consists of a novel historical view on the origins of correspondent relationships. To this day, a history of one of the oldest models to enable payment transactions and to facilitate international trade relations has not been written. Such an intellectual vacuum in banking history is remarkable. However, both the noteworthy absence of literature and the aforementioned imprecision regarding terminology, definitions, and concepts of correspondent relationships throughout centuries are obviously two of the main reasons why we are still short of a thorough historical review. Thus, our decision to first explore the state of play of correspondent banking today before moving into darker corners of past centuries was a logical and necessary analytical step; in order to achieve convincing results from the study of the history of correspondent relationships, we needed to tie our approach on (more or less) timeless findings, categorizations and parameters that we developed throughout the preceding chapter.[9]

Only a small number of (the few) research papers concerned with correspondent banking would touch upon facets of its historical development. However, none of them widens its scope to a period further back than 14th century Europe - based on the incorrect assumption that the place and hour of birth for this banking model is to be found in some northern Italian cities during the Renaissance. This view entirely excludes earlier concepts emerging from ancient times, which already bear crucial components of correspondent relationships. We try to close this gap by examining the period from a time when the first elements and features of banking emerged (in ancient Mesopotamia) until the 15th century.

[9] This is also the reason why we place the description of our methodological approach between the description of today's understanding of correspondent relations and the examination of the past (at the beginning of Chapter 4). Referring to our findings in Chapter 3, we lay out the prerequisites for a historical analysis of correspondent banking, including *parameters for the identification of correspondent arrangements* in Chapter 4 1.

A historical analysis of the business of correspondent banking, its roots, role, justification and mechanisms serves several functions: it builds a concise and logical bridge to the methods that merchants and merchant bankers started to install in the Late Middle Ages across Europe; it will contribute to the history of international banking, accounting, foreign exchange, trade, transactions, markets and to the history of settlements; it offers an opportunity to learn from mistakes and to understand the essence of correspondent banking; it creates a broadened intellectual basis for current and future regulatory challenges, as well as for the validity of any new concepts; and - as we are on the threshold of a period that can be called "digital de-banking of correspondents" - the past may give us some ideas of central elements of modern structures that may substitute classical correspondent relationships.

It is certainly true that since Renaissance Italy, correspondent banking arrangements have developed from an innovative and useful activity into an essential strategic tool of global banking. But our findings will help put the role of Tuscan and Venetian merchant families in the 13th to 15th centuries into a different and more realistic perspective: from – as inflationary described – unique innovators to, undoubtedly, highly creative refiners of already existing structures and patterns.

In fact, the origins of correspondent relationships date back millennia. After the first elements of transaction banking in Mesopotamia[10], including rudimentary aspects of letter and bill arrangements[11], we find strong indicators of a correspondent system in ancient Greece, fourth century-Egypt under the rule of the Ptolemies and connected trade activities on the island of Delos[12]. Several structures of the latter served as a model for Roman

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[10] Chapter 4 2.a.

[11] We are also exploring the interconnection of correspondent banking to bills of exchange and letters of credit. Both instruments have ancient origins and grew into a widespread practice of payments over long distances.

[12] Chapter 4 2.b.

banking activities. Rome's increase of far-reaching trade and other business activities was the precondition for advanced payment and financial intermediation methods. Although there were no institutionalized clearing and settlement houses in Rome yet, clearing and settlement took place in a rather informal, or even semi-formal way. Step by step, structures of interbank correspondent arrangements under which one bank held funds in account with the other emerged in the Roman business world.[13]

But it would be insufficient to limit our view to Greek and Roman influences. Studies on Western banking history regularly lack a deeper examination of innovative developments and stimuli emerging from the Near East. These were partially parallel – and interconnected with - Greek and Roman efforts to establish a sustainable system of finance and banking. Note the advancement of the "*sakk*" or cheque system during the Persian Sasanian Empire (224-651 AD) and later the invention of the payment instrument "*suftaja*". The latter can be described as a loan of currency to be repaid by the borrower in a different place, thereby resembling essential features of letters of credit. Both the "*sakk*" and the "*suftaja*" include many parameters for correspondent relationships.

Our excursion into early Islamic trade and transaction methods[14] helps us categorize the relevance of another often neglected medieval group that was involved in long-distance payments and international transactions: the Crusaders. They were most probably building on knowledge gained from Jewish and Arab merchants about the instruments "*hawala*" and "*suftaja*". In combination with the influence of innovative Italian merchants, the Crusaders could rely on a firm and eclectic basis of financial knowledge. They established a network of branch offices and also used correspondent relationships.[15]

In summary, a long prologue for a new chapter in finance and international trade was written from Babylon to the Crusaders. Then, emerging from Italian cities, Europe became

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[13] Chapter 4 2.c.

[14] See Chapter 4 2.d.

[15] Chapter 4 2.e.

an epicentre of creativity in finance and banking. However, Renaissance Italy was less a focal point for a *revolution* in banking than the fulcrum for its productive, though somehow logical, *evolution*.

In medieval Europe, we find interbank arrangements in Genoa to enable non-cash payments between different accounts held at other banks, and mainly money changers in this city established a local correspondent system in the 12th century. In the late 13th and early 14th centuries, these structures were refined in Venice. Particularly in Tuscany, several banks increasingly concentrated on an outreach beyond town borders. Based on local experiences and influenced by merchant activities abroad, some influential families (pre-Medici) soon developed an approach to transfer capital across borders for trade reasons. Correspondent relations were not their first choice, though. Rather, they built up a network with elements of representative offices and branch structures ranging from Avignon to the Champagne fairs and beyond to Norman Winchester (St. Giles fair), and later from Lyons or Antwerp to London or Hamburg with salaried, dependent employees. However, the medieval fairs, not only in Champagne, but also in Brie and later in Geneva or Besancon amongst other places marked a turning point for correspondent banking.[16] These were the places where transactions, payment settlement, and foreign exchange activities were facilitated via currency bills of exchange and other more-or-less innovative methods. On the one hand, representatives abroad gained higher degrees of independence and offered a wider spectrum of services. On the other, independent merchants or representatives of additional merchant bankers or families would offer similar services. These are all attributes distinguishing correspondents from types of representation that are tightly connected to a parent (merchant) bank.

The first Italian merchant family that fully understood the opportunities and disadvantages of different forms of representation – agencies, branches, correspondents, or subsidiaries – was the House of Medici.[17] Diversification, historical knowledge, flexibility, and growth were the pulse of the Medici organism. It was their

[16] Chapter 4 3.a.

[17] Chapter 4 3.b.

way to minimize and spread their risk factors – a method that sounds familiar in our days. It is not an exaggeration to call the Medici truly international bankers. However, it would be an overstatement to see them as the inventors of an international transaction and finance system.

In more general terms, we conclude that Renaissance Italy, namely Florence, Genoa, Venice[18], or even the fairs in southern and central Europe are far from being birthplaces for correspondent relationships, letters of credit or bills of exchange. But *modern* Western correspondent banking emerged from the networks of Italian families that started to take shape across Europe.

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After briefly touching upon selected influences on correspondent arrangements in the 16th and 17th centuries in (continental) Northern Europe[19], we are narrowing our focus on England (Chapters 5 and 6).[20] The development of correspondent relationships in English history before the founding of the Bank of England (1694) has not been sufficiently covered so far. In Chapter 5, we explore England's historical fundaments for this choice of representation abroad. Based on our knowledge gained in the preceding chapters, we aim to prove that the use of cashless transaction methods by English merchants was already highly developed in the 14th century and that remittance payments from England through intermediaries and by means of bills and letters to fund soldiers overseas occurred in the 15th century. The predominant practice was the utilization of bills of exchange that paved the way for trans-European trade on the basis of the Italian re-invention of an ancient idea.[21]

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[18] See more details on correspondent banking in medieval Venice in Chapter 4 3.c.

[19] Chapter 4 4.

[20] Yet a full coverage of the time frame between the 16th and 20th centuries needs to be offered by a later study as it would go beyond the scope of this thesis.

[21] Chapter 5 2.a.

Yet, it is a myth that only Italian merchants supplied other merchants with money for trading as the English court records of those times revealed. As early as in the 14th century, we find so-called "*letters obligatory*", including assigned parties with features of correspondents for the settlement of debts. Other documents, like letters of attorney, hint to the growing involvement of England's merchants in correspondent structures. Since the 15th century, Antwerp grew into the position of the "intellectual initiator" for the refinement of trade instruments used between and both on the continent and with England, which involved agent- and correspondent relationships.

Finally, the role of an English "speciality" – the goldsmiths - in correspondent arrangements is also highly undervalued. They were heavily involved in domestic and international transactions where they gradually cultivated networks, in which, they used correspondents and acted themselves as such intermediaries in *inter-goldsmith correspondent networks* and, from time to time, appeared as *dual correspondents* when being involved in two different locations.[22] They became important parties in remittance payments to troops across the Channel via bills of exchange decades before the founding of the Bank of England, thus setting standards and examples of structuring these complex undertakings. But, not only correspondent relationships were well-known structures familiar to England's finance community; even correspondent *banking* had already been discussed in the early 17th century and therefore well before the Bank of England was established.[23]

Across Europe, correspondent relationships and other methods of international banking were used over centuries not only to facilitate trade but also to finance wars and bellicose conflicts abroad. One example coincides with a milestone in banking history: the inception of the Bank of England. At the end of the 17th century, the English crown had enormous difficulties paying for its commitments during the Nine Years' War with France (1688-97). In connection with public needs for war loans, some London merchants aligned their private profit expectations with the idea of forming the Bank of England. However, the crown not only needed money, but also had to tackle the problem of paying the troops in the

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[22] Chapter 5 2.b.bb.

[23] Chapter 5 2.c.

Netherlands, which was not resolvable by simply creating a privately held financial institution in the City of London. A reliable system had to be put in place that allowed long-distance remittances to the troops in Flanders.

And although most of the models that the Crown and English bankers, respectively merchants, used and discussed during the Nine Years' War were not innovative achievements of the late 17th century (as shown in Chapter 5), the result was less methodical than expected. A plethora of options were tried out, and a good number were dismissed or sacrificed due to external factors like foreign exchange rates. Still, many of them were not only based on models tied to bills of exchange and letters of credit, but also – and this had been neglected by literature so far - on correspondent relationships.

Considering numerous primary sources from archives across the UK, we gain a clearer picture of the different methods of paying war remittances during the Nine Years' War in Chapter 6. Based on the analysis of entry books, ledgers and receipts of the players involved, as well as the works contemporary authors, we offer a new classification of remittance payments: Instead of just pointing at the (sometimes multiple) protagonists of domestic and international transactions, we identify and illustrate *transaction cycles*, mostly involving bills of exchange (but also letters of credit), which follow the course of these notes from their moment of being drawn to the last step when they are cashed in. Due to the fact that before and after the launch of the Bank of England the relevant players in a bill- or letter-based transaction (drawer, drawee, payer, payee, principal) regularly changed, this method and clarification is an indispensable step to avoid further confusion in the literature. Building on the trade experiences of earlier centuries, England established a *pan-European chain of bills and letters* to enable remittance payments for its troops abroad – especially in the multiple bill cycles, where correspondents would use their network of agents and other representatives across the continent to balance their own accounts.

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With our analysis, we try to close another gap in the literature that spans over all chapters in this thesis: Correspondent arrangements have not yet been embedded in a *functional approach to finance*.

Still, it would have to fulfil a few key preconditions. Echoing Merton (1995), the functional perspective "takes *as given* the economic functions performed by financial intermediaries and asks what is the best institutional structure to perform those functions."[24] His "six core functions performed by the financial system"[25] are thoroughly developed and need to be part of any research covering the inception, development and status quo of a banking or other financial services method.

However, in order to cover historical developments in finance and banking spanning over millennia, a more generalized view seems more appropriate. This is especially if we take Merton's words into account that "the *basic functions* of a financial system are essentially the same in all economies – past and present, East and West."[26] Iqbal and Llewellyn (2002, pp. 3-4) identify "four universal functions of a financial system" which do not contradict Merton's (1995) and Merton and Bodie's (1995) findings. But they imply them, offering a wider and historically probably more flexible scope.

The first function of this academic approach is to provide financial intermediation services, thereby channeling funds from "ultimate savers to ultimate borrowers" and removing

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[24] Merton (1995), p. 23, based on Merton (1993) and Merton and Bodie (1995) who offer in-depth discussions of the functional perspective as a tool of analysis in the field of banking and finance.

[25] With the basic understanding that the primary function of any financial system "is to facilitate the allocation and deployment of economic resources" Merton (1995), pp. 23-4, describes his six functions as follows: "Function 1: A financial system provides a payments system for the exchange of goods and services. Function 2: [It] provides a mechanism for the pooling of funds to undertake large-scale indivisible enterprise. Function 3: [It] provides a way to transfer economic resources through time and across geographic regions and industries. Function 4: [It] provides a way to manage uncertainty and control risk. Function 5: [It] provides price information that helps coordinate decentralized decision-making in various sectors of the economy. Function 6: [It] provides a way to deal with the asymmetric-information and incentive problems when one party to a financial transaction has information that the other party does not."

[26] Merton (1995), p. 23.

budget constraints during this process. We will see that correspondent relationships from their first moments in ancient Greece to medieval trade constellations (Chapter 4), and as part of war remittance efforts in 17^{th} century England (Chapter 5 and 6) fulfil this *intermediation function* as much as they do nowadays (Chapter 3). Therefore, a sub-element of this first function, namely "facilitating the movement of resources between agents, over time and across space"[27] needs to be widened with the term "correspondent". Undoubtedly, correspondent relationships provide a broad range of other financial services than only intermediation, ranging from payment services to transactions, clearing, cash management and trade related services (Chapter 3 and, historically, Chapter 4), and thus comply with the second *financial services function*.

All accounting methods used in correspondent arrangements, regardless of whether they are tied to the typicality of nostro/vostro accounts (which is – as we will see in Chapter 3 – not a necessity), also reflect the third function: creating a wide spectrum of assets and liabilities with distinct characteristics regarding, for example, liquidity or certain risk-sharing elements. We witness nascent components of this *asset and liability function* already in ancient Mesopotamia (Chapter 4). Finally, correspondent arrangements are even mirroring the fourth central characteristic of a financial system, "the creation of incentives for an efficient allocation of resources within an economy, and the allocation of scarce financial and real resources between competing ends."[28] We not only underline the role of correspondents for this *allocation function* in today's environment in Chapter 3, but specifically offer case studies of (war) remittances and instruments to facilitate long-distance trade via correspondents in Europe and (in great detail) in England until the late 17^{th} century in Chapter 5 and 6. It is astonishing that one of the oldest banking methods, namely correspondent banking, has not yet been properly connected with the eminent research on the functions of a financial system.

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[27] Iqbal and Llewellyn (2002), p. 3.

[28] Ibid., following Merton's (1995), p.23, "primary function"

A few millennia ago, financial interlocutors started their services mainly at a local level. Step by step, they – and institutions replacing them - expanded to other markets, conducting business on behalf of their customers and of themselves. Today, we face globally intertwined markets, where geographical borders are still in place (and nationalistic elements resurging); yet, these traditional borders tend to be dwarfed by the boundlessness of the digital revolution. Correspondent banks, though, or maybe even because of that, are still in place. And despite the potential fundamental disruption of the services through new technologies, we might be confronted with a transition period where the old and modernized systems will have to co-exist. It is also not excluded that due to political pushbacks and regulatory barriers, the most radical forms of distributed ledger/blockchain solutions will be forced to "realign" with traditional elements of correspondent banking. While there is currently no shortage of descriptions or analyses in media – and, increasingly, also in academic circles - of the innovations emerging from hubs like Silicon Valley, New York or Shenzhen, China, we find almost no coverage of the status quo of correspondent banking, and its risks and chances. A deep understanding of some modern challenges and developments of this ancient and still powerful banking method is therefore of essential importance, but it has to be based on common ground. This, in turn, requires knowledge that can only be gained through additional historical studies. Admittedly, a hard task in the light of the scarcity of literature on our topic. Much less, though, if we keep the words attributed to British historian George Macaulay Trevelyan (1876-1962) in mind: "Every true history must force us to remember that the past was once as real as the present and as uncertain as the future."

Chapter 2 Literature Review

The present

It is astonishing how little literature exists on correspondent banking. Despite its vast size and undoubted importance, the banking research has a tendency to neglect the entire field of correspondent relationships. Even recent developments have not caused a “wake-up call”.

Take the financial crisis: It certainly has prompted an intense debate about the solidity of international banks and the influence of foreign banks on host economies (for example de Haas and Van Lelyveld, 2014; Navaretti et al., 2010; Claessens and Van Horen, 2014a and 2014b - Jeon et al., 2013, also give a thorough overview and offer an excellent survey based on a wide array of data). While some authors perceive multinational banks operating with, for instance, branches or subsidiaries in host countries to be more competitive (Jeon et al., 2011, but now more critically, Jeon et al., 2013) and stable (McCauley et al., 2010), others go a step further and emphasize the destabilizing potential of foreign banks (e.g. Roubini, 2010; Popov and Udell, 2010). Earlier, Kane (1996) had already accentuated the effects of bank failures and pointed at the higher risk that goes along with a less well-diversified banking system. These studies, however, do not specifically focus on correspondent relationships, and thus demonstrate the often imprecise delineation between international banking, cross-border banking and correspondent banking. The question of whether the financial crisis has led to a potentially significant concentration process in correspondent banking – with the larger players in the financial industry as temporary profiteers - is undervalued in literature.

Another example: the European Monetary Union has had a significant impact on the correspondent banking business in the Euro area as we can read in surveys by the ECB (2013, 2017b) or the BIS (2012, 2016, 2018). Still, the conclusion that the establishment of the Eurozone led to a significant changes in the competitive landscape of correspondent banking in Europe is undervalued in academic research. The BIS (2003) recognized already one and a half decades ago trends “towards a reduction in the number of correspondent banking accounts and a concentration among a few major banks.” We shall examine these trends and analyse their implications which is, however, only possible once a deeper understanding of the nature of correspondent banking has been gained.

While political and social developments in the last thirty years have clearly influenced correspondent banking, literature has not sufficiently dealt with the evolving disposition and constants in the field of correspondent arrangements. Only certain - narrowly defined - aspects of this important part of banking have been adequately covered in the academic literature, but there are almost no comprehensive articles or books that deal with more than a few specific elements or details of this method. Valuable works by Palmer (1990) and Wilkins (1993) give a commendable, but a slightly outdated overview of practical elements of correspondent banking, mainly aiming at the business community. From a U.S. perspective, Ostermann and Thomson (1999) properly describe on a few pages the process of further concentration in this area, but the size of the paper already limits its depth.

The dissertations of Giles (1983) and Chan (2001) may serve as a notable exception to the observation of all too scarce academic literature, though they largely concentrate on correspondent banking in or from certain economies (the USA and Australia, respectively) without sufficiently exploring the historical dimension of correspondent relationships. They are mainly descriptive and therefore only partially contribute to some of the key questions we try to resolve with this work. Yet Chan (2001) has identified useful, but occasionally redundant "[e]ighteen determinant factors to establish [correspondent banking] relationships and nineteen selection criteria of correspondents".[1] His findings mirror many of today's realities (e.g. the connection to SWIFT), but they are based on a rather narrow view of correspondent *banking*, limiting the relationship to *banks only* on both sides of the arrangement.

By referring to a plethora of primary sources of regulators (e.g. FFIEC, 2010; U.S. PATRIOT Act, 2001/2; FATF, 2012; Board of Governors of the Federal Reserve System, 2010; and industry conglomerates like the Wolfsberg Group, 2007 and 2014) it has to be explored

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[1] Chan (2014), pp. 18-9 refers to Lawrence and Lougee (1970), Dewald and Dreese (1970), Meinster and Mohindru (1975), Dunning (1979) and Palmer (1990) when he describes the eighteen determinant factors of international correspondent banking relationships with potential synergistic effects. The nineteen criteria for choosing a correspondent bank are based on (conference) contributions by Krishanan (1990) and Choo (1989).

whether a correspondent (banking) relationship essentially needs a bank on the correspondent's and/or respondent's side. As a consequence, the majority of all definitions related to correspondent relationships could be flawed or wrong.

Any research on this topic, therefore, has to look for a definition that no longer mentions correspondent *banks* but uses other terms on the correspondent's side instead. A correspondent banking relationship is traditionally a liaison between financial institutions. As an alternative to the traditional term, *correspondent banking,* we consider the expression *correspondent relationship* or *arrangement* to be less misleading. In addition, it has never been clarified whether it is justified to call correspondent banking a *financial system* with potentially far-reaching consequences for existing and future regulation. Chan (2001) calls correspondent banking only a "subsystem within the banking system". This view might need to be corrected by applying the *functional approach to finance* to respective research efforts. Based on Iqbal and Llewellyn's (2002) findings, which don't undermine Merton's (1995), as well as Merton and Bodie's (1995) important work (Their proposed six functions lack the more generalized view needed to bridge global differences in finance and banking.), it remains to be seen whether correspondent relationships of our days (and historically) can be subsumed under the *four universal functions of a financial system*.

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The research on correspondent banking is characterised by terminological chaos. In order to differentiate nascent and developed forms of correspondent relationships from other phenotypes of financial intermediation, multinational and international banking (especially in our historical research), an identification of the defining criteria, functions and parameters of correspondent arrangements has to be developed. To narrow the "intellectual dimension" of correspondent banking and to offer a clearer picture of the advantages of this business model a new *system of factors of correspondent relationships* is a necessity in literature. They could derive from a thorough look at some general characteristics of correspondent banking – like certain benefits, shortcomings and risks – that can be perceived as common understanding, regardless of where the relationship has been established. Again, academic literature on these topics is scarce – though a few of the advantages and risks are listed in papers of the ECB (2013, 2017a and b) and BIS (2016, 2018), certainly limited by the scope of the "industry" itself. Chan (2014) touches some positive elements after having formulated five basic functions of correspondent banking already in 2001 (p.8): liquidity smoothing, global liquidity distribution, international distribution of capital, hedging of risk and regulatory avoidance.

However, in the light of rapid technological advancements, an additional function needs to be added: technological openness and stability. The risks for correspondent relationships emerging from new technologies are still quite untouched academically. Tilooby (2018) just wrote a dissertation on the applications of blockchain technology in banking and finance with a useful bibliography (pp. 132-46); Peters and Panayi (2016), Shah and Jani (2018), Guo and Liang (2016) and - highly instructive - the BIS (2017, following shy steps in 2015 and 2016) are also looking into the challenges that are emerging from digital innovations connected to blockchain, cryptocurrencies and open distributed ledgers. A recent paper by Wandhöfer and Casu (2018) is more or less the first significant academic approach towards the future of correspondent banking evaluating different new ideas to disrupt the traditional correspondent banking scheme. Due to its narrow focus it falls short of analyzing the complexities that go along with controversial definitions, but it implies interesting thoughts of key requirements and designs for future cross-border payment models. The authors' goal, namely "to develop the building blocks for a future blueprint for cross-border payments" (ibid., p. 24) is a little overambitious in the light of undervalued technological details.

It is difficult to gain a clear picture of how exactly the correspondent banking business has developed in the last few years. Whereas some see an obvious concentration process (ECB, 2013 and 2017; SWIFT, 2011)[2], others correctly tend to differentiate, depending on regions and distinct environments around the globe (The World Bank, 2015; FSB, 2017 and 2018; IMF, 2017a; BIS, 2016). To understand the uneven latest dynamics in correspondent relationships it is also necessary to have a look at pre-crisis constellations. Before the 1980s, correspondent banking was a common standard with only a few banks being globally engaged, so that

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[2] For a systematic examination of the concentration of banking (as well as centralization and, respectively, decentralization) since the 19th century see Verdier (2002).

"international trade finance relied on local lenders plugging into a handful of big worldwide operators" (Jenkins, 2013). What followed were years that some called the "boom years of banking"[3]. This is certainly a highly insufficient description, as it leaves out the impacts of the Latin American debt crisis in the 1980s, the following crises of transition economies, the "Tequila crisis" in Mexico in 1994 or even the Asian crisis in the 1990s.[4] The banking problems between 1980 and 1996 are portrayed in a more balanced and sophisticated way by Goodhart, Hartmann, Llewellyn et al. (1998).

Some older works concentrate on the question of which factors drive financial institutions to establish correspondent banking relationships. For some it is a matter of efficiency, saving of costs, mergers, bank size and deposit structure (Lawrence and Lougee, 1970). Benston and Smith (1976) examine the impact on transaction and agency costs, while others focus on economies of scale (Gilbert, 1983), profitability (Knight, 1976) or liquidity issues (Dewald and Dreese, 1970; Meinster and Mohindru, 1975, who also cover the scope of services provided). Further papers accentuate the impact of regulation on the correspondent banking system of that time (Knight, 1972; Kane, 1982; see also Auerbach, 1982). Dunham (1981) and Flannery (1983) provide views on the interrelation of correspondent banking and potential costs for commercial banks based on the experiences of the 1970s and early 1980s. It almost goes without saying that these last works barely reflect relevance to the present.

For a complete picture of correspondent banking in today's world, we need to understand its vulnerabilities as well – a question Llewellyn (1999, pp. 14-6, 25-39) answers generally for the banking sector. An already useful list of traditional risk factors for correspondent banks by the ECB (2013, pp. 20-1) including concentration risks[5] (with the almost classical case of the

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[3] For instance, Jenkins, ibid. See also the interesting paper and model on "booms and banking crises" of Boissay, Collard and Smets (2013).

[4] See Laeven and Valencia (2012).

[5] See also the Federal Reserve: Board of Governors of the Federal Reserve System (2010), Section 2016.1, p. 2.

German Herstatt Bank (described by CLS Group, 2013; Kamata, 1990; Galati, 2002, pp. 55-6; Toomey, 2000, pp. 14-5)), but also liquidity, legal, credit and operational risks needs to be widened with geographical and geopolitical risks as well as with risks emerging from technological inventions – the latter based on a description of threats from the new digital environment. Finally, the ECB study falls short of mentioning growing reputational risks that regularly result from the realisation of one or more risks mentioned before.

Chances and benefits of correspondent banking cannot be illustrated accurately without a closer look at the regulatory landscape. A valuable outline of global regulatory developments, challenges and consequences is given by KPMG (2014), but also by the BIS (2016). The impact of regulation on transaction banking business with an analysis of U.S. and EU regulation covers Wandhöfer's (2014) broad study. In order to gain a concise picture, we must thoroughly scrutinise a number of primary regulatory sources in the U.S., ranging from the Bank Secrecy Act (1970) to the Money Laundering Control Act (1986), the Anti-Drug Abuse Act (1988), the Annunzio-Wylie Anti-Money Laundering Act (1992), the Money Laundering Suppression Act (1994) and the Money Laundering and Financial Crimes Strategy Act (1998).

A "game-changer" regarding the recognition of correspondent banking was – without sounding cynical - the 9/11 terror attacks, but also the eruptions caused by the latest financial crisis. Suddenly, Know Your Customer (KYC) and Anti Money Laundering (AML) rules flourished and we witness a shift from more and more "self-regulation" by the industry[6] to processes involving many different stakeholders. In the last few years, correspondent banking developed from a "matter of trust and reputation"[7] to a matter of "must and regulation". In this field, practitioners and literature already illustrated potential changes and the aftereffects of

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[6] We look into the efforts of the so-called Wolfsberg Group and the BIS to influence regulation. On the BIS see the study of Baker (2002). Koch (2007) gives insights into how the BIS tackles international financial market challenges. For the history of the BIS see Felsenfeld and Bilali (2004), pp. 946-68, Bernholz (2009), and Baker (2002). Schluter (1931) and Kilborne (1931) offer an interesting view of its original goals right after its founding offer.

[7] Manchester (2013).

(non)compliance. However, more emphasis needs to be made on analysing primary sources from governments (e.g. the PATRIOT Act, Dodd Frank Regulation, FATCA) and selected international bodies (IMF, the Financial Action Task Force (FATF), International Finance Corporation). Some of the consequences, like the rising cost factor for financial institutions, are – not surprisingly – covered by studies of the industry (ECB, 2017b; the BIS, 2016 and 2018; IMF, 2017) but also in research, as Claessens's (2013) essay shows. Choudhary (2012, p. 5) concludes that intensified regulation not only leads to higher compliance costs, it also influences the strategies of many banks of how to conduct and organize correspondent banking and, in more general terms, correspondent relationship business. And Wandhöfer (2014, Chapter 3.1.2) points at regulatory challenges due to the "lack of harmonised international definitions and in the absence of a common understanding of the nature of [the] services". However, most studies that are touching regulation in correspondent banking are merely descriptive and mainly focused on regulatory efforts coming from the public sector. Any further research needs to look at correspondent banking as a possible example of being the aim and/or root-cause for a "private-public regulatory hybrid". Aside from governmentally imposed regulation (or such from multinational public sector authorities) the role of self-regulation through the industry is remarkably forceful.

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In order to systematically identify the nature, scope, and boundaries of correspondent relationships further, work beyond the current existing literature is needed, as well as in the context of recent developments. The aforementioned terminological challenges even turn superficial banalities into a difficult task. One example is the question of how correspondent arrangements differ from other forms of international banking and types of financial organizations using national and international offices - and from related but entirely distinct banking services, such as banking correspondents.

We find several organizational varieties, which are qualified to be involved in multinational banking businesses. An important categorization of the concept of correspondent banking in relation to multinational banking is given by Jones (1992), Curry et al. (2003) and Lewis and Davis (1987). Aside from moving the academic debate on correspondent banking to the international level (although it clearly has a domestic component as well), these authors necessarily differentiate correspondent banking from other types of inter-, respectively multinational banking. They offer comprehensive examinations of the organizational alternatives in multinational banking. The analytical work in this context by Goldberg and Saunders (1981, from a U.S perspective, though), Heinkel and Levi (1992), Merrett (1995, from an Australian point of view) and PricewaterhouseCoopers (2005-2006) and more recently by Navaretti et al. (2010, covering the European perspective) needs to be mentioned as well. The entry motives of multinational banks are described by Beermann (2007).

The hugely growing sector of so-called banking correspondents - that are related, but not similar to correspondent banks - is explored by Assunção (2013), Kumar et al. (2006) and Sa Dhan (2012), but we find no clear academic distinction between the two models so far. This thesis will, therefore, contribute to a more precise definition of different international and national banking systems.

An addendum: It may sound astonishing how frequently correspondent banking is being neglected in essential essays about international money (respectively capital flows) and interbank relations (see for instance McKinnon, 1993; Speller et al., 2011; and Alfaro et al., 2007).

Another gap in literature, apart from identifying typical characteristics of correspondent relationships, becomes apparent when we take a deeper look into the accounting practices. Although correspondent relationships stood already centuries ago for a “speciality” in accounting, namely nostro/vostro (and loro) accounts, almost nobody questions whether a correspondent (banking) relationship always needs to be based on this traditional account relationship. The service spectrum as such is already an indicator of alternatives. A correspondent relationship can be initiated and maintained through correspondent services contracts and/or through opening and holding accounts with one another. It might be traditionally, but not necessarily tied to a nostro/vostro/loro account structure. Exceptions exist already and this distinction is critical for the evaluation of potential participants in a correspondent relationship. Research has to come to conclusions by evaluating primary sources from regulators and other government bodies (from the British FSA to the Federal Reserve).

A strict restriction to account arrangements would exclude certain financial institutions or players in the finance business from falling under the definition of a respondent or correspondent. Such an exclusion would make it difficult to apply present regulatory or compliance rules to some participants in financial services procedures and would open opportunities for potential misconduct and circumvention of - for instance - AML rules. It would also push simpler regulation efforts towards alternatives based on digital solutions. In order to prevent further confusion in international and domestic accounting procedures and their legal fundaments, academia must overcome the terminological polyphony surrounding the accounts involved. It must agree upon whether the vostro/nostro/loro accounts (as opposed to, for example, “due to” and “due from” accounts) should be the nomenclature established globally (and especially, in the influential financial environment of the U.S.).

One of the few voices in the academic world that also questions the nostro/vostro exclusivity is that of Naughton and Chan (1998, p. 153). These authors formulate the erosion of the vostro/nostro dogma coming from a service-orientated approach, thereby putting emphasis on the purchase and sale of services instead of on the establishment of a correspondent-side deposit account. Turning to history, Naughton and Chan explain the tradition of setting up a deposit account by referring to the U.S. system, in which smaller banks that were outside the Federal Reserve System “held their reserve balances with member banks and thereby established correspondent relationships” (ibid.).

In general, accounting practices in correspondent banking are a barely described topic. Knight (1970a and 1970b) gives a couple of examples in the U.S. context and King (2000) offers some contextual thoughts whilst focussing on wider settlement questions. Some authors touch on accounting details (see the analysis of Osterberg and Thomson (1999): According to Knight (1970b), correspondent banking opens an option for funds to move from surplus to deficit areas; for Meinster and Mohindru (1975), correspondent balances are affected by liquidity considerations and the need to pay for correspondent services; Gilbert (1983) sees a connection between deposit volatility and the scale of correspondent services).

Correspondent banking is regularly connected to cheque clearing, even outside the U.S. This correlation illustrates Richardson (2006 and 2007), more recently James and Weiman (2010 and 2011) and Sullivan (2012). Quinn and Roberds (2008) excellently explain the evolution of the cheque by evaluating its relation to other relevant payment technologies, but only mention correspondent banking in the rather narrow U.S. context. Accounting practices in (national) correspondent banking can be regarded as one of the root-causes of the collapse of a remarkable number of banks in the U.S. during the Great Depression in the 1930s. Richardson (2007) assumes that especially the cheque-clearing procedures of correspondent banking relationship led to chain reactions of bank closures. He challenges the “traditional school” of e.g. Friedman and Schwartz (1971), which in his opinion sees the causes in “withdrawals of deposits, illiquidity of assets and the Federal Reserve’s reluctance to act.” Richardson is equally as critical of the “revisionist school” whose members include Temin (1976) and Calomiris and Mason (2003) who conclude “that banks failed because the economy contracted and fundamental forces pushed banks into insolvency” (cited in Richardson, 2007).

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Considering the lack of research on correspondent accounting and the players involved in such a relationship, the necessity of a new systematic categorization of correspondent relationships becomes obvious. However, there is no sign visible on the academic horizon. The most solid bonds in a correspondent relationship are formed when two banks - or at least two financial institutions with a banking license and a nostro/vostro account relation - are correspondent and respondent. These bonds reflect a “classical/traditional” understanding of correspondent *banking* as a sub-concept of correspondent relationships and they are theoretically (as correspondents) capable of offering the widest range of potential correspondent services. The question arises, then, whether central banks, clearing houses, and other financial institutions (as well as payment systems and individuals) could form correspondent arrangements.

Although Naughton and Chan (1998) made the first notable attempt to draw a wider theoretical framework for correspondent banking, they reached their conclusions only by tying their correct findings on broader accounting options to a service-orientated structure, rather than involving a wide spectrum of potential protagonists. We encounter different banking systems and environments around the globe; this fact certainly also limits the number of analogies that are able to be drawn. So far, however, we have not seen an academic study related to the identification of international correspondent banks that encompasses not only multinational and local banks but also clearing institutions. This contribution seeks to help fill that gap. Already, some authors have argued that central banks can also be part of a correspondent bank relationship (Vorst, 1987; Osterberg and Thomson, 1999; McAndrews and Strahan, 2002). Norman et al. (2011) have emphasised this fact in an insightful article. The Federal Reserve's influence on correspondent banking has been portrayed by Evanoff (1985). Summers and Segala (1979) concentrate on the causes of the usage of correspondent services of the Federal Reserve Bank. More internationally, the central banks' role as intermediaries for payments is covered by Millard and Saporta (2005) as well as by Green and Todd (2001). Johnson and Steigerwald (2006) have provided an extensive bibliographical survey of literature relating to payment, clearing and settlement systems. Studies on international settlement rules and alternative payment systems do exist from Lester et al. (2008) and earlier from Schoenmaker (1995). However, none have ever considered the fact that it is not only clearing houses that can be part of a correspondent relationship, but maybe even clearing, settlement and payment systems as well - for which correspondent criteria would need to be developed.

In conclusion, the literature on present challenges and opportunities is merely a collection of bits and pieces that needed to be tied together in order to form a concise impression of where correspondent relationships stand today. Without the effort to find potentially common and permanent principles a historical survey would have been senseless.

The past

Chapter 3, with its main conclusions and recommendations, is therefore, the logical framework for our historical approach to correspondent arrangements in Chapter 4. A novel, universally valid definition of this method and newly developed categorizations (for example factors of correspondent relationships and different levels of correspondent relationships), as well as more or less undisputed essentials of correspondent banking and their typical spectrum of services could potentially play a significant role in the discovery and identification of early and differently shaped forms of this traditional model. Regardless of whether we look at correspondent arrangements in ancient Greece, in the 15th or in the 21st century, certain axioms may prove to be timeless.

Correspondent relationships are some of the oldest banking models. Yet for the past nearly 700 years the invention of correspondent banking has been tied in literature and practice to Renaissance Italy. This is a misperception, because significant elements of this method were already developed in ancient times. As a history of correspondent banking, and respectively correspondent relationships, has not been published so far, this dissertation covers the period between the first steps in banking in Mesopotamia and the golden age of European merchant banking families in the 15th and 16th centuries.

There are generally not many instances in literature on banking and finance that try to cover a timeframe that spans the period from antiquity to our days without running the risk of being accused of only scratching at the surface or losing academic depth. Davies (2002), for example, offers an interesting overview of the history of money but lacks a stringent description of the main protagonists that are involved in money transactions throughout the millennia he tries to cover in his book. Neal's (2015) recent history of international finance is as "concise" as the title promises. His views of the ancient world are not overly innovative, but he tries to build a logical bridge into modern times when he, for instance, states that ancient Assyrian merchant structures presage those of Genoese merchant bankers some 3000 years later (ibid., p. 41). Orsingher's (1967) view of "banks of the world" leaves – also regarding their history - only broad brushstrokes. And Ferguson's (2008) financial history of the world has the highest literary quality, but is obviously written for a broader audience than academia. Often compilations of essays are needed to come close to an intellectually sound coverage of a historical topic. A good example of this is a collection of papers on cashless payments and transactions from the antiquity to 1914, edited by Denzel and Chaudhury (2008).

There is a noteworthy number of historical approaches to multinational banking. The important work of Kindleberger (1984), the examinations of Wilkins (1970), Casson (1990) and Jones (1992 and 1995) may serve as examples. Other publications are limited to certain periods. Battilossi (2000 and 2006), for instance, examines the determinants of multinational banking "during the First Globalization, 1870-1914" and in later years. Again, it comes as a surprise that there is no such survey on correspondent banking.

The most relevant monograph for our approach has been written by Geva (2011), a pioneer for those who try to give a description of payment techniques throughout history. His work is quite legalistic but offers highly valuable insights into the development of cashless transactions and the history of instruments like the bill of exchange and letter of credit. He even thoroughly describes the different players involved in (mostly) long-distance payment efforts. Geva also repeatedly mentions correspondents and, without much success, tries to distinguish them from other types of representation, unfortunately without leaving a clear trace of their historic origins and unique position. It is obvious that he cannot build on a sound definition of correspondent relationships including the potential to identify distinct forms of involvement in payment procedures, regardless of whether we look at constellations from ancient Athens or 16th century Amsterdam.

Although literature in our field mostly focuses on the history of banking per se and not specifically on correspondent banking, some of these works are obviously relevant for the present study: An analysis of the historical development of correspondent banking has to be based on findings about the general history of banking, accounting, clearing and settlement. Of course, even research that covers only certain periods often delivers highly important results.

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For the history of ancient banking, we refer, amongst others, to the monumental (though not always accurate) work of Heichelheim (1938) and to some general views of Davies (2002). Nagarajan (2011) recently gave a valuable economic interpretation of the Laws of Hammurabi in ancient Mesopotamia while Bogaert's (1966) study on the origins of deposit banking offers excellent insights into early Mesopotamian banking activities. Another valuable source that concentrates on the historical origins of debt, is the work by Michael Hudson and Cornelia Wunsch (2004). An interpretation of Mesopotamian impulses on correspondent relationships has to recognize the work of Van de Mieroop (2004b) and Charpin (2012) on King Hammurabi and his infamous code.[8] Powell's (1990) thoughts on price developments and money in Mesopotamia need to be taken into account, and so should the broad study on the societal and economic situation of early Mesopotamia by Postgate (1994). Developments in the first

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[8] See also Homer (1977), p. 5

millennium BC are surveyed by Jursa (2010) whereas Van de Mieroop (1992) thoroughly examines trade and business structures in the old Babylonian city Uruk, using his discoveries of financial records in the forms of clay tablets. Such well-preserved tablets from the early second millennium BC show Mesopotamia's "financial system" in an impressive way. Cribb (2004, p. 92) and Neal (2015, p. 39) remind us of a tablet on which the payment by a temple in Sippar to several individuals was recorded, including terms of interest (around 1750 BC). This serves as another indication of early banking structures in Mesopotamia. The accounting challenge to record not only "[…] a single transfer, but the combination of a multitude of transfers into a summary" is excellently described by Van de Mieroop (2004a, p. 49). Hudson (2018), an eminent expert on Mesopotamian economic history, links the development of money in Mesopotamia to the debate between the *state theory* and the *commodity or barter theory* of monetary origins and criticizes the lack of reference of the latter theory to credit arrangements and to "palaces and temples in the Near Eastern inception of monetization".

For those who tie correspondent relationships strictly to banks on both sides of the arrangement ancient Mesopotamia would not be considered an important factor for the development of correspondent relationships because only one side would resemble the characteristics of a bank, mainly the royal palaces and temples. Although most of the older research comes to the conclusion that, despite existing payments systems, "banking" did not exist in that era (Their main argument is that lending was not made out of deposits yet; see, for example, Bogaert, 1965.), others would call ancient Mesopotamia not only the cradle of civilization, but even the "cradle of banking".[9] The question arises, so far unanswered in literature, whether not only the invention of record-keeping, accounting and standardization can be seen in ancient Mesopotamia, but also elements of transaction banking in order to facilitate trading efforts abroad. This would lead us to the conclusion that the basis for future banking operations, including correspondent relations, was

[9] Davies (2002), Chapter 2, even compares Babylonian banking activities with pawnbrokers in England.

“constructed” in those times.

Hudson and Wunsch’s (2004) important collection of papers on the origins of money and account keeping from Mesopotamia to Mycenaean Greece and Egypt needs to be mentioned, in order to lead our literature review on the history of correspondent banking to ancient Greece and Rome. Th first elements of transaction banking and long-distance payment systems in ancient Greece and on the island of Delos are described in the analytical works of Geva (2011) and Mugasha (2003). Both researchers do not concentrate on correspondents but give in-depth descriptions of transaction and payment structures in those times. An interesting precondition is an early form of bills of exchange which Guillard (1875, p. 9) and Baskin and Miranti (1997, p. 315) already clearly identify in Ancient Greece. Hasebroek (1965, p. 86) and von Reden (2002, p. 59), amongst others, oppose this view.

In ancient Rome, transactions of large amounts of money took place on a very regular basis, regardless of whether they were purchases of valuable real estate, investments in provinces or even trade finance. For further impulses and details on Roman money, transactions and bankers we refer to the excellent works of Barlow (1978), Harris (2008 and 2011) and Andreau (1999) and to Del Negro and Tao (2013) for more contextual questions. Grossmann (2010) reminds us that Rome certainly profited from the Greek banking experiences and inventions. By interpreting some Roman sources (such as Cicero) Geva’s view (2011, p. 139), which affirmed that Roman banking developed “nascent interbank correspondent arrangements, under which one bank held funds in account with the other” into standard practice might need to be widened. Banking research still has to come up with an answer if we see already mature elements of correspondent relationships and even correspondent banking in ancient Rome.

Two mostly neglected periods conclude the first part of our historical research on correspondent relationships: ancient to medieval Near East and the crusades. Both are tightly interlinked as the Crusaders profited from ideas, inventions and old, but refined structures originating from the Near and Middle East. These impulses, namely the innovative payment instruments stemming from the Persian Sasanian Empire (the development of a cheque system) and Arab, respectively Jewish, merchants (the *suftaja* and *hawala*) are highly underestimated by researchers – even by those who concentrate on the origins of banking.

Chester (1896) and Ray (1997) refer to the fact that the Arabs of the time of Mu'awiya in the late seventh century had already cultivated a system of financial transactions, entailing the instrument of a promissory note. In addition, Geva (2011, p. 278) recognizes another payment instrument, the so-called "*suftaja*" on which only scarce literature in English exists. According to his findings, it "contains an obligation of a paymaster or his correspondent to pay at a place other than that of the issue of the document." Goitein (1967) comes up with a similar description in which "*suftajas* […] were issued and drawn upon well-known bankers or representatives of merchants […]."Again, the restriction to representatives (or agents) of merchants is insufficient as other historians describe correspondent relationships. References can be found in works about the Abbasid period (750-1517 AD). Here we have to rely on almost only secondary sources, mainly collected by Mez (1937), Fischel (1937) and Ray (1997). The latter draws attention to (Arab and Jewish) middlemen in financial transactions whose functions were beside the administration of funds also the transfer of funds from province to province by *safatij* (plural of *suftaja*) and he also proofs the existence of "representatives".

Historically, the missing link in the history of correspondent arrangements between Near Eastern merchants and medieval Tuscan merchant bankers are the Crusaders, who gained knowledge of payment systems that were either forgotten or undeveloped in the medieval "Western world". Supported by the Curia, they used correspondent arrangements mainly for remittances but also for trade relations. Neal (2015) puts a lot of emphasis on the innovative transactional skills of the popes (especially Urban IV) of that time. It needs to be seen whether Neal belittles the impact of the encounters between the Crusaders and merchants of Eastern roots. On the "banking system" of the Templars the early publications of Génestal (1901) and Piquet (1939) are still relevant. An impression of "The Financing of the Crusades in the Twelfth Century" is offered by Constable (1982) and Grossman's (1965) dissertation presents a general view of the different efforts to finance the Crusades. However, with the exception of the latter there are almost no concise studies on that topic yet. Indirectly, we find evidence in the secondary work that concentrates on ecclesiastical ties: see the ground-breaking monographs of Lunt (1926, 1934, 1939 and 1962) and Gottlob (1892). It is controversial whether the Knights Templars could already be seen as the pioneers of the accounting practice of modern-style explicit double-entry bookkeeping (as opposed to the Roman grammar-based version). De Soto (2009) offers a good summary of the Templars' role in banking history, while the general history of the Templars is excellently reflected by Barber (1994).

The question of the roots of double-entry bookkeeping continues to be subject of vigorous discussions. Even though de Soto (2009) and many others (e.g. Arlinghaus, 2004) connect the invention of double-entry bookkeeping with Italy in the 1300s, there are more and more hints that double-entry records had been created sometime before. Under the premise that it could have been invented to some extent already in the early Islamic state (Zaid, 2004, in opposition to Nobes, 2001) and by Jewish merchants in 12th -century Cairo (Parker, 1989; Scorgie, 1994), from whom Italians learned the technique, it is not impossible that the Knight Templars had knowledge of double-entry bookkeeping. De Roover (1955) comes to the conclusion that most likely merchants of different Italian cities in the 14th century more or less simultaneously discovered this accounting method (in contrast to the hypothesis that it originated solely in Genoa around 1340 (Besta, 1909)). Napier's (2009) paper provides a thorough literature overview of Islamic accounting methods and their influences. Werner (2005), based on his reading of Roman economic history, argues that the use of grammatical cases by bankers in Roman times created the equivalent of double-entry bookkeeping while the 2nd case (genitive) indicated liabilities ("whose" money) and the 3rd case (dative) indicated assets (to "whom").[10]

All those who still praise Renaissance Italy for "creating" correspondent banking, need to be reminded that there is only scarce research on the assessment that the clergy and

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[10] Although a significant number of historical surveys exist on accounting (including the unprecedented bibliographical work of Mattesich (2008)), there are apparently only two relevant publications on (parts of) the history of nostro and vostro accounts – the accounting method for correspondent banking relationships that bears relevance until today: while de Roover (1944) discusses two-currency accounts and related bookkeeping matters in the Renaissance, a recent study of Yamey (2011) covers a broader field from 1400 to 1800. Edwards et al. (2009) give a thorough review of the role of double-entry bookkeeping from the 16th to the 18th century in mercantilist Britain and conclude that several purposes of accounting could be identified in several treatises of that period, but there is no explicit passage on the specifics of correspondent banking.

crusaders – many of them with family ties to influential Italian families – could have learned about long-existing payment systems even from their own relatives. Such a conclusion would challenge major parts of literature, regarding correspondent banking, as Italian merchant bankers could not be called protagonists of a financial *revolution*, but instead creative profiteers of an *evolution*.

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A key contributor to our goal of writing a history of correspondent banking is de Roover (1942, 1944, 1946, 1955 and 1966), who must be regarded as a pioneer, producing insightful and important research of depth and scope in describing the development of (modern) banking in Renaissance Italy and in parts of Europe. Although not always clearly differentiating between "correspondents" and "agents" of, for instance, Tuscan bankers in the fourteenth to the sixteenth century, he may be considered to be the first scholar to explore cross-border banking in Europe in detail. Like many authors, de Roover does not specifically focus on correspondent banking, but ends up producing much detail needed for the compilation of a history of correspondent banking. As such, he has been able to narrow down the origins and early developments of correspondent banking. His work is an important source that must be drawn upon for the historical analysis of correspondent banking, as well as the analytical research presented below.

A decisive role in the development of *modern* banking and also for the emergence of correspondent banking networks was played by bankers and merchants in medieval and Renaissance Italy. Cipolla's work (1982) is notable as it leads to an interpretive analysis of historical events (in contrast to de Roover, 1966 and 1974a, and Usher, 1943, who rarely interpret bigger economic developments like recessions). Some publications already point to money creation by the financial institutions in Renaissance Italy (Mueller, 1979, and Cipolla, 1982).

Historians are divided on the question of which Italian city-state could claim the crown for being the most significant source of financial innovation.[11] For many researchers, Florence remains to be the crucial driving force for banking in Renaissance Italy and abroad.[12] Other scholars point primarily at the importance of Venetian impulses[13], while a third group concentrates on Genoa and its *Casa delle Compere e Banco di San Giorgio* (founded in 1408)[14].

The history of the Medici Bank has never been described more deeply than – again – through the research of Raymond de Roover (1966). Ferguson (2008) identifies the key to the Medicis' achievements in their strategy of diversification and sees the Medici banking system as "multiple related partnerships, each based on a special, regularly renegotiated contract". A clearing system, as it was later put in place in Bruges and Venice, did not yet exist, though. According to de Roover (1966) "the Florentine banks were too numerous to permit the organisation of an efficient clearing system".

Padgett and McLean (2006) refer to the unique creativity of the banking sector in Renaissance Florence. Aside from de Roover's groundbreaking work on banking in Renaissance Italy, it was Melis (1962, 1991) who gave detailed historical insights on this period. Reliable records and information on banking in Europe stem from the 11th and 12th centuries. A comprehensive schematic of banking has been formed by historians on the basis of Genoese notarial records. The extant records start in the year 1154 (Lothian, 2002). Padgett and McLean (2006) see the year 1382 as the starting point for the establishment of wider, diversified partnerships.

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[11] On this debate see Neal (2015), pp. 52-3.

[12] The profound work of de Roover, especially on the House of Medici (see for instance de Roover, 1966) had a long-lasting impact on future generations of researchers.

[13] See especially the thorough research by Mueller (1979 and 1997), Lane and Mueller (1985) and Pezzolo (2013a and 2013b).

[14] See for example Fratianni and Spinelli (2006), Felloni (2006 and 2014), and Marsilio (2013).

The terminology for international banking in Renaissance Italy and northern Europe is all too often confusing and even misleading. We have touched upon this fact already in our description of today's difficulties with correspondent relationships. De Roover (1942) also uses the term "agencies" for Florentine's focus abroad, whereas Kindleberger (1984) generalizes and – incorrectly – calls the units across Europe "correspondents" without making a notable differentiation.

However, de Roover (1942) uses the term "correspondent" in connection with the persons or parties involved in the process of bills of exchange that were intensely used by Italian merchant bankers in medieval Bruges. Still, it seems the literature does not clearly distinguish between non-bank netting and settling of such bills of exchange between merchants as happened in annual or semi-annual intervals at the great European fairs (such as the annual St. Giles Fair in Winchester at Michaelmas, or in Champagne in France) on the one hand, and the use of bills of exchange involving banks on the other.

The difference is, of course, that bank involvement implies an expansion in purchasing power and the potential build-up of excessive money creation with all its consequences (see, for instance, Werner, 1997), while bills of exchange without the involvement of banks (as happened in the twelfth century in England) imply the extension of trade credit that widens purchasing power temporarily, while being restricted again in semi-annual or annual cycles, when the bills are being netted out, and the smaller net amounts rolled over or paid out in physical form. Moreover, this difference has implications for financial stability: non-bank use of trade credit via bills of exchange is linked to 'real economy' transactions, while the purchase of bills or other securities by banks expands the money supply in a way that can be unrelated to real economy transactions and instead fuel unsustainable asset price movements (Werner, 2005).

Despite considering a wider perspective, Lothian (2002) comes to a comparable conclusion. He doesn't, however, connect his observations to a specific region or place when assuming that "[…] the widespread use of bills of exchange meant that this early banking was by its very nature international in scope. Making it even more so" was, according to Lothian, "the way banking came to be organized in late Medieval times, with international branch networks and correspondent relationships becoming the rule." Padgett and McLean (2002 and 2006) similarly draw historical correlations between the expansion of intercompany credits and the spread of partnership systems as newfound nodes of exchange in that credit.

The Italian “banking network” faced severe regulation and restrictions in other parts of Europe, though. Particularly in England, strict measures were imposed on foreign merchants that were involved in the banking business. Several bans (for example, on the use of credit in foreign trade) were part of England’s legislation in the 15th and early 16th centuries (see Munro, 1979, who also draws attention to further controls, especially of foreign exchange practices, up until the 17th century).

Case studies

We have already pointed at the fact that our historical approach is based on parameters for the identification of correspondent banking which we develop throughout Chapters 3 and 4. From our survey of the relevant literature, we conclude that in order to distinguish former and existing forms of correspondent relationships from other types of representation for financial institutions abroad, a proper and consistent classification is overdue. For centuries (and until today), terms like “agents”, “branches” and “correspondents” were confused or used synonymously. Secondly, throughout this thesis, we are looking at the interconnection of correspondent banking to bills of exchange and letters of credit. Both instruments have ancient origins and grew into a wide-spread practice of payments over long distances.

We find excellent sources on the history of bills of exchange and letters of credit: Denzel (2006) wrote one of the most thorough descriptions of bills in post 13th-century Europe, although he does not waste many thoughts on ancient origins. Moshenskyi’s “History of the Weksel” (2008) tries to cover the full historical spectrum, but he lacks despite some innovative findings the necessary precision (probably due to a poor translation, for example, when it comes to difficult distinctions between certain forms of letters of credit and bills of exchange). Rogers (1995) offers a remarkable analysis of the early legal history of bills and notes. There is no shortage of research on letters of credit; however, as Bergami (2011, p. 83) correctly observes, it mainly stems from a legal angle (see already Finkelstein, 1930; but also Carr, 1999;

Creed 2001; Dolan, 2007) and from the perspective of the banks, as opposed to the seller's perspective. An early survey is written by Hershley (1918). More general work has been contributed by Mann (2000). Recent publications on international trade finance instruments include Foley et al. (2010) and Engemann et al. (2014) (see also Niepmann and Schmidt-Eisenlohr, 2014a and b). All of the these researchers, more or less, neglect any historical angles. Exceptions to this observation are the works of Byrne (2007), Finkelstein (1925) and Kozolchyk (1965).

In our case studies we narrow the focus on England. Across Europe, correspondent relationships and other methods of international banking were used over centuries and not only to facilitate trade but also to finance wars and bellicose conflicts abroad. One example coincides with a milestone in banking history: the founding of the Bank of England[15] in 1694. In connection with public needs for war loans (Nine Years War with France), a group of London merchants aligned their individual profit hopes with the idea of forming the Bank. However, the crown not only needed money, but also had to tackle the problem of paying the troops in the Low Countries which was not quickly resolved by just creating a privately held financial institution in the City of London. A reliable system had to be put in place that allowed long-distance remittances to the troops in Flanders.

Kleer (2017) is so far the first who wrote a comprehensive description of England's late 17th century difficulties to finance its war with France (for a perspective of a military historian see Childs, 1987 and 1991). He mainly concentrates on the years 1694-1696, but tries to show different concepts of remittance payments before and after the inception of the Bank of England. Most of his conclusions are valuable as he relies on primary sources and original documents from archives. His in-depth look at the decision-making processes and at the strategic debates within the Bank is especially impressive. However, his terminology regarding the use of representatives (agents, branches and correspondents), bills of exchange and letters of credit is repeatedly imprecise and he unfortunately neglects

[15] In this thesis, we also frequently use the abbreviated term "Bank" for the Bank of England.

to describe more options that have been used and tried by the Bank. He identifies (only) three ways to remit the needed funds using the - at this time already conventional - method of bills of exchange, yet he offers only scarce sources for his (correct) findings.[16] Identifying several further alternatives that were in use – or at least in discussion – to facilitate such "remises" serves as a novel contribution to literature.

Still, there are a lot of elements in Kleer's research that prove to be helpful for our purpose to showcase the development of correspondent relationships in England (its early stages are covered in Chapter 5) and its use by the newly established, privately-owned Bank of England. In contrast to Rowlands (2015), who wrote a remarkable study on French remittances under Louis XIV (also not always precise regarding the use of correspondents, though he mentions them), Kleer doesn't even use the term correspondents. Still, some of his conclusions are preconditions for identifying this type of representation. Kleer's work is based on his findings in a paper from 2003.

The vast literature on the Bank of England regularly points at the connection between its inception and the necessity to finance the troops entangled in wars abroad. However, the extraordinary early works of Rogers (1887), Andréades (1909), Richards (1929) and later Acres (1931), Saw (1944), and – profoundly – Clapham (1944), fail to list all the options for national and international payment procedures before and after the founding of the Bank. In Chapter 6 we are closing this gap by thoroughly analysing the early ledgers of the Bank, the receipts regarding remittances (which we found in the Bank's archives) and the Court of Directors Minute Books. Equally as important is the reflection of the Bank's procedures in the Treasury Minutes (where we had access through the British Library) and original letters and accounts of some key players involved (the Shropshire Archives, for example, hold valuable ledgers, accounts and letters of the Crown's deputy paymaster in Flanders, Richard Hill). Primary sources like contemporary works on the Bank (Godfrey, 1695; anonymously authored "Proposals for National Banks", 1696; Paterson, 1694 on the intended Bank) and pamphlets

[16] Kleer (2017), pp. 43-4.

(e.g. Luttrell, 1678-1714)[17] are equally as important as records from the House of Lords (1691-1696). A few of our key findings wouldn't have been possible without these sources, for example, the identification of the exact role of a central figure in the remittance business over many years, Jacobus de Coninck of Antwerp, as a correspondent, as well as the classification of the true nature of the Bank's "agency" at Antwerp. Yet up until today, the Bank of England doesn't use the term "agency" for its institution in Antwerp (neither calls it "branch") during the Nine Years' War. Recently, Cunliffe (2017), called it an "operation in Antwerp", which in our opinion is an all too easy way to circumvent the difficulties to categorize this endeavour in Flanders properly.

Based on our analysis of primary and secondary sources connected to the protagonists involved, it becomes clear that a new classification of remittance payments is required. Instead of just pointing out the (sometimes numerous) players in domestic and international transactions, it is necessary to identify and also illustrate *transaction cycles*, mainly involving bills of exchange but also letters of credit. There is a vacuum in literature on these issues, as shown in Chapter 5. These cycles follow the course of these notes from their moment of being drawn to the last step of being cashed in. Because the relevant players in a bill- or letter-based transaction (drawer, drawee, payer, payee, principal) regularly changed both before and after the launch of the Bank of England, this method of clarification is an indispensable step to avoid further confusion in academic research.

Given the confusion surrounding the very definition of correspondent banking, it is perhaps not surprising that literature on this topic is characterized by significant imprecision. As we shall see, most of the models used and discussed during the Nine Years' War were not, in actuality, creative innovations of the late 17th century. Based on the analytical work in the preceding chapters, our research will demonstrate that the use of cashless transaction methods by English merchants was already highly developed by the 14th century, and that remittance payments from England through intermediaries and by means of bills of exchange in order to fund soldiers overseas (and especially in Flanders) had already occurred by the 15th century. Primary

[17] The original is in Greek letters – we refer to a later version printed in English (1857).

sources like so-called 'letters obligatory' - which included assigned parties with features of correspondents for the settlement of debts from the 14th century - and other documents like letters of attorney hint towards the growing involvement of England's merchants in correspondent structures.

It is common knowledge that cashless payment via bills of exchange was one of the most influential "export products" of Italian merchants outside their own borders.[18] While some 19th century German historians see a separate form of "northern bill" that was created by merchants from the Hanseatic League since the 13th century (Neumann, 1863; Stobbe, 1865), the "Italian model" appeared north of its origin via the fairs of Champagne in the financial centres of Bruges, Paris, Geneva, Lyon and London; however, it was not only in the 14th century at the latest (as Thomas (1932) and Denzel (2014) would describe it), but already in the 13th century.

We will look at a bill of exchange structure between England and Rome dating back to 1235 by involving original sources like Mathew Paris' Chronica Majora. Our in-depth survey of the Calendar of Early Mayor's Court Rolls[19], the Calendar of the Plea and Memoranda Rolls of the City of London[20] and of the infamous Cely papers - covering the late 13th to 15th centuries - allow us to draw new conclusions regarding the early use of correspondents, agents and branches in medieval England based on bill of exchange structures. Other original sources such as the Court Records and the "Ancient Correspondence of the Chancery and the Exchequer" for the 15th century (accessible in the National Archives) will be taken into account to explore

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[18] Power (1941) reminds us that particularly in the context of wool trade, England encountered (and learned from) the skillset of Italian firms or syndicates who acted as Royal bankers since the reign of Edward I. Moshenskyi (2008) and Postan (1930, giving an in-depth explanation of financial instruments in medieval England) point at the use of letters of commitment traceable to the 13th century that emerged independently of Italian influence.

[19] Originally published by His Majesty's Stationery Office, London, 1924.

[20] The Calendar of Plea and Memoranda Rolls is preserved among the archives of the Corporation of the City of London at the Guildhall.

whether it is a myth that only Italian merchants supplied other merchants with money for trading.

Van der Wee (1993 and 1997) and Denzel (2006 and 2014) are eminent voices describing the role of Antwerp and Amsterdam in the development of trade and payment in Europe. Since the 15th century, these trading and banking hubs in Flanders became the "intellectual initiator" of the refinement of trade instruments used between and both on the continent and England, involving agent and correspondent relationships. Not a few scholars see the influence of Dutch financial advisors on Dutchman William III as decisive for Britain's financial reforms at the end of the 17th century (Dickson, 1967; Neal, 1990. However, both also stress London's innovative techniques in refining and improving the Dutch heritage). Earlier attempts at reforming Britain's financial sector, from Cromwell to Charles II, are highlighted by Ashley (1934), Chandaman (1975), Braddick (1996) and Carlos and Neal (2011). The importance of mercantilism for the Anglo-Dutch relations in the 17th century is covered in the highly instructive article by Rommelse (2010).

Finally, the role of England's specificum, the goldsmiths, in correspondent arrangements is also highly undervalued by literature. They were deeply involved in domestic and international transactions where they gradually cultivated networks in which they may have used correspondents and acted themselves as such intermediaries when acting in two different locations. And they became central parties in remittance payments to troops across the Channel via bills of exchange decades before the founding of the Bank of England, thus setting standards and examples of structuring these complex undertakings. For the involvement of goldsmiths we recurred to numerous sources; however, Richards' (1929) contextual approach proved to be very helpful as well as the work of Kerridge (1988). In order to specify the role of two goldsmiths for remittance transactions, we looked into the Minute Books and Entry Books of the Treasury between 1689 and 1692, leading us to the question whether Childs (1991) and Kleer (2017) were correct when they concluded that these protagonists were agents - and not correspondents. Such primary sources, discussed below, also contain obvious hints to correspondent arrangements in the decades before the inception of the Bank of England. Yet, not only correspondent relationships were well-known structures familiar to England's finance community; even correspondent *banking* had already been discussed in the early 17th century and therefore well before the Bank of England was established (Malynes, 1622; and Robinson, 1652).[21] Malynes puts a lot of emphasis on the description of the representation through "factors" (ibid. pp. 81-6). This is a terminology dominant in continental Europe at the time (the "factors" were the bankers to the princes, such as the over 300 German states of the Holy Roman Empire of German Nation – and some were even known as "war factors" – a terminology that may have been uncomfortably accurate in the 17th century). However, the literature is equally scarce on the topic of how these factors operated and whether they were linked – for instance as or through correspondents; the distinction to the services of an agent isn't always clear, though. Robinson (ibid., pp. 77-8) even mentions "correspondents".

In conclusion, the development of correspondent relationships in English history before the founding of the Bank of England, which we identify in some of the aforementioned bill cycles also as a correspondent, has not been sufficiently covered so far. Even the indispensable work of Kerridge (1988) on early trade and banking mechanisms in England does not explicitly touch upon this topic.

Our brief review on correspondent arrangements shows that in some ways, the entire subject of correspondent banking must be considered one major chasm in the banking literature. Compared to other areas of banking or banking history, it is characterised by a remarkable dearth of research efforts. This is the reason why it has been necessary – and constitutes a contribution to the literature – to reconsider correspondent banking, its nature, scope and significance, especially via the lens of a historical methodology as we do. As became clear in this survey, this covers the role of agents (at least, by way of contrast), bills and other financial instruments used in correspondent transactions. Here the biggest gap in the literature concerns an analytical framework and analysis of the various transaction and interaction modes.

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[21] Even the term "agent" and its meaning were well known in the 17th century (and before) as shown, for example, in the works of Malynes (1622) and Robinson (1652).

Chapter 3 Polychrome and Polyphony – Reconsidering the True Scope and Challenges of Correspondent Banking

When financial services were still mainly local (but already reaching out to other markets), they required interlocutors or institutions at these places to conduct services on behalf of their customers and of themselves. Today, we face a truly global marketplace, where geographical borders tend to be marginalized by the boundlessness of the digital revolution. Correspondent banks, however, still exist – whether despite this marginalization or maybe because of it. Although challenged by technological developments like the blockchain and connected “products” like distributed and decentralised open ledgers, correspondent relationships remain the most significant factor for maintaining payment flows between credit institutions and they are an important channel for effecting payments in different currencies.

Despite its breadth and undoubted importance, banking literature has tended to neglect the entire field of correspondent banking. While the financial crisis has triggered an intense discussion of the influence of foreign banks on host economies,[1] there have been no studies on the impact of (and on) correspondent banks. Moreover, while political and social developments in the last thirty years have clearly influenced correspondent banking, the modestly-sized literature on correspondent banking has not yet sufficiently covered its constants, nor its evolving nature. For instance, the European monetary union has had a significant impact on the correspondent banking business in the euro area. The BIS (2003b, pp. 75-6) recognized already fifteen years ago certain tendencies towards a decrease of correspondent banking accounts and an increasing concentration process among a few major banks. These trends need to be examined and their implications analysed. This is, however, only possible once a deeper understanding of the nature of correspondent banking has been gained.

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[1] De Haas and Van Lelyveld (2014) compare the role of multinational banks in the latest crisis to the situation during the Great Recession and give a detailed literature overview. See also Navaretti et al. (2010); Claessens and Van Horen (2014a and 2014b).

We have already seen that the term "correspondent banking" can be used with diverse connotations, aims and contents. At first, the definition of correspondent banking (as a special form of correspondent relationships) seems to be a simple and straightforward task. A correspondent bank could be described as a financial institution that frequently conducts or provides services for another financial institution (a correspondent banking client or respondent), which is typically, but not necessarily, located in another country or market area. Correspondent banking arrangements appear in bilateral or "multilateral" forms. The former is given, when two financial institutions facilitate the sorting and processing of payments and other financial services themselves, without involving an intermediary. The latter model characteristically involves at least a third financial institution.

A correspondent banking relationship between two financial institutions may be reciprocal or completely one-way, whereby, for instance, a second bank, the correspondent, conducts transactions for the first bank – henceforth called 'respondent', while the respondent does not handle any transaction for the correspondent. In the multilateral model, the correspondent bank usually receives payment orders to sort and process from either one or both participating respondent banks.[2]

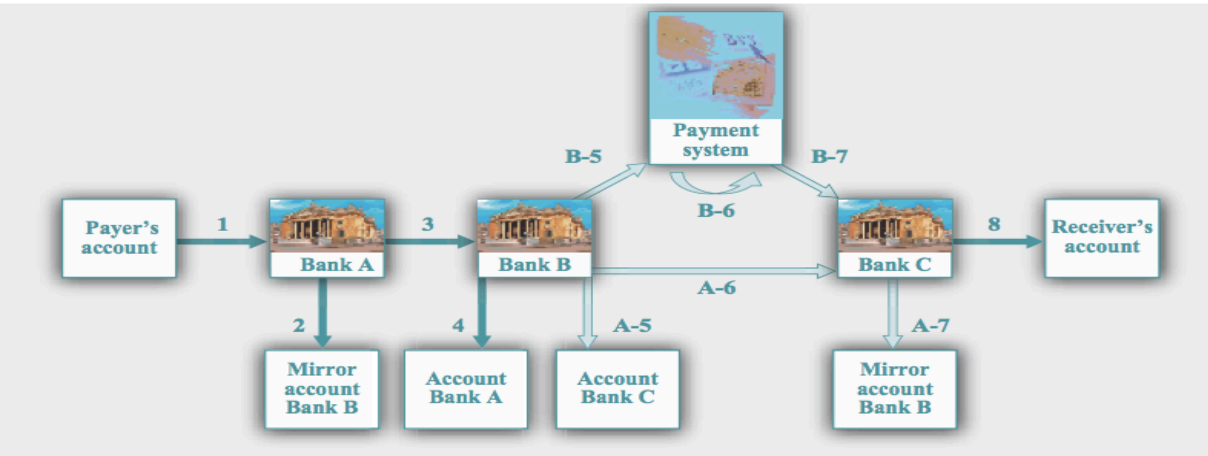

Figure 1: Settlement of a payment via a correspondent bank (source: ECB 2013)

[2] European Central Bank (2017b), p. 6. Transactions executed via the SWIFT network appear in two distinct methods: the so-called *serial method* and the *direct plus cover method*, see, in more detail, Wandhöfer and Casu (2018), pp. 12-3.

Figure 1 shows the settlement of a payment from Bank A to Bank C via a correspondent bank.[3] Both Banks, A and C, need to involve a third party, Bank B (the service-providing, respectively, correspondent bank) as they do not hold accounts with each other. Consequently, Bank B holds accounts for both Bank A and C. Such accounts are traditionally called “vostro” accounts. For the respondent it is a “nostro” account (in Chart 1 a “mirror account” of the correspondent Bank B), which – in international correspondent banking arrangements - holds balances in another currency than the home currency, whereas the vostro account – logically – is a local currency account, mainly used to debit and credit payments of the clients. If correspondent banking relationships involve a so-called “loro” account, it means that payments are made on the account of a third financial institution. Etymologically, the terms “nostro, vostro, and loro” are derived from the Latin words “noster, voster, and loro”. In English, they mean “ours, yours, and theirs”.

We have identified the respondent and the correspondent, but who could be a customer in correspondent banking relationships and the recipient of transactions? It might be another financial institution, corporation, and, of course, an individual. These customers, but also the respondents themselves or, for the most part, customers of other banks, can be the beneficiaries of transactions conducted through correspondent banking.[4] It is a truism that also the respondent’s customers (or clients) frequently benefit from the decision to use correspondent banks and to therefore widen the respondent’s own range of services. All of this may sound like a description with which most experts in the academic or banking sphere would agree. Yet, it is not as trivial as that.

The widespread confusion of the main terms is revealing – even in the professional financial world. The Bank of Beirut is only one of many professional participants in this business that has difficulty using, for example, the words “respondent” and

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[3] This example is based on the ECB’s description of a standard multilateral settlement via a correspondent relationship (European Central Bank, ibid.).

[4] Financial Service Authority (2011), p. 43.

"correspondent" correctly. Such is the case when it states under the headline "Respondent Banks (Vostro Accounts)" that the "Bank of Beirut maintains accounts for correspondent (sic!) banks based in various foreign jurisdictions, which take advantage of services and products delivered by the bank."[5]

In this context maybe unsurprisingly, it easily occurs that the definitions of correspondent banking diverge rather significantly. Four steps not only illustrate this observation but offer solutions to overcome the negative consequences of terminological chaos. First, we will lay out the large scale of the correspondent banking model, its advantages and risks – combined with a look at current regulatory developments. Secondly, correspondent banking has to be differentiated from other forms and types of using national and international offices for financial services that seem similar or comparable to correspondent banking relationships. A closer look at accounting methods and a critical view on the "dogma" that correspondent relationships necessarily need a vostro/nostro account relationship shall follow as the third pillar of our survey of modern correspondent banking in this chapter. In addition, as correspondent banking is not only business between commercial banks, we will, as a fourth step, evaluate which parties can be involved in a correspondent banking arrangement. Before we offer a new perspective and definition of correspondent relationships, we will give some examples of the broad spectrum of definitions, mirroring the usage in the academic and practical world of banking and finance. This, finally, will also give as indicators whether today's model of correspondent relationships fits into the *functional approach to finance*, based on Merton and Bodie's (1998) six basic functions performed by the financial system or Iqbal and Llewellyn's (2002) four universal functions of a financial system.

1. Range, risks and chances of a traditional banking model

Ostensibly, correspondent banking, as a truly global business, requires a globally identical definition. On the other hand, we face a notable variety of national and multinational banking rules and regulations - and recurrent failure, postponement or

[5] See the bank's homepage: http://www.bankofbeirut.com/Corporate/en/Correspondent-Banking.

suspension of global, voluntary regulatory standards. The longstanding disputes about the Basel Accords may serve as a dimly shining example.[6] Yet, some general characteristics of correspondent banking can be identified by common understanding, regardless of where the relationship has been established. We will summarize them in a system of *factors of correspondent relationships.*

a. Survival of the fittest? Advantages of correspondent banking – a concentration process towards an oligopoly

Regularly, correspondent banking implicates international relationships, whereas in some countries – like in the United States[7] - the fragmented banking system still leads to a large domestic dimension of correspondent banking. Even big international banks with a wide branch network hold correspondent banking relationships to provide their clients with a full range of services in different parts of the world. There are many cases in which an international bank keeps a branch in a certain city, but also has a correspondent bank in the same city, in order to - for instance – offer trade finance solutions or settle specific transactions, if the main focus of the branch may be investment banking.[8] As an example, Deutsche Bank holds branches in Dubai and Abu Dhabi[9] but also refers to the Emirates Bank International Ltd in Dubai as a correspondent for transactions.[10] This may be described as the *access and influence factor* of correspondent banking.

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[6] On the Basel System, especially on the rocky path to an agreement on the Basel III accords, see Blundell-Wignall et al. (2013); Blundell-Wignall and Atkinson (2010). See also Wandhöfer (2014); Auer et al. (2011). The latest monitoring results are published by the European Banking Authority (EBA) (2018). On the changes of Basel III, agreed in 2016 and 2017 under the contested term Basel IV, see Davies (2017) and Amorello (2016). On the credit risks, already connected with Basel II, see Llewellyn (2010).

[7] See James and Weiman (2010).

[8] Cranston (1997), p. 42.

[9] See the homepage of Deutsche Bank: https://www.db.com/mena/en/content/Contact.htm.

[10] http://www.deutschebank.co.in/swift-transfer.html.

aa. Benefits for the respondent

Banks with a certain size and an international focus typically need international banking partners, which would reflect the global outreach and services that cannot be conducted alone. Or in other words, the respondents ask for services in areas where they do not have a (sufficient) physical presence. As there is no further investment in personnel, systems, or facilities, the respondent bank has lower costs than establishing or strengthening its own branch; therefore, the potential costs for market entry are marginal (*savings factor)*. Additionally, respondents can take advantage of local knowledge and networks. But it also raises the banks' experiences in international trade, offers them access to the widespread global network, potentially to advanced technology, and, therefore frequently accelerates their international transactions (*local and global networks factor* as well as the *efficiency factor*). Correspondent banking arrangements not only facilitate payment flows between credit institutions. They also open access to payment systems as indirect participants, which makes them a significant link in the payment chain (*interconnectivity factor*).[11] Many small banks rely on larger correspondents to facilitate fixed-income trades for institutional clients.[12]

bb. Profits for the correspondent – a matter of size?

Looking at the other side of the fence, the advantage of choosing to act as a *correspondent*, is not that apparent at first sight. Correspondent banks have to make sure that payments flow smoothly between financial institutions.

Obviously, facilitating correspondent banking is more profitable for larger banks. Particularly due to growing regulation efforts, smaller banks have higher costs in relation to the size of their balance sheet, which means that their risk exposure rises as well. Moreover, the impact of lobbying political decision-makers (and therefore the predictability of certain costly regulations) is usually much higher through large financial institutions than through smaller competitors, which also face the possibility

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[11] European Central Bank (2017), p. 6.

[12] Steinberg, in *The Wall Street Journal* (May 11th, 2014).

of less stable "vostro" accounts – due to lower business volumes and typically fewer alternatives to cause revenues they could use for their correspondent accounts.[13]

However, most importantly, correspondent banking is a tool for large banks to gain and broaden global influence by establishing correspondent relationships in the role of a respondent *and* a correspondent. As a correspondent it can also act as a "cross-seller of products of other business units within the bank"[14] (*business accelerator factor*).

Wells Fargo, for instance, praised its correspondent banking business "with more than 3,000 strategic banking relationships worldwide [...] and more than 50 products and services"[15] until 2015. The bank did not distinguish between its function as a correspondent or respondent, though (today, it only speaks of "one of the largest correspondent bank networks in the U.S. and overseas"[16]). According to a survey of the European Central Bank in 2013, the largest four correspondent banks in the Eurozone accounted for 81.1 per cent of the total turnover value (1.1 billion euros per day as of March 2012).[17] However, in 2016, only 16 responding banks stood for a decline to less than 900 million euros, but the largest four reached almost 85 per cent of the total turnover value.[18]

The concentration within this banking sector has been remarkable during the last decades. It is almost impossible for smaller banks to compete as correspondents with the range of services a large financial institution can offer. In addition, the introduction of new

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[13] See Vorst (1987), p. 483.

[14] Chan (2014), p. 18.

[15] Until 2015, on the homepage of the bank: https://www.wellsfargo.com/com/cobank/ (meanwhile taken offline).

[16] Reflecting a more careful approach on the homepage of Wells Fargo: https://www.wellsfargo.com/com/correspondent-banking.

[17] European Central Bank (2013), pp. 4, 16-7.

[18] European Central Bank (2017b), pp. 9 and 15-6.

regulatory requirements (see below) and changing business strategies - like the completion of the Single Euro Payments Area (SEPA)[19] migration, an initiative stemming from the 2001 Lisbon Agenda for a more competitive internal market - have led to a substantial decrease in correspondent banking activities of smaller banks throughout the last years.[20] Larger banks are generally maintaining or even enlarging their correspondent client base.[21]

In 2013, the ECB even used the term "oligopoly"[22] to describe the correspondent banking business in Europe. In 2012 twenty-four of the largest banks in the Eurozone had together 14 198 respondents. On average, this meant that there were 592 respondents per service-providing bank.[23] In 2016, the sixteen largest banks had 9,754 customers (averaging 610 respondents per bank).[24] In sharp contrast stands the number of correspondents that these banks were relying upon (respectively where they were keeping nostro accounts): The 24 correspondent banks (on the basis of the ECB survey of the year 2012) were also respondents when engaging other banks as their correspondents. However, there were only 801 correspondents of these 24 banks, averaging only 33 correspondents per bank.[25] Four years later, in 2016, 401 correspondents would average not more than 25 correspondents of each of the 16 banks.[26] The Bank for International Settlements (BIS) is correct when it sees the main reasons for this development in the rising competitiveness (additional services and

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[19] For a comprehensive analysis of SEPA, see PricewaterhouseCoopers (2014), furthermore Bolt and Schmiedel (2009), and, especially, the excellent study of Wandhöfer (2010).

[20] European Central Bank (2017b), p. 3; BIS (2016), p. 1.

[21] Ibid.

[22] Ibid, p. 17. We do not find the term any longer in the ECB's latest survey (2017).

[23] See European Central Bank (2013), pp. 12, 15-16. The ECB sees the reasons in the establishment of the single currency, going along with new integrated Euro payment systems.

[24] European Central Bank (2017b), p. 9.

[25] Ibid, p. 12.

[26] European Central Bank (2017b), p. 14.

lower transaction fees) that leads smaller customer banks to concentrate their correspondent banking activities to no more than two service providers as opposed to keeping a plethora of relationships.[27]

In comparison and beyond the European scope, the Hamburger Sparkasse, a savings bank in Germany with total assets of more than Euro 43bn in 2017[28], maintained at that time a worldwide network of ca. 1500 correspondents.[29] The Austrian Sparkasse Oberösterreich, a regional bank with total assets of more than 12bn Euro[30] referred to a network of ca. 2000 correspondent banks globally.[31]

It is a general observation that the volume of a bank sets the limits of services provided. From a respondent's perspective, we could summarize it in many cases under the term "the more regional a bank, the higher the number of correspondents". Correspondingly, the size of a bank determines the number of its respondents ("the larger, the higher") and its impact on national and international banking as well as on widespread economic activity. Larger banks also have the possibility to offer lower fees, which repeatedly leads respondents to shift from numerous correspondents to only a few.[32] Furthermore, Vorst's (1987, p. 484) reflection on regulatory restrictions is still valid, namely that "it

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[27] BIS (2016), pp. 6-14; European Central Bank (2017b), p. 15.

[28] Hamburger Sparkasse AG, Annual Financial Report 2017, p. 30, online at: https://www.haspa.de/blob/103266/39150d2aa46f8b0ef7c44bd1aeebfae0/annual-report-2017-data.pdf.

[29] See the homepage of the Hamburger Sparkasse: https://www.haspa.de/firmenkunden/beratung/grossunternehmen/angebote-4636/.

[30] Sparkasse Oberoesterreich (2018), p. 20.

[31] See the Homepage of the Sparkasse Oberoesterreich: https://www.sparkasse.at/oberoesterreich/finanz_kapitalmaerkte/kundengruppen/financial_institutions/international-expertise.

[32] See European Central Bank (2013), p. 16.

seems reasonable to expect a large bank within an established network of correspondents to be in an immensely advantageous position to increase its market share significantly when interstate banking restrictions are relaxed."

Thus, for the moment, larger banks seem to be the profiteers of the concentration process in correspondent banking.[33] Although the revenues of the correspondent banking sections in larger banks are comparatively smaller than those in other banking fields like investment banking, the potentially higher predictability of revenues generating from positive externalities of a large correspondent network must not be neglected (*predictable revenue factor*).

Of course, due to the mentioned advantages, correspondent banking still may be an attractive option for smaller banks, regardless of whether they are respondents or correspondents. The Financial Institutions Group of Citibank puts it this way: "Our correspondents rely on Citibank® for authoritative market intelligence, state-of-the-art processing capabilities, and responsive client service."[34] Therefore, elements of the *access, influence, global network* and *interconnectivity factors* apply also to the correspondent's side. Even the *local network factor* may be strengthened by the higher intensity of existing and new connections through respondents' demands. Many correspondents expect to profit from the network which other, expressly large banks bring into the relationship. They may presume that an expanded national and international association with other, well known financial institutions may attract further clients. On the surface, this hope seems to be materialized. Yet, in a midterm perspective, the bank's decision to widen its use of correspondent business could backfire. Many large banks aim to establish their own businesses in regions where they have no physical presence. The opportunity to gather information about regional economic specifics and activity as well as about clients' customs via correspondent relationships is undeniable - and very often a correspondent arrangement results in the setup of agents, branches or subsidiaries. The direct and dependent connection of these business models to the parent bank leads to growing competition for the small banks on

[33] See also the important report by the World Bank (2015).

[34] Quoted on the Homepage of Citi: https://www.citibank.ae/uae/corporate/markets_banking/financial_institutions.htm.

their home market. In addition, specific risks when large banks act too slowly in the light of the newest developments in technology or when they take the wrong decision (such as betting on the wrong digital solution) are harder to control.

Many smaller banks are obviously still not aware of the big players' potential strategy to exploit expansive correspondent banking networks for influence over other financial institutions' activities. Some counter-models seem to prevail, though. In Germany the small savings banks (*Sparkassen* as well as the cooperative banks *Volks- and Raiffeisenbanken*) often hold close service relationships with large (but since a few years dramatically declining) German commercial banks with an international exposure or with Landesbanken, from which they expect less competition with their core businesses (e.g. loans for local SMEs). Still, many choose to have an impressive number of different correspondents. This solution could make the market entry with alternatives to correspondent banking less appealing.

cc. The impact of creating the Eurozone

In addition to these causes, the launch of the Euro has significantly altered the role of correspondent banking in Europe. Since the introduction of the single currency, the average number of respondents per large correspondent bank shrank to a third.[35] Correspondent relations in Europe certainly still exist, but new payment systems like TARGET2 have taken over many components of traditional correspondent banking[36] – large-value payments may serve as an example – and these systems are driving forces for a further concentration process of this banking model in the Euro area. The discussion about a monetary union also triggered the idea to create a European large-value payment system. Before that step, 25 different and generally independent and not linked payment systems existed in the European Union, and large-value payments

[35] From 26 003 in 2002 to 9,754 in 2016, see European Central Bank (2013, p. 12 and 2017b, p. 9).

[36] Below (Chapter 3 5.), we will shed some light on the question of whether (some of) these payment systems can be characterized as correspondents as well.

between the member states depended on correspondent banking.[37] However, these correspondent banking arrangements proved to be incompatible with the preconditions of the intended monetary union, respectively, a single monetary policy.[38] Correspondent banking in Euros with financial institutions within and outside of the Eurozone moved from a "pole position" to a complementary function. In 2012 we saw even "signs of banks moving away from correspondent banking arrangements for small-value retail payments and into retail payment systems operating in [E]uros."[39] This observation is manifested by the full implementation of SEPA, as SEPA focuses on creating a harmonized, common market for payment processing across Europe – some compared SEPA's perspectives already to any efficient domestic clearing market[40].

In conclusion: due to centralized Euro clearing and settlement systems correspondent banking relationships are progressively in decline in the Euro area.[41]

dd. New technologies – a game-changer

It can be expected that the use of modern, disruptive technology will accelerate this process - without breaking off the trend towards concentration.

Superficially, larger banks seem to be strategically in a better position in times of "*big data*". The – costly - ability to thoroughly analyse the flow of client and market information through a substantial number of experts is a more and more viable factor. González (2013) underlines this observation seeing the "one significant advantage" of banks in the accumulation of "the vast array of financial and non-financial data". Yet, with his sublime

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[37] Johnson et al. (1998), p. 17.

[38] See Johnson et al. (1998), ibid.

[39] BIS (2012), p. 93.

[40] Press Release of the European Commission from November 3, 2009: http://europa.eu/rapid/press-release_IP-09-1666_en.htm

[41] See, for example, Österreichische Nationalbank (Austrian central bank), on its website on the Eurosystem: http://www.oenb.at/en/Payment-Processing/Payment-Systems.html.

wish he overlooks the technological cumbersomeness of major banks whose structures still lack the ability to keep up with the speed of invention in large information and communication technology (ICT) companies like *Google, Amazon,* or *Facebook,* which have already explored more than just first steps to become serious competitors for certain banking services. Deutsche Bank Research (2012, p. 2) already stated that it “cannot be ruled out that potential competitors such as Google, Apple, Amazon or PayPal will expand the existing service offering in order to enter, for example, the market for standardised financial services” and that they “are increasingly putting out their feelers in segments outside of their own territory, e.g. the market for (mobile) payments” (ibid., p. 1).

In the meantime, rapid technological advancements have led to concerns amongst traditional banks becoming cannibalized by lean start-ups. Today, most conventional financial institutions are inefficient monoliths that do not change course or reinvent themselves easily. They are highly interested in maintaining what some see as oligopolies and high barriers to entry for their markets. A lot of this quicksand is located in their IT infrastructure, which is causing major issues for them. When the banking sector was thriving in the late 1990s and early 2000s, many institutions delayed technology investments. During the crisis, though, they were distracted from such investments – while in the immediate post-crisis period there arguably was a lack of sufficient investment capital. We also witness a paradox with IT-spending in the financial industry in that this sector is a major spender on technology, but, unfortunately, most of it is still used on maintenance activities rather than helping to integrate multiple systems and using IT as a strategic initiative and competitive advantage.

Now banks are doubling down their efforts to keep their systems up to speed, in order to comply with rapidly growing demands by regulators to deliver enormous amounts of data for stress tests or anti-money laundering checks.[42] Banks, in this context, adapt – according to

[42] Some attempts to update technology in large banks are quite ambitious: Deutsche Bank promised to rip out and replace much of its outdated technology (see Financial Times, October 26th 2015 “Deutsche Bank to rip out IT systems blamed for problems”). At that point, with “more than 100 different booking systems for trades in London alone [it] has no common client identifiers. It has even been unable to retrieve some of the data requested by regulators — which contributed to its failure in this year’s US bank stress tests” (ibid.). However, Deutsche Bank’s IT systems were in

Hart (2016) - a loss-leader pricing strategy and "[t]hey provide certain products (checking accounts) at a cost below their market value to stimulate the sales of more profitable products (loans) and to attract new customers. Now FinTech companies are skimming the most profitable portions of the banking model, leaving banks stuck with high overhead and less profitable products."[43] These FinTechs nowadays offer a variety of services that not long ago almost exclusively were in the hands of banks. We face a growing number of personal peer-to-peer lending innovations to personal finance apps that make the classical service spectrum of intermediaries from the finance and banking sector more and more obsolete. Other young companies develop methods to "facilitate investments, financial planning, and portfolio management […] as popular alternatives to traditional wealth managers."[44]

Companies like *Ripple* disrupt already the classical correspondent banking sector by experimenting with the blockchain technology[45] and using open distributed ledger technologies (DLT)[46]. With the understanding that increasingly outdated clearing and

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trouble as well when the Financial Times (October 19 2015) revealed that its London foreign exchange desk paid $6bn by mistake to a U.S. hedge fund and only recovered it the following day.

[43] Hart (2016).

[44] Ibid. Many of these innovations are rooted in new technologies, whereas the approaches based on big data analytics, cloud computing, decentralized ledgers and artificial intelligence are often tied to a customer base with which traditional banks are struggling: so-called millennials..

[45] On the applications of blockchain technology in banking and finance, see, in more detail, the recent dissertation of Tilooby (2018) with a useful bibliography (pp. 132-46); see also Peters and Panayi (2016); Shah and Jani (2018); Guo and Liang (2016).

[46] The BIS (2017) published a thorough study of DLT effects on payment clearing and settlement and its ramifications for correspondent banking and FX clearing and settlement, recognizing "initiatives under way that seek to enable simultaneous settlement and reconciliation of cross-border payments between banks" as well as the "potential for use in improving and reducing the costs of customer due diligence ("know your customer") processes. In addition to improving the efficiency of correspondent banking arrangements, there have also been projects that seek to replace such arrangements by exploring how DLT could link payment systems, thus removing the need for an

settlement systems create issues for transparency, regulatory oversight, and the efficiency of trading and remittance networks, among others, this young company is not only gaining major banks as clients, but also openly questioning the future of SWIFT.[47] In only a few years since its founding, *Ripple* has established partnerships with more than 100 banks (including large institutions like Banco Santander) and moved into an interesting strategic spot to influence the market significantly.

It took the BIS and its Committee on Payments and Market Infrastructures until 2015 to formulate the threat of innovative technological and digital solutions for traditional correspondent banking. However, their finding that a decentralized payment mechanism based on distributed ledgers could facilitate certain cross-border transactions with the potential to accelerate them with lower costs "for end users (such as consumers and merchants) [by partially] eliminating the intermediary banks in the payment chain"[48] had been discussed in bankers' and startup circles already for a few years.

Except for creative models of cooperation (that could offer a win-win situation for both business sectors) there is no viable reason ICT companies should give up their technological advantage to the benefit of traditional banks. In addition, the future banking services will not be determined by the possession of big data, but by its innovative interpretation and utilization (e.g. through refinement of algorithms). Still, one could be tempted to see large banks in an advantageous position regarding new developments connected with the blockchain and distributed ledgers as it is easier for them to react to regulatory changes (or even to influence them) than it would be for start-ups in this field. Acquiring competitors from the tech sector or hiring talents generally seems easier for the bigger players. But, as

intermediary correspondent bank" (see the summary in BIS 2018, p. 15). One of the first deep academic studies on the foundations and use of DLTs has been published by Rauchs et al. (2018).

[47] Recently, a potential partnership between Ripple and SWIFT was in the news (see Coincierge, October 15 2018, https://coincierge.de/2018/partnerschaft-zwischen-ripple-und-swift/), following a communication strategy that encompassed to supplant the SWIFT network, see Financial Times, 18.01.2018 ("Bitcoins rival's rise unnerves banking sector").

[48] BIS (2015) and (2016), p. 9.

stated above, they are also often slow-moving “tankers” without the capacities to integrate highly distinct ideas and mindsets.

New technologies are definitely rewriting core elements of traditional banking models. And even structures in existence from ancient times (see Chapter 4), like those of correspondent relationships, are openly challenged by inventions like the blockchain and - based on it – cryptocurrencies.[49] González (2013) anticipates the creation of a “new financial ecosystem” driven by the necessity to digitize the banking services. He expects a dramatic shift “from 20,000 “analogue” banks today worldwide to no more than several dozen “digital” banks.” However, for years to come, the methods described in this chapter will prevail, at least in parallel until the new alternatives have passed the maturity test. The latter includes that existing major risk factors are mitigated, and strong international regulations are in place.

All in all, the charm of correspondent banking for financial institutions of all sizes is based on a combination of predictable and increasing revenue, business development, modest capital requirements, and potential for a sizeable profit. Chan’s (2001, p. 8) list of “five basic functions of correspondent banking” – liquidity smoothing, global liquidity distribution, international distribution of capital, hedging of risk, and regulatory avoidance – should therefore be expanded. And, in the light of our technology discussion, an additional point needs to be added: technological openness and stability.

b. The latest Financial Crisis and correspondent banks – too big to prevail? In-house global networks and trade finance moguls

As stated above, in the last few years we have observed an uneven development in the field of correspondent banking: consolidation goes hand in hand with concentration processes – especially in parts of the so-called “Western world.” But, in other regions around the globe, we also witness elements of a renaissance of correspondent

[49] Further details of the role of technology, blockchain, digitization and challenges for the future are discussed in the conclusion of this thesis (Chapter 7).

relationships.[50] Still, in 2011, for approximately 3700 banking groups in 200 countries correspondent banking was an essential business.[51]

Nonetheless, and despite all potential positive global effects of correspondent arrangements, the question arises whether the latest global financial crisis has led to major changes in this banking model. For some observers, the extreme events of the latest financial crisis have shown that correspondent banking proved to be a safe haven - one of the few reliable pillars within the business divisions and activities of larger banks. Overall, revenues and cash flows were comparatively predictable in this business sector. In September 2013, the head of global transactions of a leading global bank shared with the author his assessment of the importance of correspondent

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[50] The IMF (2017a), p. 6, is cautiously avoiding a clear statement: "The factors leading to global banks' withdrawal from CBRs [correspondent banking relationships] are multiple and interrelated and their relative significance varies across countries." More precise is the BIS (2016), p. 16, recurring to SWIFT data: "For African regions, the picture is mixed, with pronounced declines in Northern Africa and partly in Southern Africa, but substantial increases in other regions. The Americas saw significant declines in the number of correspondents with exception of Central America. Asian regions experienced declines in 2012, but mostly increasing numbers thereafter. As an exception, Western Asia encountered significant reductions in correspondent banking relationships over the full period, which can be attributed partly to developments in Syria. In Europe, active correspondents fell steadily over time. […] The most pronounced relative decline of active correspondents has occurred in Oceanian regions."

[51] See SWIFT (2011a), p. 1. Let us also not undervalue broader economic effects that can go along with (international) correspondent relationships. As Agénor (2013, p.112) correctly explains (though "only" in the wider context of "international financial integration"), "[a]ccess to world capital markets may allow a country to engage in risk sharing and consumption smoothing by allowing it to borrow in bad times [...] and to lend in good times". It also offers connections for foreign direct investment, the chance for a more efficient banking system and it can lead to a higher quality of loan portfolios with enhanced capital allocation of domestic banks in regions where they are under political pressure to only lend to "favourite" borrowers, see ibid., pp. 114-5, referring to Gianetti and Ongena (2009). However, it is hard to follow Agénor's discussion that the free flow of capital across borders also leads to enhanced macroeconomic discipline, see ibid., pp. 113-4.

banking, with respect to the effects of the latest financial crisis:

> "Citigroup would be gone without correspondent banking."

There can thus be no doubt that correspondent banking is an important, if little-known discipline of banking, and a worthy topic of further research. Nevertheless, the financial crisis calls for a more differentiated view, especially if we take a closer look at the big players in the banking business.[52]

aa. Attractiveness of correspondent banking – the pendulum swings back

Before the 1980s, correspondent banking was a common standard as only a few banks were globally engaged in it, and "international trade finance relied on local lenders plugging into a handful of big worldwide operators" (Jenkins, 2013). In the words of SWIFT (2011a, p. 3) "[...] the traditional 1.0 correspondent banking model of the late 1970s […] and a long list of correspondents was seen as a sign of importance. What followed were years that some called 'boom years of banking'"[53]. This is certainly a highly insufficient description as it leaves out the impact of the Latin American debt crisis in the 1980s, the following crises of transition economies, the "Tequila crisis" in Mexico in 1994 or even the Asian crisis in the 1990s.[54] However, in this period many banks inflated their global outreach and amongst the largest banks it became common to offer customers a universal service, which made expanding correspondent banking services less attractive.

Moreover, improved access of banks to foreign markets through better automation and communication systems led to a situation which some described as a move from "collaboration" to "competition".[55] Smith and Walter (1997, p. 419) conclude that "[l]ike

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[52] On the role of innovation during the financial crisis, see Llewellyn (2009).

[53] So, for instance, Jenkins, ibid. See also the interesting paper and model on "booms and banking crises" by Boissay, Collard and Smets (2013).

[54] See Laeven and Valencia (2012).

[55] See, e.g., Smith and Walter (1997), pp. 417-8.

international finance generally, the drift has been from a relationship-driven to a transactions-driven business." The years before the latest financial crisis were also times of change due to significant financial deregulation.[56]

The financial crisis led to a smaller number of banks that were willing and capable of keeping a widespread international network of branches, agencies and subsidiaries. The necessity for many banks to cut expenses, lower risks of international exposure and healthily shrink caused a(nother) renaissance of correspondent banking – at least in some parts of the world. Letters of credit resurfaced as an attractive option "for alleviating the spike in credit risk concerns"[57]. This development is also a major cause for the process of concentration that took place recently as only a few global players like Deutsche Bank, or Citigroup remain extensively engaged as "in-house global networks" and "trade finance moguls" and therefore also as potential correspondents for respondents across the world.

bb. Dominance in decline?

However, even here we face a "dominance in decline": by identifying regional difficulties and risky engagements, media reports of spring 2013 hinted at a gradual reduction of bank agencies and other forms of international offices in some more remote areas in Africa, the

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[56] Deregulation specifically meant liberalization, including laxer controls over financial institutions and activities (see the in-depth study of Padoa-Schioppa, 2004), and the elimination of country-barriers between financial products and markets (Claessens (2013) looks at the macro developments; Jayaratne and Strahan (1998) offer a U.S. perspective; Barros et al. (2005) discuss the specifics of the European Union).

[57] Nitzgen (2013), also pointing at the fact that letters of credit normally "require local bank involvement, which demonstrates the importance of a strong international banking network. During the financial crisis, it was correspondent banking that came up trumps, because many global banks retreated towards their home market, leaving constraints in trade funding and risk mitigation. Local banks became vital, both for local corporates and their international trading partners. For instance, when it came to securing the handling of trade flows – despite a spike in perceived risks during the crisis – local banks proved that their knowledge of local companies was critical to keeping trade flowing."

Middle East and Asia.[58]

So it appears likely that the financial crisis produced both: less correspondent banking relations due to the deteriorating reputation of some major banks, but also a shift from riskier, self-conducted businesses to the services of banks that proved to be stable during the crisis. Exceptions remain, of course: In January 2014, J.P. Morgan decided to go a slightly different path by reviewing its correspondent relationship with U.S. respondents.[59] According to *The Wall Street Journal* (May 11th 2014), J.P. Morgan "stopped soliciting new business from its few hundred domestic correspondent-banking clients [and it] also stopped accepting new clients." As a result "the bank may decide to cull a small number of clients."[60] SWIFT (2011) mentions the perspective of "fewer, but deeper relationships", whereby it sees the "concept of "reciprocity" [evolving] from a traditionally "arms-length" relationship to deeper partnerships."[61] Professionals in the banking industry have established the term "de-risking" for this process.[62]

The *Financial Times* (*FT*) reports that "three of the world's biggest banks have withdrawn from correspondent banking relationships in 30 jurisdictions [...] They are believed to be HSBC, JPMorgan and Citigroup."[63] This development, of course, is mainly related to the tough stance regulators have taken on breaches of sanctions and AML and anti-terrorist finance rules. Banking groups with licenses to clear U.S. dollars have recently cut hundreds of correspondent banking relationships in risky developing nations. A number of larger U.S. dollar-clearing banks have stopped dealing with lenders in developing countries to mitigate the risk of heavy fines. According to the *FT* (ibid.), other groups "with a licence to

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[58] See *Financial Times*, April 22nd 2013.

[59] Steinberg, in *The Wall Street Journal* (May 11th 2014).

[60] Ibid.

[61] SWIFT (2011), p. 3.

[62] See *The Economist* (2014), Poor correspondents, June 14th 2014.

[63] *Financial Times*, January 23rd 2015. See also, in a wider context, Erbenová (2016).

clear US dollars, such as Standard Chartered and BNP Paribas, have also been severing hundreds of correspondent banking relationships in some of the riskier emerging markets."

Another factor should be taken into consideration: In times of high interest rates the question of the fixed costs to uphold global correspondent networks is comparatively insignificant. This, of course, changes when profitability sharply declines. If clients of a bank only ask for a marginal number of transactions in a certain currency - as is often the case in a severe financial crisis - many bankers struggle to justify the fixed costs of correspondent relationships with financial institutions in that market.[64]

This is particularly true when mutual trust in banking is under strain, as evidenced by the breakdown of the interbank market in September 2008 and the following year or so, when banks were unwilling to accept obligations by other banks, due to their worry that the other banks may in fact be insolvent - if they are owners of illiquid and practically worthless financial instruments, such as structured credit derivatives. Since correspondent banking is a form of interbank relation, the breakdown of the interbank market must also have negatively affected the large correspondent banks' appetite for this line of business.

In summary, despite the continuous concentration, or better, centralization, of this banking model in many parts of the world, we also face some corrections of the - until then - constantly growing outreach.[65] As shown, a good number of these adjustments are linked to the latest financial crisis, but more and more also to new integrated payment systems. Yet, two other driving factors for the changes in the correspondent banking business must not be taken too lightly - intensified compliance and regulation efforts and eventually, an increasing number of mergers in the banking sector. Shortcomings in the context of financial crises, significant changes in the banking landscape, and intense regulatory measures are recurrent reflections and reactions to certain risks and limitations of a business model.

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[64] See Neville (2013).

[65] For a systematic examination of the concentration of banking (as well as centralization and, respectively, decentralization) since the 19th century, see Verdier (2002).

c. Constrained flexibility – disadvantages of correspondent banking

Hitherto, there is no such thing as a banking model without risks and deficiencies. Llewellyn (1999, pp. 14-6 and 25-39) concisely describes he vulnerability of banks. Over the centuries, correspondent banking has developed or been exposed to recurring risk factors. Many of them have been repeatedly illustrated by (mainly) practitioners and (some) scholars.

aa. Traditional risks

The European Central Bank (2013, pp. 20-1) provides a list of risks in correspondent banking and distinguishes between *legal risks* (unanticipated laws and regulation or invalid contracts; conflicting settlement or insolvency laws and jurisdiction in the host country or state), *credit risk*s (through incomplete settlement and thus negative correspondent (vostro/loro) account balances or through insufficient collateralisation, e.g. in case of intraday credits to its customer banks), *liquidity risks* (no settlement of counterparty at due date; deficiency of expected incoming payments for any of the counterparties; block of payment systems because of correspondent bank's inability to provide enough liquidity), *operational risks* ("disruption" of the services of a large correspondent or respondent bank – often combined with liquidity shortage or "trapped liquidity" through blocked payment systems) and *concentration risks* (here the ECB differentiates between "external" and "internal" concentration - the former is given when the "correspondent banking business is concentrated on a relatively small number of service-providing banks. On the other hand […] internal concentration […] occurs when correspondent banking business is concentrated within a service-providing bank on a relatively small number" of large respondent banks. Both scenarios can raise the probability of any of the other risks).

The concentration risk prompted an unusually sharp warning by the ECB: "[...] the default of one of the larger and most interconnected correspondent banks might quickly trigger a domino effect on their respective customer banks and/or service-providing banks, as well as the risk of spillover to interdependent payment systems."[66]

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[66] European Central Bank (2013), p. 22. The possibility of "bank contagion" in interbank, respectively correspondent banking networks has been surveyed (historically and mainly in the

In a recent statement the CLS Group (2013), the firm with the biggest turnover on earth,[67] elaborated on that development, confirming the ECB's assessment:

> "[o]ver the last decade, many banks have been consolidating their funding arrangements to reduce costs and better manage liquidity through one main correspondent relationship, or 'Nostro Agent'."

This constellation, of course, would also lead to higher risks for CLS members in case of the failure of a "Nostro Agent" as many of them would lose their channel for CLS Pay-In obligations; therefore, "one failed payment [could cause] a contagion of unsettled instructions and additional calls for liquidity for all other CLS Members."[68] Ironically, we face some parallels to the case of the "Herstatt risk", one of the reasons for founding the CLS Bank in the first place, and named after the FX exchange settlement risk in the context of the failure of the German Herstatt Bank. [69]

U.S.-context) by Kaufman (1994) and Saunders (1987). A more general view is offered by Schoenmaker (1996). See also Paroush (1988); Calomiris and Gorton (1991); and, recently, Tonzer (2013).

[67] CLS (Continuous Linked Settlement) is a financial institution, owned by the world's leading financial institutions, that operates the largest multicurrency cash settlement system to mitigate settlement risk for the FX transactions of its Members and their customers through the operation of a Payment-versus-Payment (PvP) settlement service, see http://www.cls-group.com/About/Pages/default.aspx. On the initial arrangement of the CLS Bank, see Kahn and Roberds (2000). Schaller (2007) covers historical elements and consequences of the inception of the CLS Bank.

[68] CLS Group (2013). As a possible solution to mitigate the risk, CLS Group proposes to those banks that only maintain one nostro account "to subsequently set up a second Nostro Agent" or to consider "nostro contingency swaps" in order to "reduce the CLS Pay-In obligation to zero". Another option would be to conduct "self clearing in those currencies where it makes business sense." (ibid.).

[69] On the "Herstatt risk", see Kamata (1990); Toomey (2000), pp. 14-5; Galati (2002), pp. 55-6.

Other examples are contagious bank runs like in 1933. They can emerge for multiple reasons. However, interbank ties through correspondent banking to another bank's (worthless) assets are one possible root-cause.[70] The failure of a correspondent "can bring down a chain of its respondent banks" (Garcia and Plautz, 1988, p. 19). Unsurprisingly, more and sharper regulation leads to even more concentration in the correspondent banking sector.[71]

Two different kinds of "concentration risk" have been outlined by the Federal Reserve: a respondent's relationship to a "correspondent may result in credit (asset) and funding (liability) concentrations", whereby "on the asset side, a credit concentration [means] a significant volume of credit exposure that a financial institution has advanced or committed to a correspondent"; on the liability side we would find a "funding concentration" when a respondent depends on one or only a few correspondent(s) "for a disproportionate share of its total funding."[72]

bb. Modern risk developments

The ECB's list is not complete, though. At least *geographical and geopolitical risks* need to be added as well as risks emerging from *new*, *disruptive technologies*. Criminal elements like money laundering, terror financing, and drug trafficking are not only a consequence of lax jurisdictions or legal systems of a certain country, especially if they are tied to new digital tools that regularly evade national borders.[73]

More and more global security threats are reflections of cross-cutting risk clusters (societal, economic, geopolitical, technological, environmental risks) that can possibly

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[70] Selgin (1996), p. 216. See also Smith (1991) in his insightful article on bank panics.

[71] Citi Transaction Services (2013), p. 3.

[72] Board of Governors of the Federal Reserve System (2010), Section 2016.1, p. 2.

[73] Recently, the Wolfsberg Group came up with a paper covering "Country Risk Frequently Asked Questions" (2018); criminal indicators and political factors are mentioned, as well as regulatory factors and economic indicators. However, from a geopolitical perspective the paper appears rudimentary and lacks crosscutting interconnections that regularly affect geopolitical developments.

affect different parts of the world at the same time. Lesser stability, weak governments and fragile multinational organizations raise the risk of undermining the legal foundations for payment transactions. Further negative developments in correspondent banking were intensely discussed and surveyed in the late 1990s and after September 11, 2001. This discussion culminated in a growing awareness of correspondent banking as a probable tool for money laundering and financing organized crime and international terrorism.

Moreover, modern payment models like *PayPal* offer easier and faster solutions than classically transferring money from account to account. With the technology of *Ripple* international transactions can possibly be completed within fractions of a second whereas wiring money across borders via classical correspondent channels, including foreign exchange details, still takes days. Another prosperous form of mobile banking and payment services can be seen in the new technologies of mobile phones.[74] The invention and progress of "web-cryptocurrencies" like *Bitcoin* or *Ripple's XRP* are being watched nervously by many financial institutions. All these new technologies have in common is that they potentially offer cheaper and (for the moment) less regulated alternatives to certain services of correspondent banking. However, aside from these *technology risks,* there are still cases that cannot be sufficiently conducted or settled via new payment systems, for example, non-standardized transactions in international trade financing through letters of credit.[75]

Finally, the ECB study falls short of mentioning growing *reputational risks* - potentially for all sides involved - that regularly result from the realisation of one or more risks mentioned above.

A major disadvantage of correspondent banking lies in the fact that possible and typical risks of the country in which the correspondent bank is located are not actively

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[74] See, for instance, the concept of M-PESA in Kenya, based on cell phone technology. It allows money transfer through SMS. Customers can deposit, send, and withdraw funds by using their cell phone. Already by the end of 2009, approximately 65% of all households in Kenya used this system, see Suri and Jack (2011); Mbiti and Weil (2011).

[75] European Central Bank (2013), p. 8.

manageable by the foreign bank. May it be restrictive practices or the exchange rate of the foreign country; unpredictable jurisdiction or even blocking instruments imposed by the foreign governments, i.e., of fund transfers. There are almost no possibilities to change the priorities of a correspondent bank if they identify other businesses as more relevant than the respondent bank. Furthermore, a correspondent bank can damage the responding customer bank, if it raises the price of services beyond the average cost of production, specifically if it has a certain monopoly capacity in the input market – a precondition to using that power in the output market with damaging results for the other bank's products and therefore its ability to compete.[76] Moreover, we often find reluctance and limitations of the correspondent banks to offer credits on a regular basis.

The possible expectation, especially in developing countries with a weak banking sector, that strong foreign correspondents lead to more stability of the domestic banking sector is an illusion as the involvement per se is only as stable as it would be in times of severe crisis. As we have seen in the last few years, many major global banks have chosen the "cut and run" option as opposed to staying.[77]

Aside from all the advantages, risks and recent developments, correspondent banking relationships are still an important factor for making cross-border payments. And the - still existing global - popularity of U.S. Dollar, British Pound and Euro, as well as the widespread perception of dealing with comparably stable currencies, explain the intensity of international correspondent banking activities in the United States and parts of Europe. The Minority Staff of the US Senate (2001) already gave a proper explanation of this theory:

> "International correspondent banking is a major banking activity in the United States in part due to the popularity of the U.S. dollar. U.S. dollars are one of a handful of major currencies accepted throughout the world. They are also viewed as a stable currency, less likely to lose value over time and, thus, a preferred vehicle for savings, trade and investment. Since U.S. dollars are also the preferred currency of U.S. residents, foreign companies and individuals seeking to do business in the

[76] McAfee (1999), pp. 2-8; Osterberg and Thomson (1999), p. 11.

[77] Agénor (2013), p. 120.

United States may feel compelled to use U.S. dollars."[78]

d. Reshaping the model through a private-public hybrid – today's regulation of correspondent banking

Chances and benefits of correspondent banking cannot be described accurately without a closer look at the regulatory landscape.[79] We have already described it as a (legal) risk factor, especially for smaller banks. On the other hand, tighter regulation is seemingly beneficial for those who expect to profit from the concentration process that goes along with it.

aa. Post-9/11 - an era of punishments

The intensification of regulatory and compliance efforts is closely linked to the terror attacks of 9/11 and, in the last years, to the latest financial crisis. Furthermore, a growing amount of trade sanctions affect correspondent banking, such as in the context of the Iranian efforts to become nuclear or in the aftermath of Russia's annexation of Crimea.[80] The impact of regulation on correspondent banking has, thus, augmented in the course of the last decade. In numerous countries, the goal to fight terror cells around the globe and their financiers has led to stricter Anti-Money Laundering (AML) and Know-Your-Customer (KYC) rules. As a correspondent bank is usually not in direct contact with the clients and customers of the respondent, it lacks information in regards to the purpose or nature of the

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[78] Minority Staff of the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs of the United States Senate (2001), p. 287, footnote 12.

[79] A valuable outline of global regulatory developments, challenges and consequences is given by KPMG (2014); see also BIS (2016). On the impact of regulation on the transaction banking business with an analysis of U.S. and EU regulation, see the recent, broad study by Wandhöfer (2014).

[80] The Wolfsberg Group recently (2018) covered a good number of potential crisis scenarios in its "Country Risk Frequently Asked Questions", see ibid, pp. 4-5.

underlying transactions.[81] The risk of being unknowingly drawn into money laundering or terrorist financing activities is therefore inherently given.

Yet, connecting correspondent banking to money laundering practices and other criminal activities is a rather new development in the regulatory landscape. Let's take the U.S. efforts to counter money laundering as an example: neither the original text of Bank Secrecy Act (1970) nor the Money Laundering Control Act (1986), the Anti-Drug Abuse Act of 1988, the Annunzio-Wylie Anti-Money Laundering Act (1992), nor the Money Laundering Suppression Act (1994), the Money Laundering and Financial Crimes Strategy Act (1998) contained the term "correspondent banking" or even circumscribed it.[82] This observation also applies to lengthy congressional reports of the legislative measures.[83] Eventually, the latest financial crisis initiated legislative demands for higher capital requirements for financial institutions, better risk control and advanced consumer rights protection.[84]

We also see a slow shift from more and more "self-regulation" by the industry[85] to processes that involve many different stakeholders. In the last years, correspondent banking

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[81] Basel Committee on Banking Supervision (2014), p. 24.

[82] As a European example, Italy, in the wake of September 11, 2001, launched a Financial Security Committee (FSC) by Decree Law No. 369/2001. The FSC also creates relationships with foreign correspondent units, in order to coordinate freezing mechanisms with foreign jurisdictions, see IMF (2006), p. 43.

[83] See, for instance, the Report from the Committee on Banking and Financial Services of the House of Representatives on the Money Laundering and Financial Crimes Strategy Act (1998), submitted on June 25, 1998, http://archives.financialservices.house.gov/banking/hr1756rp.pdf.

[84] On recent regulation of transaction banking connected to the latest financial crisis, see Wandhöfer (2014), pp. 5-57.

[85] According to Claessens, Underhill, and Zhang (2008), large international banks intensely influenced the rules of Basel II.

developed from a “matter of trust and reputation”[86] to a matter of “must and regulation.”

Eminent cases of painful multibillion-dollar fines for major banks involved in criminal correspondent banking procedures illustrate a tighter stance of regulatory bodies. Simultaneously, compliance and regulation costs are mounting for the banking sector. According to a presentation of SWIFT in 2011, sanction regimes, AML- and KYC measures had already cost the industry up to $7 billion per year ($5 billion compliance costs growing at almost 8% per year and $2 billion in noncompliance fines).[87] A few years later, this number is even higher. In June 2014, BNP Paribas agreed to pay $8.97 billion to settle a sanction probe connected to correspondent banking activities by U.S. authorities.[88] BNP Paribas entered the U.S. financial system by working through satellite banks with U.S. correspondent accounts.[89] U.S. officials commonly call these accounts “nested accounts”.[90] One month earlier, the Credit Suisse Group agreed to pay $ 2.6 billion to U.S. authorities after pleading guilty of supporting the tax evasion of American citizens. Other big international banks were prosecuted by the U.S. after control failures connected to AML, terror financing and sanction regimes. HSBC paid a $1.9 billion fine and Standard Chartered, ING and Barclays were confronted with remarkably high penalties as well. These cases may also lead to a higher awareness of AML risks by bank executives. In 2011 their alertness was surprisingly – to put it mildly – underdeveloped. According to a KPMG study, only 62 percent of bankers responding then saw anti-money laundering as a high profile issue for senior management, down from 71 percent in 2007.[91]

National and international authorities are continuously working on rules that reflect

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[86] Manchester (2013).

[87] SWIFT (2011b), p. 5.

[88] *The Wall Street Journal*, BNP Paribas Draws Record Fine for 'Tour de Fraud', June 30th 2014.

[89] Wolf (2014).

[90] Ibid.

[91] KPMG (2011), p. 10.

sufficient consumer rights protection and enough capital in the banks' balance sheets in order to limit prevalent risks in the correspondent banking system. In globalized financial markets it is a simple equation that regulatory failure in one country can lead to severe ramifications in other countries. Conversely, successful implementation of regulation in one country may lead to necessary regulatory activities in other parts of the world.[92]

Correspondent banking is a core example of being the aim and root-cause of a "private-public regulatory hybrid." Aside from governmentally imposed regulation (or such from multinational public sector authorities), the role of self-regulation through the industry is remarkably forceful.

bb. The industry as regulator

"Private" initiatives were launched by the industry itself through such organisations like The Wolfsberg Group[93] and the Clearing House[94]. The Wolfsberg Group consists of leading members of the international banking industry that have given themselves a set of rules for correspondent banking (The Wolfsberg Principles for Correspondent Banking, 2002). Aiolfi and Bauer (2012), describe The Wolfsberg Group as "an industry-driven, voluntary initiative". Founded as an association of leading banks (today, it comprises of 11 members[95]) to prevent money laundering, The Wolfsberg Group is now addressing a

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[92] See Sarpeshkar (2012).

[93] "The Wolfsberg Anti-Money Laundering Principles for Correspondent Banking" by The Wolfsberg Group (2002).

[94] "Guidelines for Counter Money Laundering Policies and Procedures in Correspondent Banking" by The Clearing House Service Company (2002).

[95] Current members are Banco Santander, Bank of Tokyo-Mitsubishi UFJ Ltd, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, J.P. Morgan Chase, Société Génerale, and UBS.

broader spectrum of activities and principles to counter (mainly crime) risks in the financial industry. The group's programs have been continuously adjusted over the last years.[96]

The Bank for International Settlement (BIS)[97] is in an interesting position, as it is difficult to distinguish its multinational (driven by central banks) institutional character from its industry-related banking role. The BIS was originally established by an intergovernmental agreement (1930) and owned by governments and private investors.[98] Today, it is owned by the central banks that are members of the BIS. Although some see the BIS simply as an "international institution"[99], the active role of a significant number of central banks in correspondent banking justifies a categorization of the BIS' regulatory outreach as "self-regulation by the industry". Even more, as the BIS itself has the competence to act as a correspondent (of any central bank).[100]

cc. Selected approaches by governments

Some of the risks of correspondent banking mentioned above have been openly addressed in legislation, for example, through the USA PATRIOT Act, where the U.S. government

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[96] The Wolfsberg principles were expanded in 2004 with a due diligence questionnaire, which reflected industry practice at that time. The due diligence questionnaire was updated in 2014 and in 2017. In 2007, the Wolfsberg Group published a statement on payment message standards, supported by the Clearing House Association; in 2017, additional standards were put in place.

[97] On the BIS, see the study of Baker (2002). Koch (2007), gives insights of how the BIS tackles international financial markets challenges.

[98] On the history of the BIS, see Felsenfeld and Bilali (2004), pp. 946-68; Bernholz (2009); Baker (2002). A noteworthy view on its original goals, right after its founding, offer Schluter (1931), and Kilborne (1931).

[99] Lyngen and Simmons (2013), Appendix II, Baker (2002), p. xi.

[100] See Article 21 (k) of the Statutes of the Bank for International Settlements (of 20 January 1930; text as amended on 27 June 2005): "The Bank may also […] act as agent or correspondent of any central bank". Regarding the role of the BIS as a correspondent bank, see below Chapter 3 5.

undertook a major regulatory step regarding corresponding banking. Signed by U.S. President George W. Bush on October 26, 2001, to enhance security after the 9/11 terrorist attacks, the Act established expectations for increased due diligence for foreign correspondent banking relationships. It authorized the forfeiture of funds in U.S. correspondent bank accounts where criminal proceeds have been deposited into an account at a foreign bank holding a U.S. correspondent account. The PATRIOT Act prohibits U.S. banks from maintaining correspondent accounts in the U.S. for foreign shell banks and requires U.S. banks to ensure that foreign banks are not misusing their correspondent accounts for indirect banking services to any foreign shell banks.[101] Other requirements are that banks need to apply risk-based due diligence procedures and controls to their correspondent accounts maintained in the U.S. for foreign financial institutions. Enhanced due diligence is necessary regarding accounts established or maintained for certain higher-risk foreign banks.[102]

In addition to the provisions of the PATRIOT Act, the U.S government issued via the Federal Financial Institutions Examination Council (FFIEC)in 2010, and again in 2014, an updated version of the "Bank Secrecy Act/Anti-Money Laundering Examination Manual". It describes the expectations of U.S. federal regulators regarding due diligence and recordkeeping requirements for U.S. banks in connection to its maintenance of correspondent accounts in the United States for any foreign financial institutions. Logically connected, the U.S. Treasury published a notice of proposed rulemaking on customer due diligence requirements for financial institutions on August 4, 2014.[103]

The Dodd-Frank Wall Street Reform and Consumer Protection Act's[104] relevance for

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[101] Sections 313/319 of the PATRIOT Act (31 U.S.C. § 5318(j)-(k)). See on the provisions of the PATRIOT Act, in detail, The Clearing House (2014).

[102] Section 312 of the PATRIOT Act (31 U.S.C.§ 5318(i)).

[103] 79 Federal Register 45151 (August 4, 2014)

[104] Commonly referred to as "Dodd-Frank" - U.S. federal law since July 21, 2010 (Pub.L. 111–203, H.R. 4173).

correspondent banking is given through greater capital buffer and disclosure requirements (the latter even for non-U.S. partners in a correspondent relationship) and ex-ante constraints on risk-taking. This also leads to significant changes in U.S. electronic fund transfers. Small banks are particularly affected.[105] A good number of banks is, therefore, re-evaluating their stance on cross-border retail services and are concerned about mounting compliance costs.[106]

Another significant U.S. federal law is the Foreign Account Tax Compliance Act (FATCA). It especially affects non-U.S. banks to make relevant changes to their internal reporting systems as they need to inform the U.S. Inland Revenue Service about financial accounts held by U.S. taxpayers. When a covered financial institution tries to dodge the requirements of the new law, it risks losing its U.S. correspondent banking relationships.[107]

dd. Inter- and multinational efforts

As hard (or currently impossible) as it still is to coordinate a global regulatory effort for safeguarding sound and efficient financial services and intermediation, we have witnessed some remarkably organized multinational, multi-institutional and industry-led global efforts to face new and existing (but well-hidden) challenges of the financial sector – from the Basel II to the Basel III capital accords (and its changes of 2016 and 2017)[108] to the Basel Core Principles on Banking Supervision and the capital markets standards, published by the International Organization of Securities Commissions (IOSCO). In addition, several

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[105] Mazur (2014).

[106] See also already SWIFT (2011).

[107] Stated on the website of IRS: http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-FATCA.

[108] Referred to by many as “Basel IV”, see only Amarello (2016).

international bodies, including the International Monetary Fund (IMF)[109], the Organisation of Economic Cooperation and Development (OECD), the Financial Stability Board (FSB), and the International Association of Insurance Supervisors (IAIS), among other institutions and organisations, have discussed and delivered insurance, corporate governance rules, and transparency and monetary management guidelines.[110]

International organizations also tried to establish far-reaching rules for correspondent banking. The impact of Basel III on correspondent banking becomes evident by its liquidity coverage ratio (LCR) that requires banks to have enough high-quality liquid assets and to keep or install sufficient reporting schemes – potentially with daily reporting. Additionally, the so-called Net Stable Funding Ratio became obligatory in 2018. It is a longer-term structural ratio that covers the whole balance sheet, forcing banks to establish stable sources of funding.[111]

The Financial Action Task Force (FATF), established in 1989 by the ministers of its member jurisdictions, is also concentrating more intensely on correspondent relationships.[112] Its goal is "to set standards and to promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist

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[109] The IMF (2017b) has provided technical assistance and training to help countries enhance their monitoring of correspondent banking relationships and foster their legal framework, as well as their supervisory and enforcement capabilities, see also BIS (2018), p. 34.

[110] See, for example, Claessens (2013), p. 168. A good overview on international financial regulators and the discussion about their future role is given by Porter (2013).

[111] See Deutsche Bank (2015), p. 2.

[112] The FATF currently consists of 34 member jurisdictions and two regional organisations, representing most major financial centres around the globe. Members are Argentina, Australia, Austria, Belgium, Brazil, Canada, China, Denmark, European Commission, Finland, France, Germany, Greece, Gulf Cooperation Council, Hong Kong (China), Iceland, India, Ireland, Italy, Japan, Republic of Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Portugal, Russian federation, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, United Kingdom, and the United States. On the scope and range of the FATF, see Alexander (2001).

financing and the financing of proliferation, and other related threats to the integrity of the international financial system."[113] In its "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation", the FATF gave one recommendation (Number 13) of the so-called 40 Recommendations that highlights correspondent banking. In 2016, it provided further guidance on how to apply a risk-based approach to prevent terminations of correspondent banking relationships and other so-called "de-risking" practices (FATF, 2016).[114]

Noteworthy is also the International Finance Corporation's "Correspondent Account KYC Toolkit"[115], issued in October 2009 by the private sector arm of the World Bank Group. However, this paper is mainly a review of best-practice standards for due diligence practices for any correspondent account applications. The Financial Services Authority (FSA) of the UK published another guideline called "Banks' management of high money-laundering risk situations"[116], as did the U.S. Federal Financial Institutions Examination Council (FFIEC) with its "BSA/AML Examination Manual"[117].

ee. Consequences of compliance

In general, smaller banks are hit harder by stricter regulatory frameworks. In one study, the U.S. Consumer Financial Protection Bureau (CFPB) evaluated "that the two smallest participants in the Study incur higher costs (as a relative share of their estimated total retail

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[113] FATF (2012), p. 7.

[114] See also BIS (2018), p. 34.

[115] The International Finance Corporation's "Correspondent Account KYC Toolkit" can be found at http://www.ifc.org/wps/wcm/connect/dfb227004ec4ea109697bf45b400a808/CORRESPONDENT+ACCOUNT+KYC+TOOLKIT.pdf?MOD=AJPERES.

[116] Financial Services Authority (FSA) (2011).

[117] The FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual (last revised in 2014) is available at: https://www.ffiec.gov/bsa_aml_infobase/pages_manual/manual_ online.htm www.ffiec.gov/bsa_aml_infobase/default.htm.

deposit operating expenses) than the five larger banks. Specifically, the two smallest institutions had in-scope compliance costs of about 4% and 6%, respectively, of their estimated total retail deposit operating expense. The five largest Study participants incurred costs to comply with these regulations roughly equal to 1% to 2% of their estimated total retail deposit operating expenses."[118] Some banks, struggling to bear the costs of properly managing the risks, have given up offering a wide spectrum of correspondent services or have even pulled out of certain regions and countries. This frequently leads to a reassessment of their relationships with large global transaction banks and to a movement toward smaller correspondents.[119]

SWIFT predicted that the implementation of the Dodd–Frank Act would create costs of $10 to 300 million per bank.[120] Other regulatory measures, like Basel III with its revised Liquidity Coverage Ratio (LCR), cause a painful shortage of liquidity in many smaller banks. Citibank (2013), for instance, "believes there is a high likelihood that correspondent banking models will change as a result" as banks conventionally "have put assets on their balance sheet to protect their cash management and deposit business. But if those liabilities that they are protecting have no value under LCR there will be dramatic ramifications in the near term."[121] Deutsche Bank (2015, pp. 1-2) also acknowledges that compliance with additional regulations like Basel III, Dodd-Frank Act, the membership in the Single European Payments Area (SEPA)[122] and FATCA will only expand the complexities and

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[118] CFPB (2013), p. 14.

[119] See Imeson (2015), p. 1.

[120] SWIFT (2011b), p. 5.

[121] Citibank (2013), p. 3. The regulatory standards of Basel III - agreed upon by the Basel Committee on Banking Supervision in 2010/11 to be implemented between 2013 and 2015 - aim at counterparty risk through higher capital buffer requirements, stress testing and liquidity requirements. Additionally, they promote risk reduction at financial institutions through clearing and hedging. See Chorafas (2012); Khan (2013); recently Dietrich et al. (2014).

[122] SWIFT (2011a) estimated the costs of implementing SEPA at EUR 8-10 billion for the banking industry. It is extremely difficult to gain a precise number as the real costs very much depend on the

costs of correspondent banking.

Higher costs involve higher capital adequacy and liquidity requirements, but also direct expenditures on compliance, augmented reporting, and enhanced development of internal systems.[123] The rising cost factor is acknowledged by the ECB (2017b), the BIS (2018 and 2016) and the IMF (2017).

The Board of Governors of the Federal Reserve Bank (2015, p. 4) sees "[a]necdotal evidence […] that, in light of these obligations and associated costs, depository institutions are making business decisions to re-examine their cross-border payment service offerings and account relationships." Furthermore, the Federal Reserve points at suggestions of reports that "large depository institutions may be reducing or restricting correspondent banking relationships, which in turn may limit the ability of smaller depository institutions to provide remittance transfer services."[124]

ff. The dream of standards

Closely related to movements in the regulatory landscape are attempts to standardize the correspondent relationship industry. For example, formats of financial messaging differ vastly. As a consequence, the ISO 20022 standard (electronic data interchange between financial institutions) was developed by the International Organization for Standardization to simplify financial messaging and global business communication by offering a common

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strategies of the different financial institutions. Larger global banks spent exceptionally high amounts to create own new payment platforms that could cope with the whole variety of regulation and new payment systems. Smaller financial institutions may tend to find third party providers that could manage SEPA's (and other) requirements. In contrast to this, a PricewaterhouseCoopers Study (2014, p. 2) for the European Commission sees "[p]otential yearly savings to all stakeholders of €21.9 billion – a recurring annual benefit resulting from price convergence and process efficiency."

[123] Claessens (2013), p. 180.

[124] Board of Governors of the Federal Reserve (2015), p. 4, referring to International Chamber of Commerce (2014).

messaging language for - among others - payments, securities, funds, FX trading.[125] Adopted in Europe, ISO 20022 is still being evaluated in some other countries like the U.S.[126] or Australia.

Other paradigms for more coherence in the international arena of payments are the "Statement on Payment Message Standards" by the Wolfsberg Group and The Clearing House Association[127] as well as attempts to establish international standards for transparency in payment messages by the Basel Committee on Banking Supervision[128], the U.S. Treasury's Office of the Comptroller of the Currency[129] and SWIFT.[130] Yet, in the light of the variety of rules and regulations around the globe and also due to the existing confusion of how to correctly define correspondent relationships, we still value global standardization as a Sisyphean task. The sheer amount of players involved adds up to this conclusion.

In summary, intensified regulation not only leads to higher compliance costs, but it also influences the strategies of many banks of how to conduct and organize correspondent

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[125] Deutsche Bank (2015), p. 2. See "ISO 20022 Universal financial industry message scheme", www.iso20022.org. The co-sponsors included the Federal Reserve Bank of New York, The Clearing House Payments Company L.L.C., NACHA-The Electronic Payments Association, and the Accredited Standards Committee X9-Financial Industry Standards, Inc.

[126] The Federal Reserve made clear that it aims "to work with the co-sponsors to consider ISO 20022 implementation strategies", Board of Governors of the Federal Reserve System (2015), p. 4. In 2018 the Fed requested comments on the proposed adoption (beginning in 2020, ending in 2023).

[127] The Wolfsberg Group & The Clearing House Association (2007).

[128] BIS (2009).

[129] U.S. Department of Treasury (2009).

[130] On November 21, 2009, SWIFT implemented a new MT 202 COV message that entails further information about the originator and the beneficiary for any bank-to-bank transfer that is a cover payment - with the goal to enable banks to effectively manage the required sanctions screening and suspicious activity monitoring, see Payments Market Practice Group (2010).

banking and, in more general terms, correspondent relationship business.[131] In the wider framework of transaction banking, Wandhöfer (2014) also points at the "challenge when it comes to regulation, as the lack of harmonised international definitions and in the absence of a common understanding of the nature of [the] services [of transaction banking] also means that regulatory measures may not be properly designed to take them into account (or prevent unintended consequences)."[132]

2. Banking *sui generis* or regular (inter)national banking?

Although fulfilling all universal functions of a financial system (see Introduction and Chapter 7) correspondent banking has to be strictly differentiated from other forms and types of using national and international offices for financial services, we find several organizational varieties, which are qualified to be involved in multinational banking businesses.

In general, multinational banking is unthinkable without its regional and national dimensions. The institutional presence and business activities of multinational banks are regularly also given in their home countries. Correspondent banking is per se not multinational banking as it does not imply foreign direct investment or any physical presence in a foreign market. In theory, it can also be concentrated solely on a domestic market. Yet, throughout the last centuries and due to the growing interdependence of financial markets the importance of this (local) option has more and more waned (see in detail Chapter 4). If we follow the definition of a multinational bank as a bank that "owns and controls branches and/or affiliates in more than one country"[133] and that typically deals with foreign direct investment, correspondent banking can – besides an exclusively national outreach - only be a form of international (or foreign) banking which is defined broader. The latter implies "cross-border and cross currency facets"[134] and Eurocurrency banking.

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[131] Choudhary (2012), p. 5.

[132] Wandhöfer (2014), Chapter 3.1.2. Grolleman and Jutrsa (2017) are advocating a questionable national monitoring framework to be used by national central banks and supervisory authorities.

[133] Jones (1992), p. xiii; Curry et al. (2003), p. 28.

[134] Lewis and Davis (1987), p. 219.

McCauley et al (2010, p. 10) also distinguish sharply between "multinational" and "international" banking: "In other industries, as a firm expands from its home market, it sets up subsidiaries abroad that borrow locally to finance assets: this is the multinational model […]. Accordingly, the multinational bank operates sizeable foreign branches and subsidiaries in multiple jurisdictions […] and, at the limit, funds those positions locally in the host countries. In contrast, the international bank operates out of the home country or in a (major) financial centre and conducts mostly cross-border business."

a. Types of (inter)national banking offices

Aside from moving the academic debate on correspondent banking to the international level it also has to be differentiated from other types of inter-, respectively multinational banking.

aa. Representative Offices

The most restricted alternative and simplest form of organization in multinational banking is the establishment of *representative offices.* They are commercial premises of multinational banks and they conduct businesses in a limited form, mainly assisting and supporting the businesses of the multinational bank, but they may generally not conduct a commercial banking business. A representative office is especially not allowed to make any business decision on behalf of the foreign parent bank or to commit the parent bank to any banking transactions. Therefore, neither the purchase and sale of funds, notes or bills of exchange nor loan transactions or the acceptance of deposits are permitted.[135] So, a representative office usually engages in an administrative and representative role for its parent bank and often has the function to investigate a new banking market initially.

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[135] Curry et al. (2003), p. 39. According to Goldberg and Saunders (1981), p. 366, *representative offices* may organize loans in foreign markets as long as they are referred to and administered by the home bank; furthermore they can – on behalf of the multinational bank – collect and forward payments in foreign countries, see Curry et al. (2003), pp. 39-40. Another exception we find in the U.S., where federal law, under Regulation K, Sec. 211.24 (d) (ii), allows representative offices to make credit decisions if: "(i) the foreign bank operates one or more branches or agencies in the United States; (ii) the loans approved at the representative office are made by a U.S. branch or agency of a foreign bank; and (iii) the loan proceeds are not disbursed at the representative office."

Recurrently, an enlarged foreign presence through representative offices tallies with the wish to widen the referral business from offshore markets to the parent bank. Such a business could certainly be conducted by correspondent banks as well. However, the decision to install representative offices keeps the head office independent of potential conflicting own interests of a correspondent bank. In other words: representative offices serve as marketing offices and as a liaison between the head office of the foreign parent bank and its customers - and correspondent banks in the host country.[136] It is a rather common approach for multinational banks to maintain concurrent relationships to correspondent banks even if representative offices are being established as the "existence of representative offices can even improve the quality of such relationships"[137] The possibility of being in contact with officials from correspondent banks of the parent bank involves options for the representative office to help to resolve certain operating challenges and problems that may stem from transactions or other businesses between the head office and correspondent banks. Many representative offices concentrate on research and information gathering for the parent bank; their services may also consist of investigating and preparing loan applications as well as offering back-office functions.[138] The superficial disadvantage of restricted powers for representative offices still bears the advantage of being exposed to only minimum regulation by the host country's banking authorities.

bb. Foreign agencies

A wider scale of banking activities can be provided by *foreign agencies*. An agency is an operational and a legal extension of its parent foreign bank; it is not a separately capitalized cooperation in the host country.[139] In contrast to representative offices, agencies can conduct and respectively finance certain transactions. They have the capacity to accept bills

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[136] PricewaterhouseCoopers (2005-2006), p. 25.

[137] Curry et al. (2003), p. 43.

[138] See ibid.; Goldberg and Saunders (1981), p. 366.

[139] PricewaterhouseCoopers (2005-2006), p. 27.

of exchange as well as honour and issue letters of credit[140], activities that allow them to be facilitators of "foreign trade between home and foreign countries"[141]. Other banking services imply corporate and commercial loans and, to a limited extent, deposit taking - often with the exception of taking them from residents of the host country. Typically, agencies maintain credit balances.[142] Because of their involvement in foreign capital and money markets, which comprises foreign exchange markets, agencies can also be an important factor in asset-management for the foreign head office.[143] Agencies may also be chosen by the head office to facilitate growth in exporter servicing or lending.[144] For the FSA, a correspondent "is effectively an agent for the respondent and executes/processes payments or other transactions for customers of the respondent"[145]. This definition may lead to misunderstandings - despite the moderating term "effectively". Due to the fact that an agent is a dependent entity, agencies and correspondents have to be strictly differentiated in the financial terminology.

cc. Foreign branches

A *foreign branch bank* operates in countries other than the parent bank to which it is legally tied. However, the branch and parent bank are not separate legal entities under the law of the host country. This leads to an obligation to abide by banking regulations established both in the home and host countries. Foreign branches are, therefore,

[140] Goldberg and Saunders (1981), p. 367.

[141] Curry et al. (2003), p. 40.

[142] In this context, "credit balance" means a deposit-like obligation that is generated by the exercise of other lawful banking powers (PricewaterhouseCoopers (2005-2006), p. 27).

[143] Heinkel and Levi (1992), p. 253.

[144] Ibid., p. 259.

[145] Financial Service Authority (2011), p. 43.

regularly defined as legal and operational extensions of their parent foreign banks.[146] This also is its major difference from a correspondent bank, which is based in and legally tied to the host country.[147]

It bears clear advantages for a head bank to choose branches or agencies instead of correspondent banks, especially if the head bank concentrates on trade finance: Whenever a head office decides to expand its multinational business, the probability of an amplified frequency and volume of cross-border movement of money is very high. If the head office then only relies on correspondent banks, the increase of these transactions can lead to considerably large cash balances in the accounts of the correspondent banks.[148] These Cash balances could be used efficiently by the head bank itself through agencies or branches.

A foreign branch can operate in many fields of banking, including investment and trading activities. It is also possible for a branch to give credits, to appear as a fiduciary, to receive foreign deposits and to engage in wholesale commercial activities; as a limitation, foreign branches are not allowed to conduct retail deposit-taking activities.[149] The decision to establish a branch (instead of, for example, a subsidiary) is often driven by the aim to keep costs as low as possible. The legal and operational ties to the foreign parent bank lead to the advantage that typical costs of a separate organization – e.g., for accounting and legal advice or initial capital investments– can be shunned. A major benefit of this organizational form is, of course, that branches have a much wider margin of making loans – due to the fact that the credit limits are based on the capital of the foreign parent bank[150]. The

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[146] See, for example, PricewaterhouseCoopers (2005-2006), p. 25.

[147] In this context, the term “unit banking” may lead to misperceptions. According to Verdier (2002), p. 67, it is “a system in which banks are not allowed to establish branches outside the area where they are headquartered–it is the opposite of branch banking.”

[148] Merrett (1995), p. 83; Curry et al. (2003), p. 43.

[149] PricewaterhouseCoopers, ibid.

[150] Ibid.

motivation of establishing branches can also be the desire to have access to the savings of the respective population in the form of individual deposit accounts.[151]

dd. Shell branches

So-called *shell branches* are mostly nothing more than a box at a post office (the German expression is typically enough "Briefkastenfirma"). It is a financial institution without a physical presence in any country and without being affiliated to any financial services group that is subject to effective consolidated supervision.[152] Thus, it is the parent bank that conducts the actual business in the country where the parent is located. The Wolfsberg Group defines a shell bank as follows: "A Shell Bank is a bank that: (i) does not conduct business at a fixed address in a jurisdiction in which the Shell Bank is authorised to engage in banking activities; (ii) does not employ one or more individuals on a full time business at this fixed address; (iii) does not maintain operating records at this address and (iv) is not subject to inspection by the banking authority that licensed it to conduct banking activities. A bank which meets these requirements but which is also a Regulated Affiliate is not a Shell Bank for the purposes of these Principles."[153] The lack of services tells a shell branch from a correspondent. An initial intention to allow shell banks was to give banks the opportunity to step into international competition while sparing the expenses of arranging operations "for real". The focus on many such institutions has changed, though. They have increasingly been connected with criminal activities. In the U.S., legislation was created in order to prevent money laundering, which often was conducted by involving shell banks (as well as correspondent banking structures. As an example, Subtitle A of the USA PATRIOT Act (2001) explicitly prohibits shell banks – of course with the exception of shell banks that are controlled by a bank that is physically located in the U.S.

[151] Verdier (2002), p. 44.

[152] Definition of the Working Group on Cross-Border Banking (2003), p. 1.

[153] The Wolfsberg Group (2002), p. 3. "[A] Regulated Affiliate is a bank which would otherwise be a Shell Bank or an Offshore Bank (as the case may be) but which is owned, directly or indirectly by a financial institution that is licensed in a jurisdiction that is not a FATF Non-cooperative Jurisdiction and which is subject to supervision by the banking authority of that jurisdiction", ibid.

ee. Subsidiaries

Furthermore, we have to distinguish *subsidiaries* from correspondent banks: a subsidiary bank is incorporated in one country but is either wholly or partially owned by a parent bank in another country. The other features of subsidiaries come very close to correspondent banking, though. It is a separate legal entity with its own capital basis that is separate from its foreign parent bank. Thus, the bank, which they represent, is neither legally nor for tax reasons regarded as being present in the foreign country. The subsidiary bank follows only the laws of the host nation. Frequently, this is an opportune way for parent companies to circumvent stricter regulations in their home country. Subsidiaries have to abide by the same regulations and requirements as other banks from the host country. Consequently, they may perform the same banking activities as domestic banks in the host country. There are generally two ways to establish a subsidiary bank: either by buying the shares of an existing bank in the host country or by obtaining a new charter.[154]

Usually, the subsidiary's board of directors consists - at least in the majority - of citizens and/or residents of the host country, and the local management has a high degree of decisional autonomy within the parent bank's group. Compared to branches, a major disadvantage of subsidiary banks is the extent of loans that the bank can make. As a separate organisation, it does not have the credit-"backchannel" to the parent bank. On the other hand, the subsidiary may underwrite securities. Very often, large parent organisations chose subsidiaries to circumvent unwelcome regulation constraints or taxation regimes at home.

In contrast to representative offices, agencies and branches, whose activities are closely tied to the foreign parent bank, a subsidiary acts "more independent of its parent [and is] thus seen as being a financial investment rather than a supporting arm of the parent bank"[155]. Compared to other models of representation, subsidiaries regularly do not play an active part in the capital market of the parent bank's market. Blandon (2000) adds "[B]anks tend to establish subsidiaries in locations with a more restrictive attitude towards foreign

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[154] PricewaterhouseCoopers (2005-2006), p. 28.

[155] Curry et al. (2003), p. 43.

entrants, possibly due to the existence of monopoly rents in the retail segment”.

ff. Edge Act banks

In addition, *Edge Act banks* apply to certain U.S. banks. They are based on a constitutional amendment of 1919 to the United States Federal Reserve Act of 1913 that allows U.S. banks to engage in international banking through federally chartered subsidiaries. The rationale behind the legislation was to offer U.S. banks more international competitiveness.[156] They are physically located in the United States and act internationally under a federal charter.

On the national level, correspondent banking has to be differentiated from agencies, branches and subsidiaries as well. The distinctive features are very similar – again, the most important difference is the de facto independence of a correspondent bank from the respondent.

b. Correspondent banking and banking correspondents

We have already mentioned the construct of *banking correspondents* - in Brazil they are called *correspondents bancários* - where numerous banks use correspondents to extend their service and distribution reach by partnering with outlets that are “commercial entities whose primary objective and business is other than the provision of financial services.”[157] These entities are mainly retail commercial outlets, including pharmacies, grocery stores, post offices, kiosks, gas stations, or the lottery outlet chain. The rapid development of modern information technology has fostered the expansion of this model.

It is highly popular in Latin America, but also in other emerging markets, namely in India, where it was adopted in 2006 as a bank-led, technology-driven model for the progression of branchless banking to achieve financial inclusion (Sa Dhan, 2012).[158] “Financial Inclusion”

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[156] The Act is named after Senator Walter E. Edge who sponsored the original legislation for these types of subsidiaries.

[157] Kumar et al. (2006), p. v.

[158] According to Sa Dhan (2012), p. 17, the “legal relationship between the BC [banking

serves as a popular catchphrase, defined by the World Bank as "the proportion of individuals and firms that use financial services."[159] Services, of course, that provide people and firms in less developed parts of the world with access to resources to eventually meet their individual financial requirements and expectations. In the light of about 50 percent of all adults around the globe without a bank account, the demand is evident for a correspondent model that closes existing gaps of regional outreach.

The growth numbers of "banking correspondents" are impressive: McKinsey (2012) describes the example of a bank in Colombia with 700 branches and 900 correspondent outlets. According to this study, correspondent outlets in Brazil outnumber bank branches by seven to one and in Colombia by two to one.[160] Correspondent outlets in Brazil increased from less than 6,000 at the turn of the millennium to 38,160 in 2004.[161] A report of the Banco Central de Brasil (2010) indicated more than 170,000 correspondents in June 2010[162], of which more than 50,000 were authorized to open accounts and handle deposits[163].

Although some use the term "correspondent banking" also for this particular type of banking outreach (Kumar et al., 2006; Diniz et al., 2008; Mettenheim et al., 2013), and

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correspondent] and the bank is that of an Agent and Principal bound by a legally enforceable contract. The BC, in turn, employs CSPs [community service points] who are sub agents of the banks. The BC gets compensated by the bank for the services rendered which is shared with the CSP and the technology provider. The technology provider acts as a link between the bank, BC, CSP and the client creating an enabling environment using technology."

[159] World Bank (2014), p. 1.

[160] McKinsey (2012), p. 21.

[161] Kumar et al (2006), p. 9.

[162] Banco Central do Brasil (2010), pp. 54-5. See also Assunção (2013).

[163] CGAP (2010), p. 2. In 2014, more than 207,000 correspondents were counted, see de la Torre; Gozzi and Schmukler (2017), p. 179.

others see it as a specific form of *correspondent banking* (Sanford and Cojocaru, 2013), we have to strictly distinguish it from the latter. Above, our rough – yet incomplete - definition of correspondent banking encompassed two financial institutions on both sides of the relationship. Still, a correspondent relationship as we find it, for instance, in Brazil and India requires a non-bank firm as a correspondent. The term “branchless banking” for “banking correspondents” is correct in a wider sense, but not sufficient to classify both models correctly, because correspondent banking is also branchless banking (with at least two financial institutions involved). Although a financial institution does not necessarily have to be a bank, it is clear that some typical “banking correspondents” like lottery agencies, supermarkets, drugstores and gas stations cannot be defined as financial institutions, if at all as “micro finance institutions”[164]. In summary, we find a better and less misleading term in the expression “business correspondents” as it is commonly used in India (Kamatchi and Hasan Banu, 2013; Ananth and Sabri Öncü, 2014).[165] To avoid misunderstandings, “business correspondents” should be the general term for correspondent agreements that are based on a contract between a bank and a non-bank firm.

Usually, the services of a “business correspondent” relationship need the approval of the central bank. In Brazil, the activities of the *correspondentes bancários* are regulated by the National Monetary Council, a government body in which the Banco Central do Brasil Central Bank takes part. The Brazilian example shows that contracts can be either exclusive or non-exclusive.[166] Business correspondents typically receive applications for opening checking accounts and savings accounts, collect deposits and provide payments for checking and savings accounts and even investment funds; they may implement payments for the host bank, receive credit applications and perform credit evaluations.[167]

Another significant difference from correspondent banks is not only the limitation to the

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[164] Reserve Bank of India (2009), p. 9.

[165] But see, on the other hand, IFC (2013) that also speaks of “banking correspondents” in India.

[166] Assunção (2013), p. 2808.

[167] For the system in Brazil, see ibid.; for India, see Reserve Bank of India (2009), p. 10.

domestic market of business correspondents, but also their main goal, namely to primarily serve poorer parts of the population in remote areas of a country. Sanford and Cojocaru (2013) have identified four major motives behind the establishment and the rapid growth (about 19 percent per year) of business correspondents in Brazil: the distribution of social transfer payments to numerous families with no or almost no access to financial institutions, laxer regulation for branchless banking, better prospects for retail and credit within the lower classes of the population due a sounder economy with decreased poverty and, finally, a new, flexible bill payment system "that allowed bills to be paid at nearly any shop."[168] Another reason for the expansion of this system has to be added. Like other emerging market economies, Brazil has been at the forefront of developing digitized and automated banking procedure technologies.[169]

Finally, business correspondents seemingly perform like regular bank *branches* for many retail banking operations "and are therefore able to manage different types of accounts and provide loans and payment services."[170] Nonetheless, there is a significant divergence of bank branches as described above: business correspondents do not list any of these services on their balance sheets. In reality, business correspondents are a prime example of cost-reducing *branchless* banking.[171]

c. Bankers' banks as untypical correspondents

A correspondent banking relationship can lead to a situation that the correspondent suddenly becomes a competitor in the region where the respondent is located. Especially in "small to big" relationships, where a local (community) bank uses the service spectrum of a large correspondent bank, the correspondent may feel tempted to use the flow of

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[168] Sanford and Cojocaru (2013), p. 5.

[169] See Diniz et al. (2008). However, their assumption that "the high inflation rates that prevailed for decades until the mid- 1990s provided major incentives for banking automation, leading to the development of superior expertise in this area" (ibid.) seems to be rather far fetched.

[170] Assunção (2013), p. 2808.

[171] See also Sanford and Cojocaru (2013), p. 9.

information to reach out to a valuable new customer base as well. According to Brickley et al (2012, p. 114), "[d]eregulation and technological change during the last third of the 20th century" led to a higher "likelihood that these large banks would compete with community banks in their local retail and commercial lending markets." In this context, the deregulation aspect has to be connected to rules as to not compete for a client's customers. Consequentially, a growing number of smaller community banks in the U.S. established a contractual (vertical integration[172]) relationship with so-called *bankers' banks*. They can be seen as business cooperatives without retail banking operations.[173] U.S. legislation clearly limits the range of services. As stated by, for instance, the Virginia Code a bankers' bank, while being vested with all of the powers and subject to all of the restrictions imposed upon a bank, shall only accept deposits from or make loans to another financial institution.[174] In 1975, the first bankers' bank was founded in Minnesota (United Bankers' Bank). The model proved to be successful: as of January 2014, 15 bankers' banks offered their correspondent services to more than 6,000 banks in 48 states in the U.S.[175]

d. Reimbursement banks and group networks

A specific type of correspondent bank can be the so-called *reimbursement bank (or reimbursing bank)*. As a third bank (usually in the letter of credit business) it regularly

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[172] On "competition and vertical relationships in capital markets", see Asker and Ljungqvist (2010).

[173] See Brickley et al. (2012), p. 114, who also offer a definition of *business cooperative* (ibid., p. 117): "Broadly defined, business cooperatives display a variety of legal forms, including corporations, partnerships, and mutuals. Some are formed through negotiation among the participating firms (for example, joint ventures), while others, such as bankers' banks, are member organizations in which each qualifying firm makes an independent membership choice. Cooperatives vary in the rights and obligations associated with membership (for instance, voting rules and the distribution of profits)." Business cooperatives are not to be confused with *cooperative banks* (more on this model by Ayadi et al. (2010)).

[174] VA Code § 6.2-809 (2013).

[175] See http://www.federalreserve.gov/SECRS/2014/March/20140314/R-1466/R-1466_013114_111931_337075897307_1.pdf. More generally on bankers' banks, Fine (1992).

settles high-volume business transactions that would overstretch the capacities of the correspondent bank.[176]

The BIS (2012, p. 93) points out that so-called “group networks” stand for a “special kind of correspondent banking service.” Established in the late 1980s and early 1990s by groups of banks these networks aimed to reach local retail payment systems in a good number of countries and thereby facilitate cross-border payments for their customers.[177] The most prominent of these networks are Eurogiro[178] and TIPANET[179].

Lastly, in numerous countries banking groups have created their own patterns and networks for transactions between the banks concerned. The BIS (2012, p. 93) mentions that savings banks in some countries have developed their own payment clearing networks with the aim of engaging and interconnecting all savings banks to direct their intra-network payments to the clearing provider.

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[176] See Khambata (1996), p. 25.

[177] BIS (2012), p. 93.

[178] Eurogiro, originally established as “a partnership between postal and giro organisations” and later reorganized “to form a holding company, processes credit transfers and cash transfer orders without any limit on the size of payments; transactions [take place] directly from member to member and are settled bilaterally on a gross basis once a day”, BIS (2012), ibid., according to which “it has formed strategic partnerships with, inter alia, Visa, Western Union the Federal Reserve System [and] since November 2001 it has been possible to settle transactions” in Euro with a single settlement agent, the Euro Settlement Service Provider; see also ECB (2010), p. 203.

[179] TIPANET, a network put in place in 1993 by 11 cooperative banks from 9 countries ensuring “reach for retail payments destined for Europe, Canada, the United States and northern and sub-Saharan Africa, processes credit transfers, direct debits and cheques” (ECB, 2010, p. 202). According to the ECB (ibid.) and the BIS (ibid.), “the local correspondent collects all payment instructions, creates payment batches and sends them to its foreign correspondents, which then process the payments in the relevant local payment systems. The settlement of payments takes place via existing reciprocal accounts.”

3. Accounting methods – detached bookkeeping

As already stated above, a correspondent relationship can (but not necessarily have to)[180] be based on a very specific scheme of accounts where a financial institution holds on its books an account on behalf of any other financial institution for which it conducts correspondent services. It is called a "vostro" account. For the respondent, it is the "nostro" account. In international correspondent service arrangements the nostro account maintains balances in another currency than the home currency. Consequentially, the vostro account is a local currency account, mainly used to debit and credit payments of the clients. The use of a "loro" account means that payments are made on the account of a third financial institution. Correspondent bank balances (or, in the United States, "due from bank deposits") are regularly seen as part of the primary, uninvested funds of every financial institution.[181]

As it so often happens in the framework of correspondent relationships, we stumble into terminological confusion. The terms "nostro" and "vostro" are recurrently, but not generally used in the international context. In the United States, for instance, the (official) terminology is "due to" and "due from" balances.[182] This tallies with the liability and asset entries for the deposits of the respondent with the correspondent. Others use the term "bankers balance" without further differentiation[183] or "correspondent account"[184] instead of "nostro/vostro account".

It is not sheer romanticism to vote for keeping the nostro/vostro/loro terminology as it is the only and internationally well-established form to reflect all models of correspondent banking. The "due to" and "due from" alternative lacks the option to distinguish clearly

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[180] See the findings below, at Chapter 3 4.

[181] See, for instance, U.S. Department of Treasury (1990/98), p.1.

[182] See Board of Governors of the Federal Reserve System (1994-2013), Section 2010.1; Osterberg and Thomson (1999), p. 13.

[183] Sullivan (2012).

[184] U.S. Congress, Office of Technology Assessment (1995), p. 19; The Clearing House Service Company (2002), p. 4.

between “loro“ and “vostro“ accounts; most of the other attempts at word creation are even vaguer. It is hard to understand why a truly global business, in which the major banks even phrase their own rules (e.g., Wolfsberg principles), does not rely on common terms.

A modern rationale of the nostro/vostro accounting agreement lies in the fact that the respondent bank does not have - or does not want to have – an entrée to the main clearing procedures (usually with the Central Bank) to settle transactions within the foreign country or state of the correspondent bank. Secondly, this construct offers for the correspondent all advantages of a so-called off-balance sheet item – meaning assets or liabilities that actually do not turn up on the balance sheet, and for which a company that holds such an item, has no further responsibilities or potential claims. However, the flip side of the coin is a misuse of such items as the example of creating special purpose vehicles (purchasing financial instruments with debt and therefore increasing profits without having further leverage on the balance sheet) before the latest financial crisis has shown.[185]

To understand the rather complex method of accounting in correspondent banking, let us first have a look at the easiest form of money, respectively funds transfers: two accounts in the same bank. It offers two options. Either money will be moved from one account to another through so-called “book transfers”, or funds are simultaneously debited from one account and credited to another; each account may be either a customer account or the bank’s own account.[186] Banks are financial intermediaries when they provide payment services – and they become parties to a transaction when they are engaged as originator and receiver of payment by a nonbank actor initiating a payment to a different nonbank actor. In case that the correspondent services provided are one-way, the respondent would normally maintain a minimum balance in the nostro account in order to fully or partially compensate the services in a timely manner.[187] If we have a transaction where more than one bank is engaged, the model of correspondent banking still allows *direct* book transfers. As described above, one bank holds a nostro account at the other bank with the intention to

[185] See, in more detail, Wandhöfer (2014), Chapter 4.1.1.

[186] U.S. Congress, Office of Technology Assessment (1995), p. 19.

[187] U.S. Department of Treasury (1990/98), p.1.

settle transactions for its customers and, of course, itself.

Suppose, Bank X debits customer A's account and credits its own account, and then sends a payment order to its correspondent bank, Bank Y. With this payment order Bank Y will debit Bank X's correspondent account and pay the money to, or into the account of the designated recipient, Bank Y's customer B. For the respondent, a nostro account with a debit balance will be considered a cash asset on its balance sheet. On the other side, a credit balance - for instance a deposit - on the correspondent's vostro account is seen as a liability. Consequentially, a vostro account with a debit balance (for example a loan) has to be an asset; this leads to the interesting constellation that a correspondent bank considers a credit entry on its (vostro) account as a negative transaction and a debit entry as a positive transaction. Normally, commercial accounting principles would lead to the opposite outcome.

Modern accounting technologies allow a simplification of the reconciliation process as nostros and vostros only ask for opposite signs within a financial institution's broader accounting scheme. Assume, a nostro in debit has a negative sign. In that case, a vostro in debit needs to have a positive sign. In consequence, all accounts can be summed to zero – a prerequisite of a proper reconciliation method in double-entry bookkeeping.

A good number of financial institutions still hold on to the double-entry bookkeeping system. In correspondent relationships this leads to the following procedure: whenever the correspondent receives or makes a payment, an equivalent (in the best sense of the word "corresponding") entry is being made on an internal general ledger account.[188] The latter correlates to the nostro account of the respondent that usually would have received a statement from the correspondent, called a "nostro account statement". The respondent would keep a replica of the nostro account, known as "nostro mirror account" for operational reasons.[189]

Suppose, Bank of Melbourne holds a nostro euro account with Commerzbank Frankfurt and Commerzbank maintains an Australian dollar account with Bank of Melbourne. Bank of

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[188] King (2000), p. 52.

[189] Adepu (2013), p. 2.

Melbourne's euro account with Commerzbank has a credit balance of Euro 100,000. Commerzbank's Australian dollar account with the Bank of Melbourne has a credit balance of $900,000.

Bank of Melbourne's Ledger

Vostro account (of) Commerzbank

	Balance b/f $900,000

Nostro account (at) Commerzbank

Balance b/f Euro 100,000	

Commerzbank's Ledger

Vostro account Bank of Melbourne

	Balance b/f Euro 100,000

Nostro account Bank of Melbourne

Balance b/f $900,000	

Now suppose, Mr. A, a customer of Bank of Melbourne, maintains a Euro account and the balance is Euro 60,000. Mr. A now instructs Bank of Melbourne to remit Euro 30,000 to his ex-wife Mrs. A in Frankfurt who maintains a Euro account at Commerzbank and the balance is Euro 900. At the same time Company K, a customer of Commerzbank instructs the bank to pay AUD $400,000 to Company L, a customer of Bank of Melbourne.

On the respective ledgers this would appear as follows:

Bank of Melbourne's Ledger

Vostro account (of) Commerzbank

Company L	$400,000	Balance b/f	$900,000

Nostro account (at) Commerzbank

Balance b/f	Euro 100,000	Mr. A Account	Euro 30,000

Mr. A's account

Nostro at Commerzbank	Euro 30,000	Balance b/f	Euro 60,000

Company L's account

		Vostro of Commerzbank	$400,000

Commerzbank's Ledger

Vostro account Bank of Melbourne

Mrs. A	Euro 30,000	Balance b/f	Euro 100,000

Nostro account Bank of Melbourne

Balance b/f	$900,000	Company K	$400,000

Mrs A's account

		Balance b/f	Euro 900
		Vostro Bank of Melbourne	Euro 30,000

Company K's account

Nostro of Bank of Melbourne	$400,000		

The correspondent bank services of financial institutions usually do not cause any transactions subject to entry on the general ledger; the correspondent bank is responsible for guaranteeing that collateral and other non-ledger elements are correctly recorded and controlled.[190]

Reconciliation allows tracking settled and unsettled transactions as well as, for instance, still open or paid amounts, respectively, cash received - either in mirror or in actual nostro accounts.[191] Hereby, nostro debit entries are reconciled against nostro mirror account credit entries and the other way around. Adepu (2013, p. 2) points at the importance “to reconcile Nostro accounts immediately on receipt of the statements from the correspondent banks as this will enable them to reconcile the same with their Nostro mirror balances and also take quick remedial action in case of unsettled/ discrepancy in transactions.”

It is in the core interest of host banks to reconcile nostro accounts instantly after they have received the statements from their correspondent banks: it allows direct reconciliation of the host banks’ nostro mirror balances and – if needed – prompt corrective measures if problems have occurred (e.g. (1) interbank transactions or payments initiated by the host bank have not (yet) been conducted or received; (2) another possibility is that funds have been paid twice or without the nostro credit; (3) also noteworthy is the risk factor of un-reconciled nostro credits: such a case can occur when a party of interbank transactions has paid without an existing deal or before due date. It may also happen when the host bank has not realized that it had received a payment. Thus, it is not inconceivable that incorrect or unapplied credits in a nostro account lower the bar for criminal behaviour, especially if the transaction volume is remarkably high. There have been cases, where bank employees dealing with nostro credits have rerouted un-reconciled funds to fraudulent operative accounts).[192]

Not surprisingly, banks are seeking automated nostro reconciliation solutions to minimize credit risks. A preventive measure is to ensure that the host bank’s reconciliation department operates with thoroughly reviewed nostro account statements that should imply

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[190] Board of Governors of the Federal Reserve System (1994-2013), Section 4110.1.

[191] Adepu (2013), ibid.

[192] See in greater detail Adepu (2013), p. 4. See also Mitchell et al. (1998), p. 589: “[…] accounting has developed as a means of recording transactions and thereby inhibiting, fraudulent activity.”

specific amounts, reference and due dates of debits and credits.[193] Another "classic" approach that should be considered is to charge interest on delayed payments and, of course, demand back validation of the affected payment. Finally, banks should have "intra- and inter-bank mechanisms" to inform the top management about un-reconciled nostro credits and debits as well as the correspondent banks and – where applicable – the Central Bank (in some countries banks are required to submit the un-reconciled nostro entries to the Central Bank periodically).[194]

The Wolfsberg Group gives in its definition of correspondent banking not more than a hint to the accounting procedures: "Correspondent Banking is the provision of a current or other liability account and related services to another institution used to meet its cash clearing, liquidity management and short-term borrowing or investment needs."[195] From an intra-bank perspective, the question occurs, which department has to monitor and fund the nostro and vostro accounts. Usually, the responsibility for nostro accounts is held by the reconciliation's department and for vostro accounts by the host bank's accounts department.[196]

Correspondent Banking also offers the opportunity for some accounting "tricks": via loan participations a larger correspondent bank can transfer funds to a smaller respondent bank and under certain circumstances provide a possibility for funds to move from surplus to deficit areas.[197]

Throughout the centuries, banks have been reproached for practicing "concealment

[193] King (2000), p. 52.

[194] Adepu (2013), p. 5. In this paper, the example of India is examined.

[195] The Wolfsberg Group (2002), p. 1.

[196] King (2000), p. 33.

[197] Knight (1970b), pp. 12-24; for a short description, Osterberg and Thomson (1999), p. 12.

accounting".[198] Correspondent accounts have been in the focus just lately, again, when, for example, Wegelin & Co., a Swiss private bank, was sentenced and ordered to pay approximately $58 million to the United States "for conspiring with U.S. taxpayers and others to hide approximately $1.5 billion in secret Swiss bank accounts"[199]. According to the United States Attorney for the Southern District of New York "[t]he sheer volume of transactions in WEGELIN's correspondent bank account served to conceal the repatriation of money from U.S. taxpayers' undeclared accounts at WEGELIN and the other banks."[200]

Numerous banks have centralised operations and product management into "Global Transaction Banking" units.[201] As a consequence, the traditional nostro/vostro accounting approach can easily become part of the accounting scheme of the overarching unit.

4. Spectrum of correspondent services - the end of the nostro/vostro dogma

Correspondent services mainly - and traditionally - entail payments, transactions, clearing, cash management, and trade-related services whereby payments are at the core.[202] In 2013, more than 65 percent of international payments between banks were conducted via correspondent banking.[203] The globalization of financial markets and trade activities led to a widening of international capital flows and to thriving foreign exchange markets - with a whole new spectrum of business prospects for correspondent relationships ranging from treasury services, securities market services to custodian services, and even advisory

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[198] See Laeri (1966), p. 57. Different theories of accounting ethics in a wider context can be found in Ketz (2006).

[199] United States District Attorney of New York (2013).

[200] Ibid.

[201] SWIFT (2011a), p. 3.

[202] SWIFT (2011a), p. 2.

[203] Wandhöfer (2014), Chapter 3.1.3.1.

services.[204]

For Wandhöfer (2014), typical correspondent services can be: “online and real-time access to account and payment information to support underlying service, and reconciliation and investigation activities, as well as liquidity management; FX conversion services facilitated through the account to other currencies: settlement of CLS and payments/receipts to clearing houses/exchanges […]; receivable services, balance pooling services; and trade services or business continuity services to facilitate payment activity through alternate means.”[205]

According to the U.S. Federal Financial Institutions Examination Council (FFIEC), correspondent services may encompass holding deposit accounts, transfer of funds, and other services, whereby deposit accounts mean “[a]ssets known as "due from bank deposits" or "correspondent bank balances" [...] represent[ing] the bank’s primary operating account”.[206] Funds transfers can occur when checks or other cash items are collected, securities transactions are transferred or settled, federal funds are sold or purchased, customer transactions are processed, or participating loan funds are transferred.[207]

The Joint Money Laundering Steering Group (JMLSG)[208] sees “banking-related services” as the main provision of correspondent banking. Its choice of words is meaningful, as it could have spared the term “related”. Instead, it widens the scope of potential services.

The USA PATRIOT Act offers a noticeably wide definition when it describes (international) correspondent banking as “any account established for a foreign

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[204] In more detail, Chan (2001), pp. 19-26, who also points at new services in relation to countertrade, swaps, options, and futures.

[205] Wandhöfer (2014), Chapter 3.2.3.

[206] FFIEC (2014), p. 173.

[207] Ibid.

[208] See JMLSG (2014), p. 171.

financial institution to receive deposits from, or to make payments or other disbursements on behalf of, the foreign financial institution, or to handle other financial transactions related to such foreign financial institution."[209] This approach implies, more or less, any financial activity, from facilitating foreign exchange transactions to clearing to loan participation, etc.

The U.S. Senate's Minority Staff Report (2001) on correspondent banking explained the range of services as follows:

> "[...] an array of cash management services, such as interest-bearing or demand deposit accounts in one or more currencies, international wire transfers of funds, foreign exchange services. Correspondent banks also often provide an array of investment services, such as providing their respondent banks with access to money market accounts, overnight investment accounts, certificates of deposit, securities trading accounts, or other accounts bearing higher rates of interest than are paid to non-bank clients. Along with these services, some correspondent banks offer computer software programs that enable their respondent banks to complete various transactions, initiate wire transfers, and gain instant updates on their account balances through their own computer terminals."[210]

The UK's Financial Service Authority (FSA) states that correspondent banking "can include establishing accounts, exchanging methods of authenticating instructions (e.g., by exchanging SWIFT keys) and providing payment or other clearing-related services […] Activity can also encompass trade-related business and treasury money market activities, for which the transactions can be settled through the correspondent relationship."[211]

These services (which are typical for "small to big" correspondent banking) can include

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[209] USA PATRIOT Act, Title III, Section 311(e)(1)(B).

[210] Minority Staff of the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs of the United States Senate (2001), p. 288.

[211] Financial Service Authority (2011), p. 43.

payment processing, check clearing, preparing and submitting electronic files for automated payment systems, portfolio and marketing advice, loan participation, foreign exchange and a variety of international banking services, transfer of funds, brokerage and trust services, and the training of employees, as well as IT Services.[212]

A comparatively broad range of services describes the Bankers' Bank Council in a letter to the Board of Governors of the Federal Reserve System.[213] In the council's opinion correspondent services involve *operational functions* "[…] such as electronic item processing, image cash letter check clearing, safekeeping, wires, ACH, ATM networking lockbox, and credit cards", *capital functions* "[…] through bank holding company financing", *lending functions* "[…] through the facilitation of participation loans, bank holding company loans, and letters of credit", *liquidity functions* "[…]through the provision of federal fund lines of credit used to facilitate payments in the form of checks, DTC, securities transactions, and government remittances", as well as *risk management and technology functions* "[…]through community bank system redundancy, backup facilities, hot sites, cold sites, imaging, and access to state-of-the-art technology" and finally, *international operations and payments functions* "[…] including foreign item clearing, supplying foreign currency, foreign exchange, and international letters of credit."[214]

In general, the parties themselves define the scope, spectrum and range of services. It is almost a platitude to state that the extent of services and products in their relationship, its establishment and maintenance eventually depends on the ability and readiness of both

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212 Meinster and Severn (1982), p. 196; McAndrews and Strahan (2002), pp. 322-23; Board of Governors of the Federal Reserve System (1994-2013), Sections 2010.1 and 4060.1.

213 On Bankers' Banks, see above Chapter 3 2.c. The Bankers' Bank Council is an organization comprised of the nation's fifteen bankers' banks (as of 2014). The letter of the Bankers' Bank Council (from January 31st 2014) to the Federal Reserve can be found on the Fed's website: http://www.federalreserve.gov/SECRS/2014/March/20140314/R-1466/R-1466_013114_111931_337075897307_1.pdf.

214 See footnote 3 in the aforementioned letter. A comprehensive list of services is also given by Hudson et al. (2000), pp. 326-7.

parties to satisfy their respective needs.

The activities mentioned above typically require a nostro/vostro account arrangement. The vast majority of literature and practice still connects correspondent banking exclusively to existing nostro/vostro accounts. However, not all of the services in a correspondent relationship necessarily need a monolithic nostro/vostro structure. Some services could be provided without an account of the respondent on the correspondent's side. In particular, some of the so-called "other services" on FFIEC's list, like "performing data processing" and specific "payroll services"[215], are not inextricably linked to vostro account structures on the correspondent's side (although in certain contexts another correspondent, the central bank or even the CLS Bank may come into the play[216]). Further correspondent services like providing reports and surveys on economic and political conditions or recommendations for securities[217] do not automatically call for an account relationship.

The FFIEC also indicates that establishing a correspondent relationship does not necessarily include a step to open a nostro/vostro account when it speaks of either "account opening" or "on-boarding procedures" to describe the initiation of the connection between a respondent and correspondent.[218]

Naughton and Chan (1998, p. 153) formulate the erosion of the vostro/nostro dogma using a service-orientated approach. They put emphasis on the purchase and sale of services instead of concentrating on the establishment of a deposit account on the correspondent's side. Historically, they explain the tradition of setting up a deposit account by referring to the U.S. system, where smaller banks outside the Federal Reserve System "held their reserve

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[215] FFIEC (2014), p. 173.

[216] See below Chapter 3 5.b. and c.

[217] See Osterberg and Thomson (1999), p. 11.

[218] FFIEC (2014), p. 174, in its chapter "Correspondent Accounts (Foreign) – Overview"; see also https://www.ffiec.gov/bsa_aml_infobase/pages_manual/OLM_047.htm.

balances with member banks and thereby established correspondent relationships"[219]. This is certainly true for the U.S.-system, though it could lead to confusion as the nostro/vostro account method was originally not developed as an alternative to a relationship between a commercial bank and a central bank. Instead, it already existed as an accounting scheme centuries before the first central bank was founded in Europe. Furthermore, it is probably the most solid inter-financial-institutions structure in correspondent banking creating a mutual "account dependence" that goes - in its potential range of services - beyond a more limited scope of contractually based correspondent relationships that may only comprise of one or a few services.

One could also argue from a purely practical point of view that maintaining deposit balances at the correspondent is a useful way to avoid the payment of direct fees to the correspondent as the deposit account offers a comfortable indirect method of payment for the services. For several reasons this argument has little merit:[220]

First, it can be extremely difficult for smaller respondents to assess the real costs of certain services. Secondly, some larger banks have shifted their correspondent banking units into wider ranging departments like transaction banking. Not only is it more challenging to maintain strictly separated accounts on a broader account landscape. In a worst-case scenario, such structures could lead to less transparent feeing and accounting methods. Finally, instead of having complex fee arrangements within deposit accounts, a direct fee-payment could be organized in a more efficient and stringent way with a lower risk of misconduct. Today, it is more common to use direct fees for correspondent services anyway.[221] There are good reasons to agree with Naughton and Chan's observation that providing deposits or stepping into a mutually structured account relationship is not a prerequisite for establishing a correspondent relationship and that - as a minimum – the

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[219] Naughton and Chan (1998), p. 153, also mentioning the article of Meinster and Severn (1982) who give a thorough overview of the U.S. correspondent banking system in the early 1980s.

[220] See also Osterberg and Thomson (1999), ibid., referring to Knight (1970a).

[221] See already Chan (2001), p. 10.

parties only need to contractually agree on the purchase and sale of services.[222] And, generally speaking, a correspondent relationship is about purchasing services – or "input"[223] from a correspondent. As a reaction to the latest financial crisis and to existing as well as forthcoming regulatory and compliance initiatives, banks are widely reducing their nostros, and many relationships to other financial institutions with vulnerable balance sheets are being abandoned.[224] It is therefore possible that contract-based alternatives will become more attractive as many financial institutions are still seeking to profit from the benefits of correspondent networks.

Noteworthy is SWIFT's (2011a) hint at correspondent networks without a correspondent account. In the light of higher costs for regulatory changes, numerous banks have streamlined their correspondent network in the last couple of years. Yet, an international outreach is still needed for surviving in a competitive landscape and for certain transactions - even "with many small banks without holding a correspondent bank account or being required to route transactions via complex serial chains".[225] SWIFT therefore proposes a "payments hub to complement existing correspondent banking arrangements" that would entail a "multilateral legal and SLA framework for the clearing and settlement of a limited set of basic payments products" where the parties would agree to "receive and process payments from all (or a limited subset of) other participants under a set of business conditions communicated in the framework".[226] Such an arrangement could also comprise foreign exchange and settlement instruments being offered by some participants in such a

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[222] Naughton and Chan (1998), p. 153. They incorrectly state that correspondent banking without a deposit account can only occur on the international level - and do not give further reasons for their service-orientated approach.

[223] See Osterberg and Thomson (1999), p. 10.

[224] SWIFT (2011a), p. 3.

[225] SWIFT (2011a), p. 7.

[226] Ibid.

network.[227] As a consequence, even the "classical" vostro/nostro case of clearing services could be arranged without an account at the correspondent's side.

According to the British Financial Service Authority (FSA) correspondent banking activity *can* - but does not have to – include establishing accounts.[228] Furthermore, it allows methods of authenticating instructions, for example by exchanging SWIFT keys.[229] Therefore, a correspondent relationship can be established only on the exchange of test keys; in this case direct payment instructions would be set through a third financial institution for credit to the correspondent's/respondent's own account in another jurisdiction.[230]

However, this creates different intensities of correspondent relationships depending on the choice of having strong, long-lasting account-based ties or only, for instance, an ad hoc correspondent connection through a contract.

In conclusion: A correspondent relationship can be initiated and maintained through correspondent services contracts and/or through opening and holding accounts with one another.[231] It is traditionally, but not necessarily, tied to a nostro/vostro/loro account structure. Exceptions exist already, and this distinction is critical for the evaluation of potential participants in a correspondent relationship. A strict restriction to account arrangements would exclude some financial institutions or players in the finance business from falling under the definition of a respondent or correspondent. Such an exclusion would make it difficult to apply present regulatory or compliance rules to certain participants in financial services procedures and open opportunities for potential misconduct and

[227] Ibid.

[228] Financial Service Authority (2011), p. 43.

[229] Ibid. The FSA also refers to "providing payment and other clearing-related services" as well as "trade-related business and treasury money market activities" as part of the service spectrum in a correspondent relationship.

[230] Ibid.

[231] Chan (2001), p. 11, comes to the same conclusion without further explanation.

circumvention of, for instance, AML rules. It also creates less complicated regulation efforts towards alternatives based on digital solutions.

5. The players: correspondents and respondents – banks only?

According to our vague description above, a correspondent bank could be defined as a financial institution that frequently conducts or provides services for another financial institution (a correspondent banking client or respondent). By using the term "financial institutions" the question occurs whether correspondent banking necessarily is an inter*bank* business. In other words: do the correspondent and the respondent have to be banks? Superficially, this seems to be a logical interpretation of the term "correspondent *banking*". Still, banking services can be offered by very different institutions such as commercial banks, cooperative banks, savings banks, savings and loan associations (S&Ls) and, for instance, credit unions – normally based on a banking license.[232]

a. The minimal (ingenuous) approach: bank to bank

Many, apparently roughly drawn, definitions in the theoretical literature only mention *banks* as possible correspondent or respondent.

For Cattani and Tschoegl (2002, p. 30) "[…]one bank, the correspondent, makes payments to (generally local) parties, for a fee, at the request of its client bank located in another county, state or country." In the eyes of Curry, Fung, and Harper (2003, p. 39), correspondent banking "consists of a correspondent relationship, typically on a reciprocal basis, between domestic banks in different countries. The relationship involves the foreign domestic bank (the correspondent) conducting financial transactions and related activities in the foreign market on behalf of the home bank." Even Naughton and Chan (1998), who explored correspondent banking in a number of papers, call this banking model "the

[232] Llewellyn (1999), p. 21, already raises the question whether banks are necessary for banking.

provision of services by one bank to another bank"[233]. For them "[o]ne bank, termed the correspondent, sells services to a purchasing bank, termed the respondent."[234] Berndsen (2014) refers only to banks on both sides[235] as well as Sarigul (2013)[236], Chernykh and Edmister (2009)[237], Khambata (1996)[238], Johnson et al (1998)[239], and also the articles of Gilbert and Alton (1983), Cranston (1997, pp. 42-3), Kohn (2004, p. 173) and already McLusky (1978, p. 1328) and Vorst (1987, p. 483) concentrate on a bank to bank approach.

Large parts of the American literature deal with the domestic development of correspondent

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233 Naughton and Chan (1998), p. 153. In a recent article, Chan (2014, p. 18) points at "financial institutions" on both sides. However, the text only covers banks as parties in the correspondent banking relationship.

234 Ibid.

235 Berndsen (2014): "After all, correspondent banking is defined as an arrangement whereby one bank (the service-providing bank) makes or receives payments on behalf of another bank (the service-user bank)."

236 Sarigul (2013), p. 296: "Correspondent banking is defined as the provision of banking services by one bank (the correspondent) to an overseas bank (the respondent) to enable the respondent to provide its own customers with cross-border products and services that it cannot provide itself, typically because it lacks an international network."

237 Chernykh and Edmister (2009), p. 3: "Foreign correspondent bank relationships are established bank-to-bank, private-sector, agreements which facilitate inter-bank transactions such as wire transfers for private customer accounts."

238 Khambata (1996), p. 24: "Correspondent banks provide a range of services to banks located in other countries that do not have local offices or whose local offices are not permitted to conduct certain transactions."

239 Johnson et al (1998), p. 237: "Correspondent banking: an arrangement under which one bank (correspondent) holds deposits owned by other banks (respondents) and provides payment and other services to those respondent banks."

banking. The emphasis also lies on "interbank networks"[240] (including the Federal Reserve) without further exploring whether other financial institutions could (have) be(en) seen as parties in a correspondent relationship as well. Lawrence and Lougee (1970) focus on the different sizes of banks and the question whether they are members of the U.S. Federal Reserve System. However, they limit their view to interbank relations too.

Even renowned dictionaries echo a narrow "bank only" view.[241] Mass media - often tempted to simplify – regularly just refer to banks on both sides. *The Economist* only speaks of "banks"[242] as correspondents and respondents. So do *The Wall Street Journal*[243] and *Financial Times*[244].

All the more so, SWIFT (2011a, p. 2), the self-declared "global provider of secure financial messaging services", limits its definition to banks on both sides when it states this: "We define correspondent banking as the banking services – mainly payments, cash management and trade services - provided by banks to customers via other banks."

In its "Glossary of Terms Related to Payment, Clearing and Settlement Systems" the ECB (2009, p. 7) describes correspondent banking as an arrangement whereby one bank (the settlement or service-providing bank) makes or receives payments (potentially performing other banking services in addition) on behalf of another bank

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240 See, for example, James and Weiman (2010); Stewart (2014).

241 See e.g., Butler et al. (1997), p. 82; Rutherford (1995), p. 97; Pallister and Isaacs (1996), p. 131; Hussey (1999), p. 98.

242 *The Economist* (2014), p. 65.

243 Steinberg (2014).

244 Hall and Fleming (2014): "A correspondent banking relationship typically involves a large bank offering services such as payments, cash management and trade services, on behalf of a smaller bank […] or for a foreign bank […]." One might see the term "typically" as a qualified statement, though.

(the customer or user bank)."[245]

In the Basel III Liquidity Coverage Ratio and liquidity risk monitoring tools (LCR), correspondent banking "refers to arrangements under which one bank (correspondent) holds deposits owned by other banks (respondents) and provides payment and other services in order to settle foreign currency transactions (e.g., so-called nostro and vostro accounts used to settle transactions in a currency other than the domestic currency of the respondent bank for the provision of clearing and settlement of payments)."[246]

The French Interbank Teleclearing Consortium (GSIT) describes correspondent banking as an "arrangement under which one bank (correspondent) holds deposits owned by other banks (respondents) and provides payment and other services to those respondent banks."[247] The German Bundesbank is also denoting that it solely sees banks involved in correspondent banking.[248] Equally narrow is the definition that relates to the parties involved in a correspondent relationship of the (then still existing) British Financial Service Authority (FSA), where it refers to the "Guidance" of the Joint Money Laundering Steering Group (JMLSG)[249]:

> "Correspondent banking is defined in the JMLSG Guidance as the provision of banking services by one bank (the 'correspondent') to an overseas bank (the

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[245] In 2017, though, the ECB mainly uses the term "financial institution" – albeit not entirely (see European Central Bank (2017b), p. 6.)

[246] BIS (2013), No. 99, footnote 42.

[247] See the website of the GSIT: http://www.gsit.fr/glossaire/en/Correspondent_banking.htm.

[248] Bundesbank, on its oversight-homepage: https://www.bundesbank.de/en/tasks/payment-systems/oversight/correspondent-banking-626500: "Correspondent banking refers to business relationships between banks which are particularly popular as a means of facilitating foreign trade, eg for settling payment transactions and documentary collections, the encashment of foreign securities or foreign exchange trading."

[249] Its latest amended version was published in November 2014, see JMLSG (2014).

> 'respondent') to enable the respondent to provide its own customers with cross-border products and services that it cannot provide itself, typically because it lacks an international network."

The International Finance Cooperation (2009) also concentrates on banks on both sides of the relationship. Although it uses the term "financial institution" in its definition of correspondent banking[250], it focuses solely on banks in its "Correspondent Account KYC Toolkit". Referring to the "Wolfsberg Principles" (2008), it even names the necessity of a current banking license.[251]

This reference is obviously incorrect. The Wolfsberg Group only mentions in its FAQ's on Correspondent Banking (2014, pp. 3-4) that relationships with "unlicensed and/or unregulated non-bank financial institutions such as remittance or exchange houses, casas de cambio, bureaux de change and money transfer agents or entities or persons effectively operating as such [should] be avoided."

Consequentially, correspondent relationships with non-bank financial institutions obviously exist, regardless of whether they are desirable or not.

Bob Lyddon (2012, p. 247), discussing the "reciprocity model" of correspondent banking indirectly mentions the possibility of non-banks being involved in a correspondent relationship: "The degree of regulation within the Single Euro Payments Area (SEPA) should at least ensure that credit transfers and direct debits remain within the banking sector; the same cannot be said for the rest of the world. Indeed, there the degree of regulation plays into the hands of non-banks."

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[250] IFC (2009), p. 3, Footnote 1: "Correspondent Banking is the provision of a current or other liability account and/or related services to another financial institution used to meet its cash clearing, liquidity management and short-term borrowing or investment needs, which includes trade-related documentary credits."

[251] Ibid., p. 10.

However, a "banks-only" approach has obviously been chosen by the majority of banking literature in academia and practice. This limitation may often be due to a restriction of the surveyed topic, yet it bears the risk of widening the incoherence when it comes to regulatory measures in different legislatures and legal cultures.

b. The wide (secure) approach: financial institutions, non-banks

One would expect to find a precise answer regarding the players involved in the texts provided by The Wolfsberg Group. The significance of any rules proposed by this group was obvious from the outset as the banks[252] that formed the conglomerate stood for more than sixty percent of the world market in private banking and with an estimated fifty percent of the market share in each key offshore places[253]. But does the group's definition of correspondent banking hence serve as a role model? The insightful article of Aiolfi and Bauer (2012) about the founding, background, and working procedures of the group falls short of the fact that the Wolfsberg members also form a powerful lobby organisation of some of the most important global players in the banking business.[254] We have to take into account that The Wolfsberg Principles are neither legally binding nor incorporated law but recommended best practice and - according to the set-up of the group – even industry best practice. The principles are a "voluntary code of conduct"[255] and intra-industry instructions ("triple I").

Still, their influence on law-making and regulatory bodies is doubtlessly given and any definition phrased by The Wolfsberg Group has a far-reaching effect. Even more surprising are the deficits of terminological lucidity in the group's papers. With regard remarkable

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[252] At this time (2002), the group consisted of 12 banks (ABN AMRO left the group in 2007 after the takeover through RFS Holdings B.V).

[253] Numbers were taken from Pieth and Aiolfi (2003).

[254] Aiolfi and Bauer (2012), for instance, report about regular meetings with influential regulators under Chatham House Rules, while Pieth and Aiolfi (2003) describe the reasoning behind the private initiative of forming the Wolfsberg Group.

[255] Pieth and Aiolfi (2003), p. 361.

definition-confusion[256] – especially within the principles issued in 2002 - it is hard to believe that guidelines drafted by the leading global banks lack descriptive clarity only because of difficulties in coordinating a dozen financial institutions.

The founding members agreed on a description that “Correspondent Banking is the provision of a current or other liability account and related services to another institution used to meet its cash clearing, liquidity management and short-term borrowing or investment needs.”[257] With the reference to an “account”, we have a first indication that a survey of correspondent banking has to entail a systematic analysis of its accounting specifics. We also gain some clues about the range of correspondent banking services - and in a footnote to the definition, the Wolfsberg Group enumerates potential respondents stating that a “Correspondent Banking Client is a client of an institution that is a financial services firm that uses the institution's Correspondent Banking services accounts to clear transactions for its own client base. The term includes (but is not limited to) Banks, Broker-Dealers, Mutual Funds, Unit Trusts, Investment Services Firms, Hedge Funds, Introducing Brokers, Money Service Businesses, Pension Funds, Credit Card Providers, Commercial Credit Companies, Household Finance Companies, Mortgage Banks, Building Societies, and Leasing Companies.”[258]

This rather complicated description raises more questions than answers. In our initial definition we spoke of “financial institutions” on both sides of the (bilateral) correspondent relationship. The Wolfsberg Group uses the terms “another institution” and “correspondent banking client” as equivalents for the (avoided) term “respondent”. It is unclear whether the expression “that is a financial services firm” refers to the correspondent or respondent. The list of potential correspondent banking clients obviously comprises different financial services firms. However, the Wolfsberg Group

[256] See also Pieth and Aiolfi (2003), p. 361: “As a voluntary code of conduct that focuses on private banking, the Principles are specifc to this business segment. At the same time, however, they are also broadly drawn and in certain areas downright vague.”

[257] The Wolfsberg Group (2002), p. 1.

[258] The Wolfsberg Group (2002), p. 1 Fn.2.

mentions "Banks" and then other players in the financial world. It is unfeasible that this distinction happened accidentally.

We have to refer to the Wolfsberg Group's Frequently Asked Questions ("FAQs") on Correspondent Banking to gain clues about the quality of possible correspondents. In its first version of FAQ's (issued in 2006), it expresses that correspondents could be state-, publicly- or privately-owned, including central banks or supra-national organisations, "licensed and regulated non-bank financial institutions [sic!] such as a remittance or, exchange house, casas de cambio, bureaux de change and money transfer agents"[259]. We witness an important shift in wording in the FAQs' 2014 version: There, the Wolfsberg Group suddenly speaks of "[…] unlicensed and/or unregulated non-bank financial institutions such as remittance or exchange houses, casas de cambio, bureaux de change and money transfer agents or entities or persons effectively operating as such"[260]. Although these (non-) institutions appear in a list of correspondents that should be avoided, they are still considered as being thinkable correspondents. This widens the scope of potential correspondents significantly, as it would even entail unlicensed and unregulated non-bank units and individuals.

The Wolfsberg Group traditionally works in close cooperation with The Clearing House[261]. Both issued a joint "Statement on Payment Message Standards" (2007), and The Clearing House represents a good number of banks that are also members of the Wolfsberg Group. Therefore, one would expect at least similar terminology regarding correspondent banking. In the most recent exposure draft of its "Guiding Principles for Anti-Money Laundering Policies and Procedures in Correspondent Banking" (2014), The Clearing House concentrates on "traditional correspondent banking involving payment processing for foreign banks […] such as funds transfers, cash letters and pouch activity, and bulk cash[…]." It is noteworthy that it emphasizes not to "address institutional brokerage and capital market activities, trade finance or lending, or activities engaged in for nonbank financial institutions, such as brokerage firms and money service businesses." Implicitly,

[259] The Wolfsberg Group FAQs (2006), p. 4.

[260] The Wolfsberg Group FAQs (2014), p. 4.

[261] On The Clearing House, see below Chapter 3 5.c.

this sentence can be understood as evidence that not only other correspondent banking activities, but also players other than “foreign banks” can possibly be involved.

Still, in the narrow framework of anti money laundering, The Clearing House insists on the term “bank”, only to define it as “[…] any U.S. Bank, or any other financial institution”. A “bank” includes “[e]ach agent, agency, branch or office within the United States of any person doing business in one or more of the capacities listed below: (1) a commercial bank or trust company organized under the laws of any State or of the United States; (2) a private bank; (3) a savings and loan association or a building and loan association organized under the laws of any State or of the United States; (4) an insured institution as defined in section 401 of the National Housing Act; (5) a savings bank, industrial bank or other thrift institution; (6) a credit union organized under the law of any State or of the United States; (7) any other organization (except a money services business) chartered under the banking laws of any state and subject to the supervision of the bank supervisory authorities of a State; (8) a bank organized under foreign law; or (9) any national banking association or corporation acting under the provisions of section 25(a) of the Act of Dec. 23, 1913, as added by the Act of Dec. 24, 1919, ch. 18, 41 Stat. 378, as amended (12 U.S.C. 611-32).”[262]

One gains the impression that the authors of The Clearing House’s article just looked for a conventional definition of banks without even adjusting it to the specifics of correspondent banking. Thus they took the easy path using the “general definition” of a “bank” in Title 31 (Money and Finance: Treasury) of the Code of Federal Regulations (CFR)[263].

The Clearing House’s wording does not come close to the Wolfsberg Group’s choice of terminology. It is notable to find such terminological incoherence even between two regulatory partners like the Clearing House and the Wolfsberg Group (where a good number of major banks is represented in both institutions). However – and despite this obvious discrepancy – they both hint at more potential players in a correspondent

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[262] The Clearing House (2014), p. 23.

[263] 31 C.F.R. § 1010.100(d).

relationship than just banks.

A clear indication that the respondent's side is not limited to banks is given by the U.S. Federal Financial Institutions Examination Council (FFIEC) in its Bank Secrecy Act/ Anti-Money Laundering Examination Manual (2010, p. 178) in the context of (the above mentioned) Bankers' banks: "Bankers' banks, which do not conduct business directly with the public, offer correspondent banking services to independent community banks, thrifts, credit unions, and real estate investment trusts." Subsequently, the FFEIC uses the term "financial institutions" instead of "banks" in its definition of correspondent banking:

> "A financial institution, acting on behalf of other financial institutions (respondents) that can settle the checks they collect from them by using accounts on their books or by sending a wire transfer. Generally, a provider of banking and payment services to other financial institutions."[264]

The Federal Reserve – adding to the terminological confusion even within the U.S. – sees a correspondent relationship "when a financial organization provides another financial organization a variety of deposit, lending, or other services."[265] Not only is this a rather open explanation, but it also uses the term "organization" as an alternative to "institution". The Fed's correspondent banking guidance is – on the respondent's side - valid for "all banks and their subsidiaries, bank holding companies and their nonbank subsidiaries, savings associations and their subsidiaries, and savings and loan holding companies and their subsidiaries that are supervised by the Board of Governors of the Federal Reserve System."[266]

A couple of years earlier, the USA PATRIOT Act offered a noticeably broad definition, when it described (international) correspondent banking as "any account established for a foreign financial institution to receive deposits from, or to make payments or other

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[264] FFEIC (2010b), Appendix B, Glossary.

[265] Board of Governors of the Federal Reserve System (2010), Section 2016.1, p. 2, footnote 3.

[266] Ibid., footnote 2.

disbursements on behalf of, the foreign financial institution, or to handle other financial transactions related to such foreign financial institution."[267] This approach not only implies more or less any financial activity from facilitating foreign exchange transactions to clearing to loan participation and so on. We also find hints about the quality of the parties involved in correspondent banking.

It is obvious that the U.S. government struggled whether to use the term "banks" or "financial institutions". In December 2001, the Department of the Treasury still published a notice of proposed rulemaking for comment, where it defined "correspondent account" to be "an account established to receive deposits from, make payments on behalf of a foreign bank, or handle other financial transactions related to such bank."[268] Not surprisingly, this definition was heavily disputed.[269]

In a footnote of its final rules, the Department of the Treasury (2002) mentions a common understanding of a correspondent account as "a deposit account established by one bank for another bank to receive deposits and make payments"[270] before finally adopting (in the final rules) the term "financial institutions" instead of "banks". The Treasury's explanation of that remarkable move to a broader definition is to "ensure parity between different types of covered financial institutions and to treat functionally

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[267] USA PATRIOT Act, Title III, Section 311(e)(1)(B). According to the FFEIC (2010a, p. 117), it was one "of the central goals of the USA PATRIOT Act [...] to protect access to the U.S. financial system by requiring certain records and due diligence programs for foreign correspondent accounts."

[268] 66 FR (Federal Register) 67460 (December 28, 2001).

[269] See 67 FR (Federal Register) 60563 (September 26, 2002), according to which "[…] by far the most significant issues addressed by the commenters were the breadth of the definition of "correspondent account […]."

[270] Ibid., 60563 Footnote 7, referring to Federal Reserve Regulation O (12 CFR 215.21(c) and the Dictionary of Finance and Investment Terms by John Downes and Jordan Elliot Goodman (5th ed. 1998).

equivalent accounts in the same manner"[271].

Therefore, regarding the bank/non-bank quality of a correspondent/respondent the answer is hidden in further regulation that was implemented as a consequence of the USA Patriot Act. After the U.S. Treasury's illumination, The Financial Crimes Enforcement Network (FinCEN) - a bureau established in the Treasury Department to collect and analyse data about financial transactions in order to combat, amongst other crimes, money laundering and terrorist financing - issued a "Fact Sheet" (2005) to illustrate the final regulation implementing the foreign correspondent account provisions and the private banking provisions of section 312 of the USA PATRIOT Act. There it clarifies "[w]hich U.S. financial institutions are covered by the correspondent banking portion of the final rule"[272] – in other words, which financial institutions could possibly be "correspondents". FinCEN (p. 2) lists "(1) banking institutions; (2) securities broker-dealers; (3) futures commission merchants and introducing brokers in commodities; and (4) mutual funds". On the respondents' side, "[t]he final rule applies to correspondent accounts maintained for the following foreign financial institutions: (1) a foreign bank; (2) a foreign branch of a U.S. bank; (3) a business organized under a foreign law that, if it were located in the United States, would be a securities broker-dealer, futures commission merchant, introducing broker in commodities, or a mutual fund; and (4) a money transmitter or currency exchanger organized under foreign law."[273] Some of those institutions mentioned are so-called Money Services Businesses (MSBs) that "provide a full range of financial products and services outside of the banking system"[274] (e.g. money transmitters and currency exchangers) and therefore do not necessarily need a banking license. Still, a specified license for certain services may still be required – as an example: money transmitters in New York State need to apply for a license from the Superintendent for Financial

[271] 67 FR (Federal Register) 60564-5.

[272] FinCEN (2005), p. 2.

[273] Ibid.

[274] MLTA (2005), p. 7.

Services of the State of New York.[275]

The Clearing House (2014, p. 3) clarifies that the Section 312 requirements of the USA PATRIOT ACT not only apply "to traditional correspondent accounts maintained for foreign banks for the purpose of payment processing, but to any formal relationship through which the financial institution provides regular services to any foreign financial institution, which may include, for banks, demand deposit, savings deposit or other transaction or asset accounts, and credit accounts or other extensions of credit."

It has to be noted that these (broad) regulatory definitions are still not complete, as they solely reflect the purpose of the USA PATRIOT Act. Thus, foreign central banks, monetary institutions that act as central banks and other international financial institutions, e.g., multinational development banks of which the U.S. is a member are not included.[276]

Before we shed light on the correspondent banking quality of those excluded institutions, we should have a look at the attempts to find a proper definition by a standard-setting intergovernmental body, the Financial Action Task Force (FATF). Today, the FATF Recommendations, together with Special Recommendations, have been endorsed by over 180 countries, and are – in the words of the FATF – "universally recognised as the international standard for anti-money laundering and countering the financing of terrorism"[277]. Although the original FATF recommendations of 1990 were published as voluntary codes of good practice, they could be actually called mandatory for all countries and territories.[278]

Hence, one would expect a viable definition of correspondent banking. However, it is noteworthy that the term "correspondent banking" does not even appear in the original "FATF Forty Recommendations" (published in 1990). Nor is there any description of this

[275] Pursuant to the provisions of Article 13-B of the Banking Law of the State of New York.

[276] Department of the Treasury (2002), p. 60566.

[277] FATF (2012), p. 7.

[278] Alexander et al. (2004), p. 68; see also Norgren (2003).

banking model. The same is true for the widened 1996-version of the Recommendations – "revised for the first time to reflect evolving money laundering trends and techniques, and to broaden their scope well beyond drug-money laundering".[279] It is quite astounding that correspondent banking had not been mentioned in the context of money laundering as this correlation has been widely known well before the FATF recommendations had been drafted.[280]

Only after the terror attacks of 9/11, the FATF extended its mandate to deal with the challenge of the funding of terrorist acts and terrorist organisations (October 2001).[281] In the following revised FATF Recommendations (2003) correspondent banking is finally being mentioned (FATF, 2003, p. 4). Although the FATF abstains from a formal definition in this paper, it does not limit itself to a banks-only approach. Rather, the FATF uses the terms "correspondent bank", "respondent bank" and "financial institutions" (in the context of a correspondent relationship) or "respondent institutions" in an uncoordinated way. Still, it defines the term "financial institutions" as "any person or entity who conducts as a business one or more of the following activities or operations for or on behalf of a customer: 1. Acceptance of deposits and other repayable funds from the public. 2. Lending. 3. Financial leasing. 4. The transfer of money or value. 5. Issuing and managing means of payment (e.g. credit and debit cards, cheques, traveller's cheques, money orders and bankers' drafts, electronic money). 6. Financial guarantees and commitments. 7. Trading in: (a) money

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[279] FATF (2012), p. 6.

[280] So does the U.S. Bank Secrecy Act, stemming from 1970, already deal with the interrelation of money laundering, foreign bank accounts and international transactions. Although not explicitly mentioned, correspondent banking was and is a tool for such transactions. See also the article of Nath (1990), pp. 50-1. The connection between correspondent banking and potential money laundering is, for example, clearly stated in Kelly et al. (1994), p. 322 and in the Report by the EBA (1995). However, it has to be noted that it took American lawmakers until 1999 to realize that money laundering had permeated the U.S. banking system through the use of correspondent accounts with U.S. banks (see U.S. Senate Subcommittee on Investigations (1999)).

[281] In this context, the FATF formulated Eight (later expanded to Nine) Special Recommendations on Terrorist Financing.

market instruments (cheques, bills, CDs, derivatives etc.); (b) foreign exchange; (c) exchange, interest rate and index instruments; (d) transferable securities; (e) commodity futures trading. 8. Participation in securities issues and the provision of financial services related to such issues. 9. Individual and collective portfolio management. 10. Safekeeping and administration of cash or liquid securities on behalf of other persons. 11. Otherwise investing, administering or managing funds or money on behalf of other persons. 12. Underwriting and placement of life insurance and other investment related insurance. 13. Money and currency changing."[282] This, again, is a strong clue that correspondent banking cannot be reduced to a simple bank-to-bank business. However, terminologically the FATF is as confounding and unclear as, e.g., the Wolfsberg Group.

The latest version of the FATF Recommendations (2012) has even fostered the level of impreciseness. On the one hand, the revised text reflects almost the same (uncoordinated) wording regarding correspondent banking[283], mainly using the term "financial institutions" as well as the already quoted definition of "financial institutions"[284]. On the other hand, FATF this time adds a glossary where "correspondent banking is described as "the provision of banking services by one bank (the "correspondent bank") to another bank (the "respondent bank"). Large international banks typically act as correspondents for thousands of other banks around the world. Respondent banks may be provided with a wide range of services, including cash management (e.g., interest-bearing accounts in a variety of currencies), international wire transfers, cheque clearing, payable-through accounts and foreign exchange services."[285]

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[282] FATF (2003), pp. 16-7.

[283] "Financial institutions should be required, in relation to cross-border correspondent banking and other similar relationships, in addition to performing normal customer due diligence measures, to [...]"

[284] FATF (2012), pp. 116-7 and FATF (2003), p. 13. See also the in-depth analysis of Sutton (2012).

[285] FATF (2012), p. 112.

The terminology regarding the parties involved in correspondent banking could hardly be more confusing. This observation is all the more disturbing as the FATF has reviewed and updated its Recommendations “in close co-operation with the FATF-Style Regional Bodies (FSRBs) and the observer organisations, including the International Monetary Fund, the World Bank and the United Nations.”[286]

Another example: For the Oesterreichische Nationalbank (Austrian central bank) correspondent banking arrangements “are bilateral links between payment institutions”[287]. Also, this description proves to be short-sighted. As we have seen above, the parties involved in correspondent banking could be, amongst others, securities broker-dealers, futures commission merchants or a mutual fund. Using the term “payment institutions” is certainly wider than “banks”, but it does not adequately cover the span of potential correspondents and respondents. Although one could find a “payment”-component in any of the institutions mentioned so far, it is not necessarily the main characteristic of all potential players.

The term “financial institutions” is gaining ground, though. For the Financial Centre Regulatory Authority of Qatar, for instance, “[a] correspondent banking relationship involves the provision of banking services by one financial institution (the Correspondent Bank) to another financial institution (Correspondent Banking Client), where the financial institutions carry on activities or business at or through permanent establishments in different countries.”[288] All in all, it is obvious that a good number of regulators and practitioners have widened their assessment of possible protagonists in a correspondent banking relationship. Still, there is no international coherence. And even the broadest definitions may fall short of some other potential participants.

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[286] FATF (2012), p. 8.

[287] Österreichische Nationalbank on its website: http://www.oenb.at/en/Payment-Processing/Payment-Systems.html.

[288] Financial Centre Regulatory Authority of Qatar (2007), p. 4.

c. The holistic approach: including central banks and clearing houses

In order to understand that the list of potential correspondents and respondents may not be complete yet, let us take a look at the definition of Osterberg and Thomson (1999): They mention “banks” as possible correspondents (as most scholars and practitioners do), but also “central banks, and bank clearinghouses”. Unfortunately, the authors lack an explanation for this broader approach and simply refer to “banking literature”[289] without further citation. But they obviously point in the right direction – with far reaching consequences.

aa. Central banks

In this context, an obvious question arises: Can a correspondent banking relationship also include domestic and foreign central banks or monetary authorities that function as central banks?[290]

A clear signal is given by the Deutsche Bundesbank. Section 3 of the Bundesbank Act declares that one of the bank’s mandated duties is to arrange for the execution of domestic and international payments. In a fact sheet on correspondent banking the Bundesbank (2013) states: “For this purpose, the Bundesbank has a network of correspondent banking relationships. In addition to the around 200 euro accounts that the Bundesbank holds itself for foreign business partners, it maintains roughly 65 foreign currency accounts abroad for payment settlement.”

Amongst those correspondents of the Bundesbank (as respondent) are not only other central banks or similar institutions, but also multilateral financial institutions like the European

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[289] Osterberg and Thomson (1999), p. 10: “Banking literature refers to correspondent banking as the purchase (by banks) of input from other banks, central banks, and bank clearinghouses. For instance, when a bank in Cleveland sends checks to its local Federal Reserve Bank for collection, it has purchased correspondent banking services from that Reserve Bank. Another example is a recent agreement between J. P. Morgan and Chase Manhattan Bank, in which Chase provides European currency clearing services for Morgan.”

[290] Generally on the central banks’ role as intermediaries, see Millard and Saporta (2005); Green and Todd (2001).

Bank for Reconstruction and Development in London, the International Bank for Reconstruction and Development, Washington, D. C. and the International Investment Bank in Moskau, where the Bundesbank holds accounts in Euro.

The Bundesbank (as correspondent) has established correspondent banking relationships with foreign commercial banks, central banks (including comparable institutions) and "in exceptional cases foreign currency accounts can be held for domestic credit institutions in order to conduct correspondent banking business "[291] Moreover, in its list of potential correspondent account holders, the Bundesbank also offers monetary authorities, governments as well as international organizations. [292] For "purists" of correspondent banking, it may come by surprise, but the catalogue of possible respondents has to be extended to governments and international organizations. Payment services that are provided to governments (but also corporates) are often categorized as "cash management services".[293]

In the US, the Federal Reserve System plays a significant part in correspondent banking. The New York Fed, for example, provides - on behalf of the Federal Reserve System – "correspondent banking and custody services to central banks, monetary authorities and certain international organizations to facilitate their official financial operations."[294] In addition, Federal Reserve Banks offer account, wire and settlement services. Summers and Segala (1979) already give a thorough description of the Federal Reserve Banks' role in correspondent banking and come to the conclusion that "[t]he probability that a bank will decide to use Federal Reserve check clearing and wire transfer services is positively related

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[291] Deutsche Bundesbank (2013), p. 2.

[292] See: http://www.bundesbank.de/Redaktion/EN/Standardartikel/Tasks/Payment _systems/ customer_access_mechanism_correspondent_banking.html?searchArchive=0&submit=Search&searchIssued=0&templateQueryString=correspondent+banking.

[293] Wandhöfer (2014), Chapter 3.1.2.1.

[294] http://www.newyorkfed.org/banking/services_centralbank.html. On the Fed's role in selected payment systems see Green and Todd (2001).

to its administrative capacity to manage the services and its geographic proximity to those services."[295] In a later paper, Summers (1996, p. 867) points at the higher relevance of central banks in case that the banking structure is not too concentrated. Their advantage has to be seen in their access to "privileged supervisory information" and their comparatively lower incremental costs of surveillance.

The Federal Reserve does not reduce its correspondent services, respectively respondent activities, to "banks only". It uses the term "financial institutions" in its definition of correspondents and respondents.[296] It also gives an explanation of the meaning of a "financial institution" by including not only member banks[297], depository institutions[298], U.S. branches, or agencies of a foreign bank[299] and Edge or agreement corporations[300], but also "any other entity authorized to have a Master Account with a Reserve Bank"[301]. This last enclosure is particularly noteworthy as the Federal Reserve indirectly reveals the nature

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[295] Summers and Segala (1979), p. 15. See also Blommestein and Summers (1994), pp. 22-25; Thomson (1999).

[296] See Federal Reserve Financial Services (2013), p. 3: "Correspondent means a Financial Institution[…] that has authorized a Reserve Bank to settle Debit and Credit Transaction Activity to its Master Account for a Respondent or for any Financial Institution for which the Respondent acts as Correspondent […] Respondent means: […] a Financial Institution that settles Debit and Credit Transaction Activity for some or all of its Reserve Bank transactions in the Master Account of a Correspondent […]".

[297] As defined in Section 1 of the Federal Reserve Act, 12 U.S.C. § 221.

[298] As defined in Section 19(b)(1)(A) of the Federal Reserve Act, 12 U.S.C. § 461(b)(1)(A). Section 19(b)(1)(A) defines "depository institution" to include commercial banks, mutual savings banks, federal savings banks, savings and loan associations, and credit unions.

[299] As defined in Section 211.21(b) or (e) of Regulation K, 12 CFR § 211.21(b) or (e).

[300] As defined in Section 25A or 25 of the Federal Reserve Act, 12 U.S.C. §§ 611 *et seq.*, or §§ 601 *et seq*.

[301] Federal Reserve Financial Services (2013), p. 2.

of such “other entities” in a footnote to its definition of a “financial institution” – namely the U.S. Treasury, U.S. government agencies, and government sponsored enterprises.[302] At least on the respondents’ side, those institutions are far from being banks.

Central banks can also be the respondent of a commercial correspondent bank. Eichengreen (2008, p. 42) reflects on this by using the example that “central banks could intervene in the foreign exchange market or have a correspondent bank to do so in London or New York, purchasing domestic currency with sterling or dollars when the exchange rate weakened.” Blommestein and Summers (1994) see the main function of central banks in correspondent banking relationships in their role as vostro account holders[303] and they only subliminally touch the central banks’ potential to become respondents of commercial banks when they state that the “central bank […] does not hold nostro accounts with commercial banks, at least not with respect to its domestic currency”[304] – meaning that central banks could very well hold nostro accounts in foreign countries to have their foreign currency reserves managed properly[305].

De facto, correspondent banking is a business that evidently occurs between and with central banks as well.

Depository institutions (“DIs”) hold clearing balances at the Reserve Banks, a construct similar to the nostro/vostro accounts in correspondent banking relationships between commercial banks. The Federal Reserve underlines this when it says that the Reserve Bank clearing balance program “allows DIs to hold at Reserve Banks an agreed-upon level of clearing balances which serve several purposes, including facilitating settlement of transactions, protecting against overnight overdrafts, and paying for priced services through

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[302] Ibid., p. 2 footnote 4.

[303] Blommestein and Summers (1994), Pos. 529: “The central bank is a very important vostro bank because it holds accounts for almost the whole banking industry.”

[304] Ibid.

[305] Ibid, Footnote 2.

the generation of earnings credits. The Reserve Bank clearing balance program is largely modelled after similar programs offered by private-sector correspondent banks, wherein respondent banks maintain balances with their correspondents for some or all of the purposes listed above."[306]

In addition, European central banks have created their own reciprocal correspondent banking system in January 1999, the so-called "correspondent central banking model" (CCBM), where central banks are correspondents for each other and thus facilitate counterparties to obtain credit from their national central banks while having access to collateral from other countries. What triggered off an inter-central bank version was the lack of appropriate provisions for the cross-border transfer of securities for credit operations between national central banks of the European System of Central Banks (ESCB) when the monetary union was installed.[307] The CCBM is not limited to central banks of the Eurozone - the counterparties of the Bank of England, Denmark's Nationalbank and Sweden's Riksbank can use it as well.[308]

The legal basis of this important correspondent banking instrument is not tied to any national or supranational laws. The ECB is surprisingly blunt when it reveals that the "use of the CCBM by the EU central banks is based on internal Eurosystem/ESCB agreements".[309] Of course, the national legal systems of the national central banks (e.g., the lending central bank) are still applicable.

bb. Bank for International Settlements and CLS-Bank

Aside from central banks, the question arises whether other major international players on the financial markets could be perceived as correspondents as well. A prominent example would be the Bank for International Settlements (BIS). It certainly is a bank as the name

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[306] Federal Register/Vol. 74, No. 64/Monday, April 6, 2009/Notices, p. 15482.

[307] BIS (2003b), p. 75.

[308] European Central Bank (2017a), p. 2, footnote 3.

[309] European Central Bank (2017a), p. 12.

already indicates. At the Hague Conference in 1930 it was established as a commercial bank on the legal basis of a Swiss limited company with publicly held shares (but without being exposed to the Swiss legal banking or corporate system).[310] Felsenfeld and Bilali (2004) correctly assert that the BIS "was, and is, a bank and from its creation it performed the functions of a bank"[311]. Some restrictions as laid out in its Statutes certainly apply, for example accepting Bills of Exchange[312], but these Statutes give evidence that the BIS is a correspondent bank as well: according to Article 21 (k) and (l), the Bank "may also act as agent or correspondent of any central bank" or "arrange with any central bank for the latter to act as its agent or correspondent."

Correspondent functions are also part of CLS Bank's purpose. Founded to address settlement risks in foreign exchange transactions and launched in 2002, CLS Bank[313] settles payment instructions "relating to underlying FX transactions in 17 currencies and certain other transactions that result in one-way payments in a subset of those currencies"[314]. Without the participation of CLS Bank, the settlement of foreign exchange contracts usually involves correspondents. Suppose a Brazilian bank sells Brazilian Real and buys Japanese Yen from a Japanese bank, it transfers the Real via the local Brazilian payment system to the Japanese bank's correspondent in Brazil.

A private-sector enterprise, CLS Bank is owned by the world's leading FX banks, and settlement members hold a single multicurrency account and subaccounts (one for each currency) at CLS Bank.[315] Those are de facto nostro accounts for the members and vostro

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[310] Felsenfeld and Bilali (2004), pp. 954-55.

[311] Ibid, p. 948.

[312] See Article 24, Statutes of the Bank for International Settlement, (of 20 January 1930, amended on 27 June 2005), http://www.bis.org/about/statutes-en.pdf.

[313] On the history and functionality of CLS Bank, see the in-depth study of Schaller (2007). CLS stands for "continuous linked settlement".

[314] CLS Bank on its website: www.cls-group.com/About.

[315] Miller and Northcott (2002), p. 17. Settlement members can be banks, trust companies, or broker-

accounts for CLS Bank. Hence, CLS Bank has the role of a correspondent in the limited spectrum of foreign exchange.

Can the CLS Bank also be a potential respondent? Founded as a limited purpose bank CLS Bank holds accounts with the central banks of each eligible currency and is directly connected to each respective domestic Real Time Gross Settlement (RTGS) system; banking status is compulsory – otherwise certain central banks would not allow CLS Bank to hold accounts with them (Schaller, 2007, p. 71). In its relationship with and as account holder at some central banks, we can assess CLS Bank as being the respondent – again within the limited scope of foreign exchange.

cc) Clearing Houses, clearing and settlement systems

It is tricky to categorize *clearing houses*, as well as clearing and settlement systems in this context. They appear in different forms, operated and owned either by commercial banks, by the central bank, or a combination of both.[316] Today's sheer volume of payment flows leads to a higher demand for centralized inter-bank, respectively inter-institutional payments. This is where clearinghouses and settlement systems come into play.[317] Instead of dealing with a very impractical myriad of vostro and nostro accounts to operate all imaginable payments for numerous customers, the financial industry has established payment, clearing, and settlement systems.[318] The clearing and settlement process is rather complicated. In simple terms, to complete a transaction, we usually need three steps. Let's take a securities trade as an example: first, the securities trade needs to be executed. Then

dealers under supervision of an authority that is acceptable to CLS Bank (Schaller, 2007, p. 74).

[316] Sheppard (1996), p. 26.

[317] The wider term of "payment systems" has been defined by the Committee on Payment and Settlement Systems of the central banks of the Group of Ten countries (CPSS), see BIS (2003a), as "[…] a set of instruments, banking procedures and, typically, interbank funds transfer systems that ensure the circulation of money."

[318] See van Setten (2009), p. 192.

the securities trade has to clear. Thirdly, the trade has to settle.

From a purist's perspective, a clearinghouse may rather be seen as an agent, acting for the participants in the netting process; instead of holding accounts it usually would monitor the settlement account and – after all net obligations are paid – order the necessary transfers to the financial institutions in a multilateral net credit position.[319] Thus, one could say, a multilateral netting system, like a clearinghouse, is a payment system but not a correspondent. Or in other words, correspondent banking is an alternative for clearing, but clearinghouses are not an alternative for correspondent banking.

However, this thought leaves out an important consideration: namely, that correspondent relationships very often imply clearing activities through one or many correspondents - and certain financial institutions can be correspondents and clearing houses under one roof (for example some central banks).

This is what Osterberg and Thomson (1999, p. 10) obviously mean when they state that correspondent banking can be perceived as "the purchase (by banks) of input from other banks, central banks, and bank clearinghouses." Important is the distinction between a clearinghouse and a "bank clearinghouse". The latter entails the understanding that a bank also acts as a clearing house, with vostro/nostro relationships and the service offers of a clearing house.

Central banks that use large-value transfer systems performed by specialized clearing organizations outsource certain risk factors (mainly operational risks and structurally also some liquidity and credit risk components) to the clearing systems, but not the (vostro) accounts. A good example is the Swiss Interbank Clearing System (SIC), operated by SIX Interbank Clearing Ltd on behalf of the Swiss National Bank (SNB) which carries out interbank payments in Swiss francs 24 hours a day with funds held at the SNB whereby a (sight) deposit account contains a master account and a SIC settlement account and both accounts are seen as one from a legal perspective.[320] Therefore, payments are settled with central bank money. For members who are also linked to the CLS system, a SIC sub-

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[319] Van den Bergh (1994), p. 39.

[320] Summers (1994), Appendix 4; Mägerle and Oleschak (2009), p. 2.

account can be established. If we tie a correspondent relationship to the necessity of having nostro/vostro accounts, the correspondent relationship would only exist between the central bank (SNB) and the participating banks. However, the main service is conducted by the clearing system to which the participating banks have no direct account relationship.

Another example is the private sector payment system Clearing House Interbank Payments System (CHIPS). Operated by The Clearing House Payment Company LLC, an affiliate of the New York Clearing House Association, CHIPS is a U.S. dollar payments real time final settlement and transmitting system, where settling participants may be commercial banks, Edge Act corporations, certain investment companies, and New York based banking affiliates of a commercial banking institution.[321] The accounting relationship between CHIPS participants, the system, and the Federal reserve is rather complicated, but it underlines similarities to a correspondent banking relationship.

On the one hand, participants may maintain funds at the Federal Reserve Bank of New York. In this constellation the Federal Reserve Bank can act as a correspondent for the participating banks. In addition, they can hold a CHIPS prefunded balance account. Thus, we have to look at another potential correspondent arrangement – between CHIPS and the participants: After paying an opening position requirement to the Federal Reserve's CHIPS account, participants can transfer further funds to their CHIPS account throughout the day to enable the settlement of priority and non-priority payments.[322] As CHIPS' services entail continuous matching, netting, and settling of payment messages that are - during the operating day – submitted by the participants to a centralised queue maintained by CHIPS[323] (and not by the Federal Reserve Bank), we have to acknowledge that the entity which comes closest to being a correspondent is the CHIPS system.

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[321] See Summers (1994), Appendix 4. CHIPS is supervised and examined by the Federal Reserve and specific federal bank supervisory agencies, under the auspices of the Federal Financial Institutions Examination Council, BIS (2012), p. 488.

[322] BIS (2012), p. 489.

[323] Ibid.

(1) Can a system be a correspondent?

Hence, the general question occurs: Can a "system" be a correspondent? In light of further digitization of financial services this aspect is of growing importance.

Let us approach the answer to this problem from a different perspective. If a system fulfils typical services of a traditional correspondent (with or without an account relationship), we have to look at the possibility of whether it could circumvent certain regulatory barriers that would aim at, e.g., money-laundering opportunities.

In case that a system is operated by major commercial banks or a central bank[324], one would assume that all control mechanisms are in the proper place. Still, such a clearing system is often only subject to "self-control" structures put in place by the financial institutions that run the systems. Moreover, similar systems could be set up by players that are not as tightly overseen as those mentioned before. In order to avoid further confusion all such systems should systematically be treated the same. In times where more and more banks feel tempted to leave certain correspondent relationships around the world in order to avoid higher costs related to tighter regulation or just because of the reason not to be drawn into risky schemes that could lead to severe punishments, electronic and/or digital systems gain importance. This development – which even brought the chairman of the Financial Stability Board, Mark Carney, to a strong public statement in favour of correspondent banking[325] – can lead to a situation where a growing number of (mostly unregulated) players will come up with sophisticated solutions that step into a widening vacuum. Digital, respectively electronic systems are predestined to succeed in such an environment as they allow quick alterations and often complicated structures that make it harder for regulators to find similarities to existing, traditional structures.

Another strong argument can be made by drawing parallels to risk assessments. If a participant in a multilateral settlement or clearing network is unable to clear or settle, major credit or liquidity risks could emerge. A settlement or clearing system that could potentially slide in such a situation must not be treated as either a sheer addendum of lower importance

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[324] On the role of central banks in payment systems see Thomson (1999).

[325] Carney and Badré (2015).

to a larger institution in the background or an isolated system without any characteristics of a player that could be subject to necessary regulation.

The BIS (2001, p. 5) highlights a further development of this thought when it defines “systemically important payment systems”, regardless whether it is operated and owned by private and/or public institutions: “A payment system is systemically important where, if the system were insufficiently protected against risk, disruption within it could trigger or transmit further disruptions amongst participants or systemic disruptions in the financial area more widely.” The sizes and nature of the payments matter; according to the BIS, large-value payment systems would “normally” be considered as systemically important. Disruptions or even a collapse of any of the major clearing or settlement systems could easily prompt further negative consequences for other participants. The BIS’s description fits many clearing and settlement systems around the globe. A good number of them has been recognized by, for instance, central banks as “systemically important”, as the example of Canada shows.

A system that earns the attribute “systemically important” in the financial world can hardly be excluded from being considered a correspondent if it fulfils major criteria of the correspondent service structure. History shows us that badly regulated correspondent structures can lead to major ripple and domino effects in the financial world. The fact that more and more functions of transaction banking, payment flows, and financial interaction are taken over by digital and electronic systems must not lead to the conclusion that they can easily evade classifications, making them subject to oversight and regulation.

The correlation between clearing and correspondent activities is also highlighted by the Wolfsberg Group. In its FAQs (2014, p. 3), it affirms that, for instance, in the Eurozone framework, an EU-based institution providing “Euro-clearing services to other institutions within the EU, […] should treat these customers as Foreign Correspondent Banking relationships.”

Even more obvious is the correspondent nature of clearing houses in the (historical) context of check clearing. Although national check collecting systems differ around the globe, clearing houses are a very common approach as an accepted alternative to banks presenting checks directly from bank to bank, to central banks operating check clearing systems or, historically, especially in the U.S., to the option of relying on correspondent banking arrangements.[326]

In the United States, the first clearing house was launched by New York City Banks in 1853. It formed a market where banks would have one other, common party for – in simple terms – exchange activities between banks.[327] Richardson (2007, p. 643) points at three check-clearing systems that traditionally operate(d) in the United States, whereby the Federal Reserve clears checks for members of its system, clearing houses clear them for members of their organizations and correspondents clear checks for all other institutions. A bank became a member of a clearing house by depositing cash or securities and paying balances due to other banks on a daily basis against receiving certificates issued by the clearing house organization.[328]

Not only is this early evidence that clearing houses which are neither commercial banks nor central banks may hold settlement accounts of the banks involved,[329] but also a description of an arrangement that finds its analogy in correspondent (banking) relationships. Or in the words of Lacker (2015, p. 2): "The country banks (as banks outside major cities were called) were connected to city banks via an intricate web of correspondent banks, and city banks were connected to each other via clearinghouses."

Some regulators have also understood that clearing house activities need to be tied to similar rules as the traditional correspondent banking procedures. For depository institutions' (international) use of Automated Clearing House (ACH) actions federal agencies in the U.S. have publicised supervisory and compliance prospects for Bank Secrecy Act (BSA) obligations in the FFIEC Bank Secrecy Act/Anti Money Laundering

[326] BIS (2001a), p. 68.

[327] Gorton (1985), p. 278.

[328] Richardson (2007), p. 644.

[329] See also Sheppard (1996), p. 26.

Examination Manual[330]. However, clearing houses around the world do not *generally* have nostro/vostro account structures as we, for instance, find them in the relationship between the CLS Bank and settlement members.

In our opinion, a clearing or settlement system that provides services that would typically be conducted by a correspondent can very well be called a correspondent – even if it is tied to an institution that holds vostro accounts for the participants of the system. Recently, Dugan (2015), the deputy comptroller for operational risk at the U.S. Office of the Comptroller of the Currency (OCC), clearly emphasized in a keynote speech at The Clearing House's First Operational Risk Colloquium that many community banks are The Clearing House's correspondent clients.[331]

As opposed to many clearing systems, respectively clearing houses, a settlement provider (especially if it is a bank) regularly holds accounts[332] for the brokers of the buying customer and selling customer within a transaction and therefore fulfils an additional criterion for being a correspondent.

In contrast to the correspondent banking role of many clearing houses and systemically relevant clearing systems as well as the aforementioned banks that serve as settlement providers, there are so-called real-time gross settlement (RTGS) systems[333] like

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[330] The FFIEC BankSecrecyAct/Anti-MoneyLaundering Examination Manual (last revised in 2014) can be found at: https://www.ffiec.gov/bsa_aml_infobase/pages_manual/manual_ online.htm www.ffiec.gov/bsa_aml_infobase/default.htm.

[331] Dugan (2015), p. 3.

[332] Wandhöfer (2014), Chapter 3.1.3.3, points at this connection between settlement provider and account structures. However, she uses the common, but misleading term "settlement agent".

[333] Galbiati and Giansante (2010) have developed a model of emergence of networks in an interbank, RTGS payment system.

TARGET2[334] - the latter is operated on a single technical platform and owned by the Eurosystem. Although TARGET2 is branded as a systemically important system[335] and had (according to the ECB[336]) 1,076 direct participants, 701 indirect participants and 5,072 correspondents in 2017, it has to be noted that business relationships do not exist between the mentioned players and TARGET2, but between the users of the platform and the respective central bank.[337]

We gain the same result looking at the U.S. RTGS system Fedwire Funds Service, which is a real-time credit transfer service. Participants initiate funds transfers by instructing a Federal Reserve Bank to debit funds from its account at the Reserve Bank and credit funds to the account of another participating bank.[338] Here again, the system as such is not in a direct relationship with the potential respondent, as opposed to the Federal Reserve Bank which would be the participants' main correspondent. The BIS valued RTGS systems in 2001 as tried and tested, having reduced systemic risks. However, at that time they still saw them as a "means to achieving safety and efficiency in systemically important payment systems, not a goal in themselves."[339]

The U.S. National Settlement System (NSS), a multilateral settlement service, owned and operated by the Federal Reserve Banks and established to settle for clearing houses, financial exchanges, and other clearing and settlement arrangements, does not reach the threshold of being a correspondent in the range of our definition. It mainly serves as an

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[334] The acronym TARGET stands for Trans-European Automated Real-Time Gross settlement Express Transfer system.

[335] ECB in its Press Release from August 21st 2014, see https://www.ecb.europa.eu/press/pr/date/2014/html/pr140821.en.html.

[336] See the website on TARGET2 of the ECB: www.ecb.europa.eu/paym/t2/html/index.en.html.

[337] Ibid.

[338] BIS (2012), p. 487.

[339] BIS (2001), p. 13.

automated electronic mechanism for submitting multilateral settlement files to the Federal Reserve Banks.[340] If at all, the so-called “settlement agent” that is designated within the NSS arrangement to submit settlement files for the setters to a Reserve Bank would come close to the role of a correspondent.

So, instead of using the misleading term “agent” we prefer speaking of a “correspondent” (with very limited responsibilities, like determining the respective settlement amounts by the settlers and electronically submitting the NSS settlement files to the Federal Reserve Banks[341]) here as well. An agent characteristically is an operational (and often legal) extension of a parent institution with a certain quantity of dependence.

One of the most well-known organisations on the global stage connected with correspondent relationships is The Society for Worldwide Interbank Financial Telecommunication (SWIFT). Established as a member-owned limited liability cooperative, SWIFT offers a communications platform together with products and services that allow its users to exchange financial information with high security standards.[342] Members are mainly financial institutions, including central banks, but also non-financial companies, yet their use of the system is limited to corporate-to-bank communications.

So, could SWIFT itself be considered as acting as a correspondent after we have added certain settlement and clearing systems to our list of possible correspondents? SWIFT’s central application, FIN, is a store-and-forward interactive service for the exchange of standardised messages; it prioritises, monitors, validates, stores and retrieves messages, but also concentrates on more recent developments that are core for the financial industry, like cybersecurity and defence.[343]

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[340] BIS (2012), pp. 489-90.

[341] BIS (2012), p. 490.

[342] BIS (2012), p. 541.

[343] Ibid., p. 543 and SWIFT (2015), p. 11.

However, SWIFT neither holds funds nor operates or manages accounts for its customers.[344] It also does not permanently store or further use their financial data and does not call itself a payment or a settlement system - as such, it is not regulated by central banks or bank supervisors.[345] In the words of BIS (2012, p. 541) SWIFT rather "acts as a catalyst for collaborative work within the financial community to shape market practice, define standards and consider approaches to issues of mutual interest." As it is owned by its members (that use its services) it also lacks the amount of independence which is typical for a correspondent.[346]

(2) Criteria for clearing, settlement and payment systems

As these few examples show, we need criteria for the correct classification of clearing houses, settlement, and payment systems if we do not find nostrio/vostro account arrangements.

Such criteria are: (1) The value of payments cleared or settled, (2) market share, (3) cross-border relevance, (4) provision of typical correspondent services to other infrastructures[347], (5) a direct relationship to participants of the system, (6) a lasting relationship, (7) the system is subject to regulation or an instrument to circumvent regulation that would normally be in place for similar services, (8) the system has marginalized or diminished existing correspondent relationship structures.

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[344] BIS (2012), p. 541 Footnote 11.

[345] SWIFT (2015), p. 26. However, SWIFT is subject to cooperative oversight by central banks

[346] According to SWIFT (2015), p. 26, a large and growing number of systemically important payment systems have become dependent on SWIFT, which has thereby gained a systemic character.

[347] These first four principles are used by the ECB (see https://www.ecb.europa.eu/press/pr/date/2014/html/pr140821.en.html.) to evaluate the quality of a payment system to be systemically important – whereby only two of them need to be fulfilled.

Strong indicators, but not sufficient for the characterisation of a correspondent relationship, are existing regulatory measures that are analogue or similar to correspondent regulation. Furthermore, the systemic importance of clearing and settlement systems.

In summary, many clearing and settlement arrangements, respectively systems around the globe fulfil criteria of a correspondent relationship, although they usually do not come close to the typical form of first-order correspondent *banking* with not only vostro/nostro accounts, but also a wide range of services offered. Their limitations lead us to a classification of many clearing and settlement arrangements as lowest-order correspondent relationships (or second-order correspondent relationships if they are bearers of a banking license).[348]

Still, there is a good number of other clearing and settlement procedures and methods where a system is only an electronic extension or tool of a bank clearing house (like a central bank) that would actively, and not only legally, be in charge of all operations led by the system.

d. Perfect confusion or a new categorization?

Not only amongst practitioners in the public and private sector we find a variety of descriptions of correspondent banking. The academic literature has also not cleared the fog as most scholars offer insufficient terminology in the light of our findings. In addition to the bandwidth of descriptions and definitions given above, some examples shall illustrate this observation.

For Curry, Fung and Harper (2003) correspondent banking "consists of a correspondent relationship, typically on a reciprocal basis, between domestic banks in different countries. The relationship involves the foreign domestic bank (the correspondent) conducting financial transactions and related activities in the foreign market on behalf of the home bank. Common services include extending foreign currency credit, issuing or honouring letters of credit and providing information about foreign market conditions. The foreign bank performs the transactions on behalf of its correspondent in return for a fee."

Here we only witness a rough sketch of international correspondent banking between

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[348] For a concise "three level" categorization see below Chapter 3 5.d.

commercial banks. It includes neither a precise list of the possible players (commercial and central banks, clearing houses etc.) nor a hint to the national dimension of this relationship. In addition, some correspondent bank relationships are not fee-based (e.g., with certain central banks).

According to Chan (2001), correspondent banking is a “subsystem within the banking system”. In our opinion it would not be too far-fetched to consider correspondent banking – based on its historical development and significance - as a principal element of the banking system. Of course, one can only come to this conclusion, if we widen the scope and see not only the admittedly already substantial global “value” of correspondent banking within the financial scenery, but also the role of all players involved; a role, which cannot solely be limited to commercial banks, but which comprises central banks and certain clearing houses as well. Furthermore, day-to-day business in banking would (still) be unthinkable without correspondent banking arrangements. With their national *and* international dimension and especially their “network”-function within the financial world correspondent relationships thus echo a pivotal component of banking.

Some attempts to define correspondent banking bear the risk of being misleading. Naughton and Chan (1998), who have certainly tried to find a more thorough definition, conclude that “a correspondent bank essentially acts as an agent of the respondent.” The use of the term “agent” can be understood from the perspective of someone who uses common or microeconomics language. However, even banking law literature occasionally speaks of “agents”. Cranston (1997, p. 43) at least offers a slight reservation in his (still confusing) description: “The relationship between a bank and its correspondents is often one of agency. But not always, and the correspondent may be only an independent contractor providing services for reward, such as conveying messages. In so far as it brings the issuing bank and beneficiary into contractual relations, a correspondent acting as an advising bank in a documentary credit transaction seems to be an agent.”[349]

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[349] According to Dolan (1992), in his insightful article about legal questions in correspondent banking relationships dealing with Letters of Credit, it depends on the specific action of the parties involved whether a certain act can be perceived as an agent’s role.

Still, in the context of banking terminology, as we have seen, agencies are already differentiated from correspondents by their degree of dependency on the parent bank. Therefore, the term "agent" has to be avoided (even in the "softer" version like: "A correspondent is effectively an agent for the respondent and executes/processes payments or other transactions for customers of the respondent"[350]).

It is certainly insufficient, only to express that "correspondent banking has no precise definition" and that the "definition […] varies from bank to bank due to the nature of banking business and policies" (Chan, 2001). This approach evades the necessity of finding common denominators – and the possibility of doing so – and it avoids a clear delimitation or "fencing" of the business. Yet, even bankers often lack an understanding of the wider dimension of correspondent banking. None of the correspondent banking experts in global banks we interviewed added, in a first reply, other players than commercial banks as potential partners in correspondent banking relationships. They would concede, though, that some central banks must be seen as competitors. A rather purist approach is offered by Broz (1997, p. 35) when he describes the correspondent banking structure as "interior banking markets linked to money-center markets by contractual arrangement".

In the United States we find a stricter distinction between domestic and foreign correspondent banking. But already, the accounting terminology differs from the commonly used words "vostro/nostro accounts". Public authorities mainly rely on the terms "due from (domestic or foreign) bank" and "due to (domestic or foreign) bank" accounts or deposits.[351] The two fields of correspondent banking are also treated differently, especially in terms of regulation where foreign correspondent banking faces sterner measures after causes of terrorist financing and money laundering had been connected to foreign correspondent relationships.

Systematically, and in conclusion, our findings and the existing terminological as well as conceptual chaos lead to an essential *categorization of correspondent relationships*. The traditional and strongest bonds are created if two banks or at least two financial institutions

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[350] FSA (2011), p. 43, JMLSG, Part II (2014), p. 171.

[351] See, for instance, the the U.S. Department of the Treasury's Office of the Comptroller of the Currency (1990-1998), Section 202 and 809.

with a banking license and a nostro/vostro account relation are correspondent and respondent. They reflect a “classical” understanding of correspondent *banking* as a sub-concept of correspondent relationships and are theoretically (as correspondents) capable of offering the widest range of potential correspondent services. Most commercial banks fall into this category. We call these protagonists with at least a banking license *first-order correspondents* and *respondents*.

Second-order correspondents and *respondents* are holders of a banking license but are limited in their scope of services (as, for instance, central banks, the CLS Bank, or the BIS[352]). As correspondents, they can manage vostro accounts.

Third-order correspondents and *respondents* would normally not have a banking license. Therefore, they are not be allowed to hold and manage bank accounts of others, but they typically act like parties in a correspondent relationship with a reduced span of services. Clearing houses (that are not at the same time central or commercial banks) can fall in such a categorization, as they take over a characteristic subject of correspondent banking networks – without being involved in mutual account relationships.

As pointed out above, *first-order correspondents* can be tied to second- or third-order respondents on a contractual basis or – typically - via vostro/nostro accounts. *Second-order correspondents* can have a correspondent relationship with first-, second- and third-order respondents and would – in most cases – be connected through vostro/nostro accounts or through contracts. *Third-order correspondents* would naturally be linked to first-, second- and (rarely) third-order respondents via alternatives to nostro/vostro accounts, therefore usually based on a contractual agreement.

When *third-order correspondents* engage in accounting related services they can reach out to a *first-* or *second-order correspondent* to become part of the service chain.

One aspect that all forms of correspondent relationships have in common is their ongoing, recurring character[353], which excludes unrepeatable and one-off arrangements. Our concept

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[352] See above, Chapter 3 4.c.

[353] The Wolfsberg Group (2014, p. 1) speaks in its Principles for Correspondent Banking of an “on-going, repetitive nature” of a correspondent relationship.

of distinguishing three levels of correspondent relationships also helps overcome flaws in other approaches that seek to categorize banking systems related to clearing and settlement methods. As an example serves Marquardt's (1994, pp. 117-8) approach to draft four institutional forms for delivery and clearing mechanisms for payment instruments, ranging from intrabank systems to interbank correspondent arrangements, interbank clearinghouse arrangements, and central bank arrangements. According to our findings, the last two forms can very well be a part of interbank correspondent relationships.[354]

To summarize, it is incorrect to reduce correspondent relationships to correspondent *banking*. It is the most prominent, but still only a facet of correspondent relationships. Still, correspondent *banking* is almost always tied with opening and managing a correspondent account.

6) Conclusion and recommendations: Towards a consistent definition of correspondent banking

Our foregoing description of the range of services, our sceptical view on the nostro/vostro dogma, and the necessity of having a wide spectrum of potential players involved in correspondent relationships gives an indication of the difficulties to finding a proper categorisation and definition that also covers the global element of this model. In the worst case, a lack of terminological clarity can easily lead to a lack of compliance. According to a recent OECD study (2014, pp. 33-4), 50% of the OECD countries were non-compliant with the FATF Recommendations regarding correspondent banking. Although the reasons for this outcome may certainly differ, terminological confusion is not beneficial for regulatory success.

Furthermore, imprecision in wording can create loopholes for criminal activities. In today's interconnected world it does not take much effort for non-bank parties to move the starting and ending points of transactions to jurisdictions with unclear definitions of correspondent banking – or to a regulatory landscape that still sticks to a bank-only approach. The

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[354] A fact that Marquardt (1994, p. 118) at least partly acknowledges when he states that "central bank arrangements involve the central bank acting as a common correspondent to some or all of the banks in a banking system, for the purpose of clearing and settling payment instructions between banks."

developments in the digital sector will also lead to more and more innovative substitutions of the classic bank to bank relationship. However, new methods must not drift into regulatory twilight, but should be aware of existing thresholds of damaging behaviour.

We, therefore, recommend a definition that does not mention correspondent *banks* any longer, but uses the term *institution* on the correspondent's side instead. A correspondent banking relationship is traditionally a liaison between financial institutions. However, to be precise, it is only the correspondent that needs to fulfil the criteria of a financial service provider. Respondent could be any first, second and third-grade account holder or party via contract with a correspondent that asks for correspondent services. As an alternative to the traditional term *correspondent banking,* we consider the expression *correspondent relationship* or *arrangement* as less misleading.

To narrow the intellectual dimension of correspondent banking and to offer a clearer picture of the advantages of this business model, we developed a new system of factors of correspondent relationships. It comprises of (1) the access and influence factor, (2) the savings factor, (3) the local and global networks factor, (4) the efficiency factor, (5) the interconnectivity factor, (6) the business accelerator factor, (7) the predictable revenue factor. All seven points are relevant for correspondents and respondents alike.[355]

Regarding recent outside influences on correspondent arrangements, we conclude that the financial crisis and the establishment of the Eurozone led in parts to a significant concentration process in correspondent banking, with the larger players in the financial industry as temporary profiteers (however, the financial crisis caused a variety of results, often depending on where the banks were located). Many smaller banks are not aware of the risks of this development. In the Eurozone, correspondent banking relationships are progressively in decline - also due to centralised Euro clearing and settlement systems. During the last financial crisis, correspondent relationships were a predictable "safe haven" for global banks. The rising compliance and regulatory costs superficially played into the hands of the larger players in the financial industry. On the other hand, the consequences of the latest money-laundering scandals led to sharply reduced correspondent arrangements.

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[355] We have to be precise when we adapt these *factors of correspondent relationships* to our *categorization of correspondent relationships* (see above Chapter 3 5.d.): regularly, only *first order correspondents/respondents* would fulfil the characteristics of the *factors*.

Technological developments like the blockchain and open distributed ledgers pose a threat to traditional banking models. Existing (traditional) lists of risks and disadvantages of correspondent banking need to be expanded. This is the first survey where (1) geographical and geopolitical risks, as well as (2) risks from new, disruptive technologies, and (3) reputational risks are mentioned. We also call for the recognition of "cross-cutting risk clusters" (societal, economic, geopolitical, technological, environmental risks).

Modern regulation in the aftermath of 9/11, imposed sanctions and the financial crisis led to changes of perception of correspondent banking: from a "matter of trust and reputation" to a matter of "must and regulation". We also see a slow shift from more and more "self-regulation" by the industry to processes that involve many different stakeholders. This is the first time that correspondent banking is named a core example of being the aim and root cause of a "private-public regulatory hybrid". Aside from governmentally imposed regulation (or such from multinational public sector authorities), the role of self-regulation through the industry is remarkably forceful. We call for international standards, but realistically, we see a Sisyphean task. A too-tight approach regarding the players involved in correspondent banking relationships makes it more difficult to reach further – and necessary – steps of industry standardization. In the wake of recent regulatory developments, it is even more important to find international standardization and regulation that lead to predictable compliance costs. This implies those players that are important for a functioning and affordable international payment network (also in light of more prosperous perspectives for developing countries – especially in the context of remittance payments). The Federal Reserve Bank mentions certain reports suggesting "that depository institutions may be terminating the accounts of some non-bank payment providers that offer financial services to consumers, such as money services businesses."[356] And without holding accounts as respondents or even correspondents at depository institutions, certain non-bank

[356] See Board of Governors of the Federal Reserve (2015), p. 5 and footnote 14, pointing at a FinCEN (2014) report, stating that "Money services businesses ('MSBs'), including money transmitters important to the global flow of remittances, are losing access to banking services, which may in part be a result of concerns about regulatory scrutiny, the perceived risks presented by money services business accounts, and the costs and burdens associated with maintaining such accounts."

actors and payment providers may be unable to access the financial system.[357]

This research concisely and clearly distinguishes correspondent banking from any other type of inter- and multinational banking. As a novelty in literature, it finds a differentiation from so-called “banking correspondents”; we also support a fitting terminology of the latter, namely “business correspondents”.

After showing the typical characteristics of correspondent banking accounting we prove why a correspondent (banking) relationship does not have to be based on the traditional nostro/vostro account relationship. As such, the service spectrum is already an indicator of alternatives. A correspondent relationship can be initiated and maintained through correspondent services contracts and/or through opening and holding accounts with one another. It is traditionally, but not necessarily, tied to a nostro/vostro/loro account structure. Exceptions already exist, and this distinction is critical for the evaluation of potential participants in a correspondent relationship. A strict restriction to account arrangements would exclude several financial institutions or players in the finance business from falling under the definition of a respondent or correspondent. Such an exclusion would make it difficult to apply present regulatory or compliance rules to certain participants in financial services procedures, as well as open opportunities for potential misconduct and circumvention of, for instance, AML rules. It also creates less complicated regulation efforts toward alternatives based on digital solutions.

We also demonstrate why a correspondent (banking) relationship does not necessarily need a bank on the correspondent’s and/or respondent’s side. As a consequence, the majority of all definitions proves to be flawed or wrong. In this context we offer a systematic and essential categorization of correspondent relationships. The most solid bonds are given when two banks or at least two financial institutions with a banking license and a nostro/vostro account relation are correspondent and respondent. They reflect a “classical/traditional” understanding of correspondent *banking* as a sub-concept of correspondent relationships, and they are theoretically (as correspondents) capable of offering the widest range of potential correspondent services. The lion's share of commercial banks falls into this category. We call these players with at least a banking license *first-order correspondents* and *respondents*. In order to prevent further confusion in

[357] Board of Governors of the Federal Reserve (2015), ibid.

international and domestic accounting procedures and its legal fundaments, we have to overcome the terminological polyphony in respect of the accounts involved. Globally, but also in the influential financial environment of the U.S. the words vostro/nostro/loro accounts should be established (instead of, for example, "due to" and "due from" accounts). *Second-order correspondents* and *respondents* hold a banking license, but find their limits in the scope of services (as, for instance, central banks, the CLS Bank or the BIS[358]). In their role as correspondents, they can manage vostro accounts. *Third-order correspondents* and *respondents* would typically not bear a banking license, thus not be allowed to hold and manage bank accounts of others, but usually act like parties in a correspondent relationship with a reduced bandwidth of services. Clearing houses that are not at the same time central or commercial banks and not involved in mutual account relationships can fall in such a categorization as they took over a characteristic subject of correspondent banking networks. *First-order correspondents* can be tied to second- or third-order respondents on a contractual basis or – (stereo)typically - via vostro/nostro accounts. *Second-order correspondents* can have a correspondent relationship with first-, second- and third-order respondents and would, in most cases, be connected through vostro/nostro accounts or through contracts. *Third-order correspondents* would naturally be linked to first-, second- and (rarely) third-order respondents via alternatives to nostro/vostro account, thus mainly based on a contractual agreement. When third-order correspondents engage in accounting related services, they could link up with a first- or second-order correspondent to participate in the service chain. All forms of correspondent arrangements share its ongoing, recurring character, which excludes unrepeatable and one-off structures.

Our concept of distinguishing three levels of correspondent relationships also helps in overcoming flaws in other approaches that seek to categorize banking systems related to clearing and settlement methods. By developing additional (correspondent) criteria for clearing, settlement, and payment systems, we show that certain payment systems can very well be parties in a correspondent relationship. The criteria are: (1) the value of payments cleared or settled, (2) market share, (3) cross-border relevance, (4) provision of typical

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[358] See Chapter 3 4.c.

correspondent services to other infrastructures[359], (5) a direct relationship with the participants of the system, (6) a lasting relationship, (7) a system is subject to regulation or an instrument to circumvent regulation that would normally be in place for similar services, and (8) a system with marginalized or diminished existing correspondent relationship structures.

There are good ordo-political reasons to avoid more regulation and to instead ask for market discipline. However, such discipline – hopefully leading to incentives for financial institutions to circumvent fragile and risky funding and correspondent arrangements - will never be reached as long as common grounds regarding terminology, definitions and its consequences are not even visible on the horizon.

We agree with Agénor (2013) that the latest financial crisis gives evidence that “differences in national regulatory regimes across countries can trigger arbitrage-based behaviour” with the possible consequence of severe swings in capital flows which itself may lead to even more internationalisation of financial shocks.[360] Therefore, it is not too late to call for a single global institution for the regulation of correspondent relationships. Yet, in reality, such an attempt still bounces against rubber walls of national resistance. Giving up the necessary sovereignty for functioning control, monitoring, and even sanction mechanisms still faces predictable opposition from many governments, but also some industry-led bodies. Several of the multinational developments - described above, regardless whether they are of private, public, or hybrid nature - are promising, but they need coordination. If we keep calling for better, not more, regulation, we first and foremost need to achieve a common platform of the subject that is to be regulated. With a widely differing definition of correspondent relationships, respectively correspondent banking, this task is doomed to fail.

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[359] These first four principles are developed and used by the ECB (see https://www.ecb.europa.eu/press/pr/date/2014/html/pr140821.en.html.) to evaluate the quality of a payment system to be systemically important – whereby only two of them need to be fulfilled.

[360] Agénor (2013), p. 131.

Excursion: Correspondent arrangements as a financial system

All the aforementioned results and recommendations help us to close another gap in research: correspondent arrangements have not been part of a *functional approach to finance* yet.

When the idea of discussing functions of the financial system gained prominence in the 1990s, it was not only tied to an abstract academic debate of how one would construct an entirely new financial system for a country. It rather served the purpose to react to some fundamental changes that were underway and triggered, for example, by the collapse of communist systems in Eastern Europe and beyond. Today, technological advancements lead us to similar challenges as – again – existing systems are continually "under attack" from digital disruptions.

Two methods stand out in this context: Iqbal and Llewellyn's (2002, pp. 3-4) findings, and Merton's (1995) and Merton and Bodie's (1995) important work.[361] We can subsume correspondent relationships of our days under both, the *four universal functions of a financial system* (Iqbal and Llewellyn) and the *six core functions performed by the financial system* (Merton). In order to gain the anticipated results we need to distance ourselves from a purely *institutional perspective* when analysing correspondent relationships. Otherwise, we would have to take the currently prevailing and existing institutional structure of financial intermediaries "as given".[362] Generally, and according to Merton and Bodie (1998)[363], the institutional form follows its function and financial functions prove to be

[361] Other approaches, e.g., by Hubbard (1994), Kohn (1994), Rose (1994), and Sanford (1994) are briefly discussed in Bodie and Merton (1998), pp. 28-30.

[362] Merton (1995), p. 23:

[363] Based on the thoughts of Merton (1993 and 1995). His structural approach "rests on two basic premises: 1) financial functions are more stable than financial institutions – that is, functions change less over time and vary less across geopolitical boundaries; and 2) competition will cause the changes in institutional structure to evolve toward greater efficiency in the performance of the financial system" (Merton, 1993, p. 18).

more stable than financial institutions, showing fewer variations internationally (in cross-border intermediation), and not as many changes in the course of time. Merton and Bodie's "functional and structural finance" approach shows no ideological bias in choosing the ideal mix of institutions to use in performing financial functions; all institutions, regardless whether governmental, private-enterprise or family-based are treated equally.[364] In our adaptation to correspondent relationships, this precondition is central as we have identified a plethora of potential participants (ranging from central banks to privately held commercial banks to clearing houses) in correspondent arrangements. Our thesis is a reflection of a *functional perspective* which takes "as given" the economic functions conducted or performed by financial intermediaries[365]: Without this model we wouldn't have come to the aforementioned conclusions in this Chapter 3 - for example, including certain non-banks and even payment systems in correspondent relationships and creating *first- to third-order correspondents and respondents*.

Merton (1995, p. 23) insists on a basic understanding that the primary function of any financial system "is to facilitate the allocation and deployment of economic resources, both spatially and temporally, in an uncertain environment" and describes his six functions as follows: "Function 1: A financial system provides a payments system for the exchange of goods and services. Function 2: [It] provides a mechanism for the pooling of funds to undertake large-scale indivisible enterprise. Function 3: [It] provides a way to transfer economic resources through time and across geographic regions and industries. Function 4: [It] provides a way to manage uncertainty and control risk. Function 5: [It] provides price information that helps coordinate decentralized decision-making in various sectors of the economy. Function 6: [It] provides a way to deal with the asymmetric-information and incentive problems when one party to a financial transaction has information that the other party does not."[366]

Today's international payment system comprises of a complicated network of depository

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[364] Merton and Bodie (2005), pp. 13-4.

[365] Merton (1993), p. 18.

[366] Merton (1995), pp. 23-4.

institutions as well as public and private clearing houses, facilitating different ways and means of payment in order to make transfers; together, with capital markets, such a basic payment system eventually forms a *financial* system.[367] Superficially, correspondent banking seems to fall under the definition of an international payment system in capital markets (the latter connecting private and public financial activities amongst other goals). However, the question arises whether it also fulfils Merton and Bodie's six functions of a financial system.

According to Function 1 a financial system provides a payments system for the exchange of goods and services (and assets). This leads us to the question of whether we could call correspondent (banking) arrangements a payment system. Such a payment system would be characterized by "ways of clearing and settling payments", or in other words, it is "the set of institutional arrangements for accomplishing this task [of clearing and settling payments]"[368]. Undoubtedly, banks as depository financial institutions meet this condition by facilitating, for example, wire transfers and using checking accounts. The constellation of correspondents and respondents in a correspondent relationship paradigmatically fulfils Function 1. In our case, correspondents and respondents are in the majority of all cases (depository) financial intermediaries. As first-order correspondents and respondents they are bearers of banking licenses that conduct at least wire transfers to facilitate the transaction between their respective clients ("exchange of services"). But also second- and third-order correspondents and respondents live up to the requirements of this first function as they are systems for clearing and settlement designed to deal with the costs and risks connected with the method. Generally, costs are stipulated through fees and/or transfer taxes, and risks entail the failure of one party of a transaction or business arrangement to satisfy the contractual obligations. Despite all inherent own risk factors (as described in this Chapter[369]) of a correspondent relationship, this method was originally installed to mitigate costs and risks tied to transactions between two individual parties (especially across long

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[367] See Merton (1993), p. 19.

[368] Merton and Bodie (1998) make this clarification (and others) in a broader definition of the "six basic functions performed by the financial system", ibid. p. 7.

[369] Chapter 3 1.c.

distances) without professional financial intermediaries.

Function 2 expects a system that provides a mechanism for the pooling of funds to undertake large-scale indivisible enterprise or “for the subdividing of shares in enterprises to facilitate diversification”[370]. At first glance, this is probably the function that seems the least fitting for correspondent relationships. Typically, this precondition is aimed at financial intermediaries like mutual funds and at the method of securitization. Still, in order to establish a correspondent structure that copes adequately with the risks and opportunities of this transaction model, financial intermediaries as necessary players in such constellations need to be equipped with sufficient amounts of capital. And, especially in correspondent *banking* a significant degree of “pooling” funds is reached by establishing nostro/vostro accounts – at least between respondent and correspondent banks.

This observation also interacts with Function 3, with which a financial system offers ways “to transfer economic resources through time, across geographic regions, and among industries.”[371] Correspondent arrangements qualify from two angles for this function: first, we have to look at the clients of the participating financial institutions - a household or business that is tied and restricted to a geographical region would be overstretched to come up with the requirements to securely facilitate transactions across time zones, different legislations and currencies; secondly, even the intermediaries, namely the *first- to third-order correspondents/respondents*, step in to overcome the geographical and time-related deficiencies of their (*first to third order*) counterparts. Correspondent arrangements clearly help to overcome efficiency obstacles regarding the timely transaction of capital resources around the globe. Merton and Bodie’s expectation that a “well-developed, smooth-functioning financial system facilitates […] the efficient allocation of physical capital to its most productive use in the business sector” is therefore carried out by financial institutions and would find its analogy regarding processing money from household to household as well.

Function 4, that is, providing a way to manage uncertainty and control risk, is one of the

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[370] Merton and Bodie (1998), p. 8.

[371] Ibid., p. 9.

most prominent aspects connected with correspondent relationships. Despite the fact that correspondent arrangements create their own risk factors[372] (which we have touched upon in-depth above when we widened the "classical" risks of correspondent banking - legal, liquidity, credit, operational, and concentration risks - with a few new developments, such as geographical, geographical, and technological risks, as well as cross cutting risk clusters)[373], they provide "risk-pooling and risk-sharing opportunities for both households and business firms […] through private sector and government intermediaries"[374]. The correspondent system was also invented to mitigate the risks and challenges arising in long-distance trade and payment relationships without sophisticated and well-connected intermediaries (ranging from private sector banks and central banks to other *second- and third-order correspondents/respondents*). In addition – and as a further stabilizer of a financial system – the system itself is also controlled by national and international regulators, as shown in this chapter.[375] If conducted properly and according to optimized rules and regulation, a correspondent relationship eventually (and having learned from negative experiences) prevents risks that have been pushed into the limelight in connection with correspondent banking (money laundering, terror financing, circumventing sanctions, etc). Examples for adequate risk management are continuous due diligence and compliance efforts, the latter tied to "know your customer" (KYC) rules, (inter)national regulations and certain industry standards. In addition and from an operational point of view correspondents and respondents are well advised to install mechanisms that are capable of monitoring and screening any suspicious and dubious activities.

Through easily accessible fee structures provided by correspondents and respondents, clients of the financial intermediaries are supported in their decision-making processes. According to Function 5, "price information that helps coordinate decentralized decision-

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[372] Although a truism, it needs to be noted that any other financial system has its own risks.

[373] See Chapter 3 1.c.

[374] Merton and Bodie (1998), p. 9.

[375] Extensively described above, Chapter 3 1.d.

making in various sectors of the economy"[376] needs to be provided. For financial intermediaries, cost management of correspondent relationships is a difficult and complex task. This observation is mainly driven by a rapidly growing number of distinct challenges creating compliance and operational costs.[377] Even more important is the provision of reliable fee and cost information for the clients of the financial institution on both sides of the intended transactions.

Most (serious) financial institutions offer satisfactory information in this context. The Bundesbank, for instance, states on its website that "[a]ccounts are managed solely in euro and that no management fees are levied"; in addition, it sees "no obligation to maintain a certain minimum credit balance, accounts are managed exclusively on a credit balance basis [and] interest is paid on the account balance, depending on the counterparty".[378] Another example – out of many – is the detailed price list for correspondent banks by the Swedish Handelsbanken, comprising of general account conditions (account opening and maintenance fees, interest rates, reporting, investigations and audit costs), commercial payments with charging options, including transfer fees for the customers of Handelsbanken and of other banks as well as costs and fees related to financial institutions transfers, check charges, and CLS nostro agent services.[379] These examples clearly show that the fifth function of a financial system is taken care of within correspondent arrangements.

Finally, the sixth function: It "provides a way to deal with the asymmetric-information and incentive problems when one party to a financial transaction has information that the other

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[376] Merton and Bodie, ibid., p. 10.

[377] See in more depth, Sloboda (2017). For a wider perspective of compliance issues influencing international banking activities, see Ramakrishna (2015); Grasshoff et al. (2017).

[378] Deutsche Bundesbank sharing information about correspondent banking on its website: https://www.bundesbank.de/en/tasks/payment-systems/customer-access-mechanism/correspondent-banking/correspondent-banking-626406.

[379] Price list for correspondent banks on the website of Handelsbanken: https://www.handelsbanken.com/shb/inet/icentsv.nsf/vlookuppics/z3_com_financial_institutions_pricelist_correspondent_banks/$file/pricelist_correspondent_banks.pdf.

party does not, or when one party is an agent for another."[380] These problems often have their root causes in difficulties to control or monitor one another, for example due to geographical distances. Correspondent arrangements archetypically reflect this last function. By referring to our most basic (and later refined) definition that describes a correspondent as a financial institution frequently conducting or providing services for another financial institution (a correspondent banking client or respondent), which is typically, but not necessarily, located in another country or market area, we already have all indicators, specifically, preconditions for a structure bridging potential information and incentive deficits of one party in a transaction or service relationship. Although we have evidently distinguished correspondents from other forms of representations[381] like agents and branches, Merton and Bodie's approach obviously is focusing on *representatives* as such and should be altered from "agent" to "representative". There is no plausible reason for limiting the sixth function to "agents" only.

All six functions underline what the Merton's primary function already revealed in broader brushstrokes: correspondent relationships form a financial system as they "facilitate the allocation and deployment of economic resources, both across borders and across time, in an uncertain environment"[382]. Regardless whether correspondents are used within bill of exchange procedures, check clearing, or for the most simple form of remitting money from one individual to another, they stand for all these prerequisites.

Whereas Merton and Bodie's method sees the core functions of the financial system as "background for the substantive analysis of financial intermediation"[383], Iqbal and Llewellyn perceive financial intermediation as a function itself. Keeping the plethora of cacophonic voices regarding correspondent arrangements in mind, also their colourful

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[380] Merton (1995), p. 24, and – without mentioning the "asymmetric-information problems" - Merton and Bodie (1998), p. 10.

[381] See above, Chapter 3 2.a.

[382] Merton and Bodie (1998), p. 7; Merton (1995), p. 23, with slightly different terms.

[383] Merton (1993), p. 19.

regulatory landscapes around the world, we prefer a functional approach that has the potential to offer a more generalized view needed to bridge global differences in finance and banking. Iqbal and Llewellyn's ideas are not contradictory to Merton and Bodie's scheme, but the former are condensed to four "universal" functions of financial systems. Similar to the six functions we touched upon before, performing Iqbal and Llewellyn's four functions means encountering "practical problems […] also common to all financial systems."[384]

Their first function, namely to provide financial intermediation services and thereby to channel funds from "ultimate savers to ultimate borrowers"[385] as well as to remove budget constraints during this process is, according to our description of the procedures and advantages of correspondent relationships, fulfilled. Correspondent banking is a "poster child" of financial intermediation, facilitating the movement of resources between representatives of other protagonists in the spectrum of banking and finance. Therefore, a sub-element of the *intermediation function*, namely enabling "the movement of resources between agents, over time and across space"[386] needs to be widened with the term "correspondent". It could be discussed whether the description "from ultimate savers to ultimate borrowers" is the most fitting alternative for financial systems as there are other examples undoubtedly falling under the definition of a financial system, where we may have to deal with, for example, ultimate payers and payees. However, even in correspondent relationships the saver-borrower paradigm can be fulfilled (for instance in long-distance trade finance arrangements). If we see, like Iqbal and Llewellyn, the function of financial intermediation tied to the provision of "mechanisms for saving and borrowing so that agents in the economy can alleviate budget constraints" we can, again, subsume correspondent arrangements under this precondition: both correspondents and respondents alike are regularly representatives that are structured in a way that their services and security measures take care of the expectations of savers and borrowers, respectively of the "starting

[384] Iqbal and Llewellyn (2002), p. 2.

[385] Ibid., p. 3.

[386] Ibid.

and end point" of a transaction, regardless of whether it is an individual or an institution. The installation of nostro and vostro accounts can also be seen as a good example within the creation of "a variety of financial assets and liabilities with different characteristics"[387] reflecting the distinct expectations of savers and borrowers.

Our in-depth explanation of a service spectrum that goes beyond intermediation, e.g., including additional transaction, clearing, cash management, and trade-related services, gives a good impression that also the second, *financial services function*[388] fits to correspondent relationships. Thirdly, all accounting methods used in correspondent arrangements, regardless whether they are tied to the typicality of nostro/vostro accounts also reflect the third (*assets and liabilities*) function: creating a wide spectrum of assets and liabilities with distinct characteristics regarding, for example, liquidity or certain risk-sharing elements. For the latter, we have given ample evidence with our assessment of typical risk factors and related regulation.[389] Transaction methods using correspondents are also put in place to facilitate the "creation of incentives for an efficient allocation of resources within an economy and the efficient allocation of scarce financial and real resources between competing ends"[390]. We have shown in this chapter how this *allocation function* can be achieved, and we give historical evidence for this function in Chapters 5 and 6 by linking correspondents to trade and war remittance efforts through instruments like bills of exchange and letters of credit. Thus, correspondent arrangements are even complying with the fourth central characteristic of a financial system.

Llewellyn later widened his functional approach to more elements forming the basic functions of the financial system: "risk transference; pricing of risk; liquidity enhancement; credit generation and financial intermediation; insurance; asset and liability management;

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387 Ibid.

388 See, in more detail, ibid.

389 See above, Chapter 3 1.c. and d.

390 Iqban and Llewellyn, ibid., p. 3.

an efficient allocation of financial resources; and the funding of financial institutions"[391]. Even these elements are mirrored through correspondent relationships. We might only struggle with the function of credit generation in a narrow sense of the term, but come to the conclusion that the just-mentioned examples of bills of exchange, check arrangements and specific account structures that shift certain risks from the customers to their financial intermediaries comprise specific features of credit generation. And even Llewellyn (2009) reminds us that a "central feature of financial innovation is the unbundling of characteristics of different instruments and either keeping them separate or combining them in different ways."[392]

Through our analysis of two *functional approaches to finance,* we come to the conclusion that correspondent arrangements need to be added to those financial systems fulfilling the criteria of both aforementioned academic schemes. Any new technological advancement aimed to substitute traditional correspondent banking should be prepared to match the functions performed by a financial system as well.

[391] Llewellyn (2009).

[392] Llewellyn (2009), referring to his own work of 1992.

Chapter 4 A New History of Correspondent Banking – from Babylon to Florence

Methodology

This section discusses the methodology adopted in the remainder of this thesis. Maclean, Harvey and Clegg (2017) point out that “methodological transparency is increasingly necessary for both interdisciplinary dialogue and scholarly legitimacy.” In economics, and consequently also in the field of banking, scholars have not rarely favoured the deductive research approach, which on occasion has reduced research to the presentation of theoretical models developed by mathematicians that have more in common with pure mathematics than even applied mathematics.

In contrast, the research methodology adopted in this work is the inductive methodology, also known as the empirical method. Here, observed facts come first, and it is on these facts that any analysis and the formulation of any theories, conclusions or policy prescriptions are based. Since observed facts are not in the future – or in theoretical dream worlds – but instead have already taken place in reality, virtually by definition, at least in the social sciences, this means that we have to turn to history.

By adopting the inductive, historical methodology, the research investigation can be developed and guided by empirical and historical facts and findings rather than placing emphasis on a set of (usually unrealistic) axioms and assumptions, which collectively need to hold in order to explain how an imaginary world operates (see Kornai, 1971; Werner, 2005).

The empirical and inductive approach is largely in line with the research principles developed in the modern era by continental European thinkers in the late 19th and early 20th centuries. Many followers of this approach wrote in German and worked in German-speaking countries. Their interest in economic and business history as a way to study economics and business meant that they collectively even became known as the “German

Historical School". Prominent members include Gustav von Schmoller, but also the Austrian and American national Joseph Schumpeter.

So we use business history as our major approach while working with analytical tools and abstract reasoning, including analytical schemata such as in Chapter 6, only based on the prior careful assembly and arrangement of the historical facts, in order to better describe and enhance our understanding of the relationships observed.

Since correspondent banking has been somewhat neglected in banking as well as business history, much work had to be undertaken to extract often partial, but relevant information and references from other sources that were in the main interested in other topics, but happened to relate to aspects of correspondent banking. As a result, the literature review (Chapter 2) on a topic that has not attracted much direct research focus expanded rapidly. Moreover, it turned out that a 'history of correspondent banking' had not yet been written, and this also became an important focus (the present Chapter).

In the context of the history-leveraged research approach adopted in this work, original archival research is valued most highly. Smith (1984) states that

> "written texts play an especially significant role in organizations because they codify in a potent fashion, that which has been said and thought. Once it is written down, organizational talk takes on new dimensions of veracity, credibility, and efficacy—an authoritatively instrumental life of its own—often travelling well beyond the intent or expectations of the author."

Ventresca and Mohr (2002) argue that the "examination of archival materials is […] important because they are ubiquitous, consequential and strategically useful."

Carr (1961), Coleman (1987) and Decker (2013) emphasize that historians are methodologically usually pragmatists utilizing empirical evidence to construct narratives. This statement holds true, as Hannah (1984) argues:

> "In the case of historians, their isolation from the mainstream of social scientific study is, at least partly, self-imposed. Business historians have not been proof

> against this. Like their historical colleagues in other specialisms, they remain inveterate empiricists, obsessed with setting the record straight, telling the story as it really was, but eschewing general theories. The result has been a range of impressive case studies - Barker on Pilkingtons, Coleman on Courtaulds, Reader on ICI, Barry Supple on Royal Exchange Assurance, Charles Wilson on Unilever and many others. But such work rarely goes beyond the narrative method applied to the single case."

Thus there is a need to use the empirical and narrative approach in order to extract analytical insights, including from archival work. Stephanie Decker (2013) laments that "methodological treatments of archival work are especially rare which is a major issue when business historians attempt to influence other scholarly research."

A recent seminal work that favours the integration of management or organisation studies with history by making use of archival work is the historical organisation studies framework proposed by Maclean, Harvey and Clegg (2016). These researchers emphasise the five core principles of "dual integrity, pluralistic understanding, representational truth, context sensitivity, and theoretical fluency – that make for a better, more seamless interplay between history and organization theory, doing so from a business historical perspective."

In their subsequent work, Maclean, Harvey, and Clegg (2017) argue that "methodological transparency is increasingly necessary for both interdisciplinary dialogue and scholarly legitimacy". They favour business history that integrates historical organizational research adhering to those five principles as this would succeed in linking the field of business history with a wider spectrum of researchers.

This dissertation does not claim to be able to reach such high standards, but the researcher was at least a sympathiser when embarking on the long journey of examining the business history and its modern implications of the field of correspondent banking.

On the other hand, when uniting historical and archival research with a research interest in a particular discipline (such as banking in our case), it is important to keep in mind the historical narrative in the understanding of events, as Ann Rigney (1990) and others argue (see also Mordhorst and Schwarzkopf, 2017). This was attempted by the combination of both a broad history of correspondent banking, in the present chapter, and a much narrower spotlight on an important case study during a relevant time period.

Business history aims to understand specific businesses within their specific eras. Increasingly, it also aims to extract the general insights and general principles that apply to other eras or even related fields. Moreover, it aims to help us understand the topic of our research and its implications in our present day: Any historian worth their salt will be seeing parallels or contrasting developments, as the case may be in our days, where understanding and the recognition of their implications are significantly enhanced by historical work.

Thus, appropriate case studies – samples – must be identified in order to allow for the empirical reality to be scrutinized in the greatest detail and making use of primary sources – located in archives in our case – with the aim to develop an understanding of the business of correspondent banking in the real world. So an important aspect of conducting (business) history research is sampling. Carroll and Hannan (2000) argue that four areas of concern must be addressed in sampling. These are, as Ventresca and Mohr (2002) comment, *organisational coverage* (the inclusiveness of the sample of the organisation within the population), *temporal coverage* (how much does the observation period cover the critical period of research), *precision in timing* (specificity and completeness of data and their timing), and *accuracy of information* (quality and completeness of detailed data such as ownership, strategy, etc.).

In this Chapter, the first step at a business history of correspondent banking is taken. Since this banking discipline spans the entire 5000-year history of banking, this is in itself, not a small task.

From this wide focus we shall then proceed to narrow the focus of our lens: Considering correspondent banking from an analytical business history perspective, it is important to select relevant samples or case studies that are from time periods that offer insights that could also be generalized.

While many banking firms exist today, it is only a few banks that have managed to last over many centuries. Therefore, it is logical to engage in studying a longitudinally highly successful case, that of the Bank of England. Established in 1694 by a group of City of London Corporation-based institutional entrepreneurs with the aim to support British troops and the Dutch Stadtholder Willem von Oranje, who had been newly-installed as King of England (styled as William III after 1689), in the war effort against France, the Bank engaged immediately in correspondent banking as the debt financial instruments (i.e., paper banknotes denominated in pound sterling) it advanced to the Treasury were soon found to be of little direct use to pay the mercenaries now operating under the English flag in the Low Countries.

As this research relies on corporate archives, there is a possibility that the associated documentation with this particular period may have been removed as many firms are "often deeply disinterested in their own history", as Decker (2013) remarks. Fortuitously, this has not been the case for the Bank of England.

In Chapters 5 and 6, our methodology is to make intensive qualitative use of a small set of documents in line with Ventresca and Mohr's (2002) observations on archival research. For our purposes, a narrowly targeted set of archival documents is sufficient to potentially gain new insights, since they are of sufficient importance and apparent generality.

Despite the vast volume of primary archival materials in the Bank's archives, these have not been used to enlighten the development, functional details, role, challenges, and implications of correspondent banking. For our studies they present an excellent case study on correspondent banking techniques employed by the Bank of England in its efforts to "remit" money abroad.

The Bank's archives are also among the richest in the world, containing more than 80,000 items, supplemented by a number of other major archives. We can be confident that at least *organisational coverage*, as defined by Carroll and Hannan (2000), is satisfactory.

1. Parameters for the identification of correspondent arrangements throughout history

As recognized before, the research on correspondent banking[1] is characterised by terminological chaos. In order to distinguish nascent and developed forms of correspondent relationships from other phenotypes of financial intermediation and multi- as well as international banking, we have to identify the defining criteria, functions and parameters of correspondent arrangements.

In Chapter 3, we have not only differentiated correspondent relationships from other forms of banking on the national and international stage[2], but also proposed a new system of seven factors that are relevant for any correspondent relationship and that are valid for correspondents and respondents alike.[3] Regardless of whether we look at correspondent arrangements in the 15th or 21st century, (1) the access and influence factor, (2) the savings factor, (3) the local and global networks factor, (4) the efficiency factor, (5) the interconnectivity factor, (6) the business accelerator factor and (7) the predictable revenue factor are equally pertinent.

Secondly, the historical survey will be tied to our newly formed categorization of three levels of correspondent relationships,[4] which is based on an understanding that such arrangements don't necessarily need banks on both sides (if they are of lower "order") and

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[1] In Chapter 3, we conclude that the term "correspondent banking" is too narrow and potentially misleading. We consider the expression *correspondent relationship* or *arrangement* as being more concise.

[2] Chapter 3 2.

[3] See Chapter 3 1a.

[4] See Chapter 3 5.d.

that a vostro/nostro account connection may be a strong, yet not exclusive indicator.[5]

And, of course, more or less undisputed essentials of correspondent relationships, their typical spectrum of services – today and over the centuries – play a significant role in the discovery and identification of early and differently developed forms of this traditional model for financial services.

Chan (2014) offers valuable, but partly redundant and strangely formulated "[e]ighteen determinant factors to establish [correspondent banking] relationships and nineteen selection criteria of correspondents".[6] His findings mirror many of today's realities (e.g.,

[5] See Chapter 3 5.

[6] Chan (2014), pp. 18-9, refers to Lawrence and Lougee (1970), Dewald and Dreese (1970), Meinster and Mohindru (1975), Dunning (1979), and Palmer (1990), when he describes the eighteen determinant factors of international correspondent banking relationships with potential synergistic effects: (1) customer driven; (2) competitiveness; (3) cost savings; (4) foreign market entry; (5) preventing fraud and money laundering; (6) access to overseas local markets; (7) increasing bank assets; (8) improving efficiency; (9) completing international network; (10) internationalization strategy; (11) liquidity access; (12) not physically present; (13) minimizing capital investment; (14) necessity and needs (like clearing letters of credit overseas); (15) providing one stop banking; (16) profitability; (17) reciprocity and (18) bank size. Some of these points are misleading. It may be correct, for example, that the factor (6) of preventing fraud and money laundering leads to "cooperation among correspondents and respondents are definitely effective measures to reduce criminal activities" (Chan, 2014, p. 18). Yet, in reality, correspondent banking has been and still is a major risk factor for money laundering and fraud, see Chapter 3 1. The nineteen criteria for choosing a correspondent bank are based on (conference) contributions by Krishanan (1990) and Choo (1989). They are the following: (1) broad domestic and global branch network; (2) effective account or relationship officers; (3) financial strength in terms of financial resources, quality and stability; (4) formal banking presence; (5) effective and efficient products and services delivery; (6) historical relationships; (7) innovative product design; (8) linkage to SWIFT and Netting; (9) location; (10) market reputation; (11) operational capabilities; (12) consistent business; (13) pricing;

the connection to SWIFT) and are based on a rather narrow view of correspondent *banking*, limiting the relationship to *banks only* on both sides of the arrangement.

Still, those of Chan's collected (and partially repetitive) criteria that could be called "timeless" are (1) overcoming the respondent's lack of a physical presence in a certain region[7], (2) customer orientation (mostly offering correspondent banking services for cross-border - but also domestic - customer demands), (3) competitiveness (meaning expansion to other markets and thereby competing with local banks at home, other "global" players, but also with local banks in the foreign market); this goes hand in hand with (4) foreign market entry and access to overseas local markets, (5) cost reduction[8] (instead of running a branch or subsidiary or, in the case of the correspondent, getting the opportunity to widen the global network), profitability and improved efficiency as well as the aim of (6) increasing bank assets (with reputational gains at home and overseas). In terms of reliability equally as important are the (7) financial strength of a correspondent, its (8) market reputation, (9) range of services and (10) efficiency in respect of service delivery. The aspect of (11) location is almost too trivial to mention.

Whereas a "formal banking presence" of a correspondent is of less significance[9] (or even misleading when it comes to identifying early forms of correspondent arrangements) as are the factors of "innovative product design", other modern elements like "linkage to SWIFT"

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(14) a range of services; (15) reciprocity; (16) risk rating; (17) service compatibility; (18) reliability of supply; (19) technology level.

[7] Conversely, this factor (bridging the lack of a physical presence) is also relevant for the correspondent as the connection with a powerful respondent also bears the chance of gaining reputation in the respondent's market.

[8] This criterion implies in our opinion Chan's (2014, p. 19) extra point of "minimizing capital investments".

[9] See Chapter 3 5.

and other clearing, netting and settlement systems are naturally not as important for a historical survey. Other components like "pricing", "reciprocity", "service compatibility" or "historical relationships" are either already covered by already mentioned criteria or less weighty sub-criteria.

Features like "internationalization strategy" are also applicable for any other form of international expansion (e.g. via agencies or representative offices) – and it is a criterion that is too restrictive as many correspondent relationships had been and are being established on the national level.

Due to different cultural backgrounds or stages of development of the financial sector in a certain environment, it is obvious that we are not offering a monolithic set of criteria, but a toolbox, where a greater number of fulfilled criteria raise the probability of encountering a correspondent relationship. Therefore it is more about a collection of indicators than core principles.

In any case, one overarching aspect needs to be understood: A correspondent relationship has to adhere to the basic scheme of a "multipartite-payment mechanism", in its most simple form it is a four-party structure.[10] Suppose a debtor seeks a transaction of monetary value to a creditor over a long-distance. Normally, in a three-party payment mechanism, the debtor would use a bank or money transmitter to avoid the physical transport of specie and to eventually discharge the debt. Risks and administrative work are being shifted to the third party. Yet, where creditor and debtor are located in geographically different places, this third party (usually placed in the debtor's territory) also has an interest in mitigating its own risks along with long-distance transactions or other services. This is where a correspondent typically comes into play. The actual payment or requested service is then conducted by the correspondent. In such a four-party system, we face several debts that need to be discharged: the debtor's debt to a creditor, which is broken down into the debtor's debt to a

[10] The following findings are based on Geva's (2011, pp. 37-67) description of different payment orders.

respondent (debtor's "paymaster"), the respondent's debt to a correspondent ("paymaster's paymaster") and the correspondent's debt to a creditor. As respondents and correspondents usually have long-standing relationships, they typically arrange periodic net settlements (as opposed to paying in specie).

To make things a little more complicated, a correspondent relationship consisting of four parties can also entail two separate three-party mechanisms. Let us presume that the respondent and the correspondent are both money transmitters. In that case, one three-party mechanism would be initiated by the debtor's order to the respondent to pay the creditor. The second mechanism would be originated by the respondent's order to the correspondent to pay the creditor. Payment processes in different territories can also easily involve more parties than only four. A normal three-party payment system (debtor, creditor, and paymaster, or – in other words – payer, payee, and intermediary), however, doesn't create a correspondent relationship.

All too often, correspondent relationships are being and have been established to bridge (not only geographical) distances between the provider and the recipient of financial services. The necessity to do so has evolved over millennia.

Correspondent banking seems to be the stepchild of banking history. We have already touched upon the scarcity of research related to one of the oldest models to facilitate payment transactions and to foster trade relations across the globe. Based on some key findings of Chapter 3 (especially a universally valid definition of correspondent relationships and its distinction from other types of financial intermediation), we will try to widen the historical scope in international banking - a view that traditionally doesn't reach much further back than to Renaissance Italy. However, as many see the cradle of banking, lending, and deposit-taking systems already in ancient Mesopotamia, we will start our journey to the roots of correspondent arrangements in Babylon. Egyptian, Greek, and Roman stimuli will be recognized, as well as advances made in the (early Islamic) Near East and in the context of the Crusades. Late Medieval Italy certainly doesn't reflect the final destination of creative development of a highly efficient transaction method, but it can be seen as a turning point to a modern understanding of international banking and cross-border payment systems, as the model established by Italian families throughout Europe prevail with only slight changes more or less until today. In summary, significant elements of correspondent banking have been tried and formed already centuries before the Medici family even started contemplating about ideas of how to optimize its international trade and finance network. Our perspective is mainly shaped by developments originating from a region we would today call the Near East, respectively the Middle East, which evolved into Europe and its spheres of influence.[11] In our conclusions, we will also try to find an answer to the question of whether the functional perspective on correspondent banking - which we saw fulfilled in Chapter 3 regarding our present times - even applies to the past.

1. From the origins of banking to the crusaders and Templars

a. Mesopotamia – cradle of banking?

Organized trade and exchange are probably as old as the first agricultural societies that emerged around 10,000 BC in the Middle East.[12] Already at the end of the fourth millennium BC, ancient Mesopotamia had markets and fluctuating prices in place, and

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[11] For payment instruments and methods relating to long distance trade relations in other regions like precolonial India, see Habib (1993); Raychaudhuri and Habib (eds.) (1982) published an eminent work on the economic history of India between 1200 and 1750. Aspects of colonial India are covered for example by Bagchi (1982 and 1985); Pinto (1994). See, generally, on the development of money and payment systems in the East (including China) Eagleton and Williams (2007), pp. 108-61. The invention of paper money is attributed to China, see Davies (2002), pp. 55-8, 178-84, who also gives a plausible explanation of the Chinese lack of influence on monetary history of the West; Geva (2011), pp. 471-2. Hints on (not only pre-colonial) correspondent banking networks or equivalent structures in the far East are hard to find; Yago (2015) offers insights in correspondent banking and branch networks between China and Russia around 1900. See also Ku (1926), for Chinese methods to facilitate domestic transactions, and from the same year reflecting an American perspective on China, Lee (1926).

[12] Curtin (1984), p. 60.

some scholars even point at the possible existence of redistributive and reciprocal arrangements.[13] The origins and roots of banking operations and their regulation, as repeatedly described, were not only tied to royal palaces and temples, but also to private houses. It is not audacious to see Mesopotamia as the birthplace of a codified payment system.[14] Receipts were used for transfers of grain, precious metal and other commodities and with the Laws of Hammurabi (1792-1750 BC), a rather sophisticated regulatory scheme was put in place.[15] A variety of commodities were not only means of payment but also units of account.[16] As the first bank deposits were initially those of grain and other (mostly agricultural) goods, the invention of banking even preceded the origination of money. Evidence for long-distance trade combined with long-term finance originating from ancient Babylon as early as 3000 BC can be tied to artefacts recovered by archaeologists between central Asia and Egypt. However, most contracts in the form of tablets that would underline financial transactions are not available any

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[13] Ibid., p. 64, and Lamberg-Karlovsky (1975).

[14] Bogaert (1966), p. 129 calls Ancient Mesopotamia the “cradle of banking operations” (translated).

[15] In this earliest “banking operations code”, the laws 17, 24, 88, 90, 100, 101-103 (translated by King, (1898)) were the most relevant, see Nagarajan (2011), p. 113. On King Hammurabi in general, Van de Mieroop (2004b) and Charpin (2012); see also Homer (1977), p. 5; Powell’s (1990) work on price developments and money in Mesopotamia is as important as the broad study on the societal and economic situation of early Mesopotamia by Postgate (1994). For developments in the first millennium BC, see Jursa (2010). Orsingher (1967, p. viii) mentions that the Code of Hammurabi “[…] contains about 150 paragraphs which deal with nearly all cases arising from loans, interest, pledges, guarantees, the presence or absence of evidence […] etc.” Van de Mieroop (1992) thoroughly examines trade and business structures in the old Babylonian city Uruk based on his discoveries of financial records in the forms of clay tablets.

[16] Geva (2011), p. 20.

longer as once a transaction was completed, the debtor would destroy the tablet after getting it back from the creditor.[17]

Mesopotamia had established a rather highly developed lending and deposit-taking system. In the latter case, a depositor could give a depositary orders not only to withdraw his commodities but also to provide a third party with deposited goods; this is, of course, what we would call today a payment order.[18] However, translated into the world of banking we would assess this as a normal three-party banking procedure (linked to separated accounts) as opposed to a correspondent relationship. The (already existing) accounting steps would have been debiting the depositor's account in case of a direct or ordered withdrawal and crediting it in case of a deposit.[19]

Certainly, such cash-less transactions are no prerequisite for establishing correspondent functions - and it hadn't led to bookkeeping practices between two service providers in a transaction that would indicate a correspondent relationship (like a nostro/vostro account)[20]. The view of Oates (1979), who proclaims that "[w]riting was invented in Mesopotamia as a method of book-keeping"[21] doesn't contradict our assessment as the accounting techniques were still very rudimentary.

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[17] Neal (2015), p. 37.

[18] Geva (2011), p. 120.

[19] Ibid. Even when payee and payer held accounts at the same depositary, there is no evidence that the transaction would have been settled in a cash-less manner by simply debiting the payer's account and crediting the payee's account, see ibid., p. 121.

[20] See Chapter 3 3. and 4. On "merchant accounts" in early Mesopotamia, see in detail Snell (1982).

[21] Oates (1979), p. 15.

Well-preserved clay tablets from the early second millennium BC, show Mesopotamia's "financial system" in an impressive way. Cribb (2004, p. 92) and Neal (2015, p. 39) remind us of a tablet on which the payment of fourteen loans of silver by the Temple of the Sun God in Sippar to several individuals was recorded, including terms of interest (around 1750 BC). This serves as another indication of early banking structures in Mesopotamia. Still, it would take until approximately the sixth century BC for lending and credit structures in Mesopotamia to significantly outgrow the local level when mighty Babylonian families had started conducting businesses with cities and regions that were more than 100 miles away (like Uruk and Persia).[22] Long-distance trade, however, existed earlier, and already at the beginning of the second millennium BC merchant organizations were created that – according to Neal (2015) – "persisted for several generations, based on cities located along major intersections of trade routes."[23] The Assyrian city of Assur established a network of permanent representatives who resided at important cities along the routes of the caravans.[24] In modern terms of financial intermediation, this structure resembles elements of branches, representative offices or even agents. Neal (2015, p. 41) has a point when he argues that "[…] the institutions of the merchants of ancient Assur uncannily presage those of the merchant-bankers of Genoa nearly 3,000 years later". We will see below whether his bold statement "that all organized merchant efforts along the trans-Eurasian and trans-Mediterranean trade routes in the intervening centuries adopted similar techniques to those first documented by the Assurians"[25] bears some truth.

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[22] Ferguson (2008), pp. 30-1.

[23] Neal (2015), pp. 39-40.

[24] Ibid, p. 40.

[25] Ibid, p. 41.

Still, we could argue that, even in the case of distant transaction parties with documented contracts and early versions of promissory notes, a payment system that would come close to a correspondent relationship had not been developed. Geva (2011, pp. 76-7) may offer a valuable reason, when he claims that the insufficient development of transaction banking throughout the ancient era could be linked to a lack of a properly established reputation between distant parties of a payment and that "limited deposit-taking in Antiquity generated only rudimentary payment facilities so that no extensive payment mechanisms in primitive money developed […] even on a local scale." Yet, already existing forms of "primitive money" like cattle or other useful items (e.g., weapons) were step by step replaced by weighed precious metals.[26] We are sceptical of whether Geva's observation of a slow emergence of transaction banking methods and "limited deposit-taking" is entirely correct. On the one hand, silver was used as a standard of payment for the Assyrian trade already in the second millennium BC, as an example from 1820 BC, recovered by Van de Mieroop (2005), shows:

> "One and one-sixth shekels silver […] to which the standard interest is to be added, Ilshu-bani, the son of Nabi-ilishu, received from […] Shamash and from Sin-tajjar. At harvest time he will repay the silver and the interest. Before five witnesses […]. In month seven of the year that ApOil-Sin built the temple of Innanna of Elip."[27]

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[26] For Jevons (1875), p. 31, a "monetary object" ideally involves five "physical properties" (portability, indestructability, homogeneity, divisibility, cognizicability) and two "non-physical properties" (utility and value, as well as stability of value). Hudson (2018) links the development of money in Mesopotamia to the debate between the "state theory" and the "commodity or barter theory" of monetary origins, and criticizes the lack of reference of the latter theory to credit arrangements and to "palaces and temples in the Near Eastern inception of monetization".

[27] Quoted after Van de Mieroop (2005), p. 21. See also Hudson (2018).

In addition, Davies (2002) points to a higher degree of deposit-taking efforts and mentions that “[r]eceipts testifying to these deposits gradually led to transfers to the order not only of the depositors but also to a third party.”[28] And Burns (1927, pp. 284-5) already identifies payment vehicles “like bills of exchange” in ninth century BC Mesopotamia that were introduced to minimize the risks of transporting precious material over long distances. Regardless of whether we fully follow this insinuation, we witness - due to the already mentioned trade networks of the Assyrians - early forms of transaction banking with a remarkable amount of sophistication.

Excursion: Bills of Exchange and Letters of Credit – necessarily with correspondents?

One could be tempted to see the simplest forms of a “bill of exchange” or a “letter of credit” as prototypes of correspondent banking. The merely nascent state of “money” stirred the development of quite a mature system of payments that compensated for the lack of actual coin in any commercial transactions. As we will have to deal again with the instruments of bills of exchange and letters of credit in the course of this paper, we shall consider how they are connected with correspondent relationships. As bills of exchange can be part of a letter of credit arrangement, we will look at this payment method first.

aa. Bills of Exchange

Having ancient origins in the area of today’s Middle East, a wide-spread practice of payments over long-distances re-started in Europe most likely not before the late

[28] Davies (2002), p. 50.

twelfth century.[29] Earlier, comparable forms existed, though. Especially during the Greco-Roman period, new financial institutions and methods enabled the expansion of far-reaching business activities. We will cover these periods below.

The definition of a bill of exchange is, in contrast to correspondent banking[30], largely unchallenged. According to the U.K.'s Bills of Exchange Act 1882, it is described as "an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to or to the order of a specified person, or to bearer."[31] As a substitute to the practice of remitting cash, the buyer/importer of goods can acquire a bill of exchange from a bank, a bank draft, and remit it to the seller or exporter. Bills of exchange are traditionally used to finance trade and, when discounted with a financial institution, to obtain credit.[32] Today, it is absolutely common that the buyer asks his bank to instruct a correspondent bank to issue the draft to the seller. This draft needs to be sent to the seller, who in turn would present it to the correspondent bank in order to receive payment.

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[29] See Kohn (1999b), p. 1, who also states (referring to Ashtor (1983)) that the earliest still existing records stem from 1220 AD. For aspects of a modern European history of the instrument bill of exchange, see Denzel (2006 and 2014).

[30] On the terminological muddle regarding correspondent relationships, see Chapter 3.

[31] Bills of Exchange Act 1882 CHAPTER 61 45 and 46 Vict, Part II 3 (1). The BIS (2003a), p. 10, defines a bill of exchange in its Glossary as "a written order from one party (the drawer) to another (the drawee) to pay a specified sum on demand or on a specified date to the drawer or to a third party specified by the drawer." The English Bills of Exchange Act served as a role model for many other legislations that were under direct or indirect influence of the British crown.

[32] See BIS, ibid.

Some historians see this constellation already in ancient Greece and Rome[33] and - after a period of darkness and decline in financial matters - again in medieval Europe. Rubin (2010), amongst others, describes a bill of exchange in this second period as follows:

> "A lender (known as a deliverer, normally a banker) bought a bill for ready cash from a borrower (known as a taker), who drew on one of his correspondents (payer) abroad. At maturity, the payer paid an amount in a foreign currency to the lender's correspondent (payee)".[34]

This "modern" model of bills of exchange grew out of early forms of remittance - *promissory notes,* respectively, *bills obligatory*[35] - established to facilitate trade

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[33] See, for instance, Baskin and Miranti (1997), p. 29; Moshenskyi (2008), pp. 22-5. Even Max Weber (1909), p. 10, identifies early forms of a "Wechsel". A different opinion is expressed, e.g., by Hunt and Murray (1999, p. 65), who see bills of exchange as ''the most important financial innovation of the High Middle Ages". Kindleberger (1984, p. 39) would also not waste a thought on developments before the late middle ages: "The bill of exchange was a powerful innovation of the Italians in the thirteenth century […]." Geva (2003, p. 252) opposes this standpoint: "During [the era of pre-Ottoman Arab domination] centres of economic and financial activity were located in the Near East […]. It was observed that the business practices and instruments that had developed throughout those lands during that period heralded the bill of exchange, both as mechanism for the transmission of funds and as negotiable instrument." The question of where to historically locate the origins of the bill of exchange remains highly contested. The deepest insights into this academic dispute offers Moshenskyi (2008); for a concise summary, see ibid., pp. 13-21.

[34] Rubin (2010), p. 215.

[35] Bills of exchange and bills obligatory also existed in parallel, whereas a bill obligatory usually differed from a bill of exchange only in the fact that the debtor had to pay the creditor the sum in local currency, see Puttevils (2016), Chapter 4.

between merchants of northern Italian cities and the Fairs of Champagne.[36] The bill obligatory can also be found already in 12th century England.[37] Here, the St. Giles Fair in Winchester was a major location of annual settlement of debts. Kohn (1999b, p. 1) describes these early models as a

> "[…] promise to pay, typically a promissory note, drawn up formally by a notary. One merchant acknowledged the receipt from another of payment in local currency and promised to repay him at a specified future time and distant place in the currency of that place. The parties to the transaction, or their agents, were both required to appear at the place of payment to complete the transaction."

The interesting term in this explanation is "agents". Is it therefore possible – also in the light of an almost traditional confusion and often synonymous use of the terms "agents" and "correspondents"[38] – that these "agents" in 13th century Europe were actually acting as correspondents in pre-bill of exchange models? In fact, both types of representation became customary elements in the transnational finance spectrum in post-12th century Europe.

Still, correspondents that fit our definition became integral parts of long-distance payments via bills of exchange *and* promissory notes. According to a good number of historians not only agents, branches, or partners took part in such transactions, but also

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[36] They were called "instrumentum ex causa cambii", see Kohn (1999b), p. 1, referring to Blomquist (1990). Puttevills (2015) gives valuable insights on the bill obligatory in sixteenth century Antwerp.

[37] See, in greater detail, below, Chapter 5 2., and Postan (1930). See also the eminent work of Munro (1991, 2000, 2003),

[38] See above, Chapter 3 2. and Chapter 3 5.

"correspondents". Kohn (1999b) acknowledges that within the structure of a bill of payment the "payee" could be an agent or correspondent and, later, in the more developed form of a bill of exchange the trading company or merchant bank would use branches or correspondents.[39] Geva (2011) supports this view: "To that end, [the merchant] secured permanent representation in the foreign market by means of factors/agents, partners, or correspondents."[40] Moshenskyi tries a clarification when he points in his "History of the Weksel" (2008, p. 81) at the vast network of "representatives and agents in different countries" of Florentine banking companies in the 14th and 15th centuries that eventually "stimulated the development of correspondent relations and transfer operations."[41]

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[39] Kohn (1999b), pp. 2 and 4.

[40] Geva (2011), p. 376.

[41] Yet, none of the authors mentioned in this context makes a clear distinction between correspondent and the other types of representation. According to our findings in Chapter 3, an agent is a dependent entity; agencies and correspondents have to be strictly differentiated in the financial terminology. We have to clearly separate both models of representation - even if all seven *factors of correspondent banking* could be adapted to an agent as the relationships between medieval merchants and their "agents" were obviously constructed to gain access, influence and predictable revenues, furthermore to produce savings, and accelerate the business, to widen the global and local networks factor, as well as to be more efficient and interconnected. Yet the agents' scope of services was commonly limited to payments, and they were lacking the characteristic independence of a correspondent. The main obstacle to a correspondent relationship, which is typically a four-party arrangement, is that the party using agents regularly was not at the same time an intermediary (like a bank) offering services (for instance as a "paymaster") for another party (a payee). As one of the few in literature, Ryerson (1985, p. 112) would point at the difference of both the agency and correspondent model in the context of the medieval fairs in Champagne. Edwards and Ogilvie (2012 p. 139) only (and

De Roover (1942) also uses the term "correspondent" in connection with the persons or parties involved in the process of bills of exchange that were intensely used by Italian merchant bankers in medieval Bruges:

> "A typical medieval bill of exchange involved four persons and two payments: usually a *datore*, "deliverer", or remittor (1) bought a bill for ready cash from a *prenditore*, "taker" or drawer (2) who drew on one of his correspondents abroad; at maturity this correspondent, called payor (3), was expected to pay a given amount in foreign currency to the payee(4) in whose favor the bill had been made out."[42]

The instrument of bills of exchange could, but didn't necessarily have to, involve more than one banker. Consequently, a drawer could be a banker or a natural person; the correspondent could be another merchant banker or a person involved in banking businesses, as well as a natural person conducting payments. De Roover (1942) writes that bankers were usually remittors (or "*datori*"), but they occasionally became drawers (or "*prenditori*") in case they were in need of money in Bruges or other places, or if negative balances were accruing abroad.[43] Bills of exchange were largely used in

insufficiently) refer to "agents" as potential parties in a bills of exchange–relationship used by Italian firms at the fairs.

[42] De Roover (1942), p. 55. See also Leone (1983), p. 620: "A rich network of international commercial correspondents [...] extended to cover the entire economic and geographical area dominated by the Italian merchant bankers, and it was this that gave them the unrivalled possibilities for remitting to or drawing from any one place to any other."

[43] De Roover (1942), p. 56.

international settlements[44] and were a form of granting respectively extending credit and of financing trade. However, considering these bills as pioneering, more sophisticated arrangements of correspondent *banking* would be a too general approach – only if two or more bankers were involved, both constellations could appear synonymously. In this case, we meet bank to bank, or, better, inter-bank business.

Lothian (2002) uses broader brushstrokes and doesn't tie his observations to a specific region or place when he assumes that "in any event, whether used as a means of payment or to obtain credit, the wide-spread use of bills of exchange meant that this early banking was by its very nature international in scope."[45] For Lothian, this is underlined by "the way banking came to be organized in late Medieval times, with international branch networks and correspondent relationships becoming the rule."[46]

The invention of bills of exchange as a method to settle payment obligations at medieval fairs presages later developments of interbank clearing and settlement systems in a multipartite transaction situation. Over the course of history, correspondents that echo our definition became essential parts of long-distance payments via bills of exchange or promissory notes. But, again, we have to be precise here: the practice of using bills of exchange could very well include the use of a correspondent. However, a correspondent is not necessarily part of a bill of exchange operation.

In other words, none of the "typical" parties in a bill of exchange (or promissory note) relationship is, per se, a correspondent, but correspondents could be used to fulfil

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[44] Ibid, p. 56.

[45] Lothian (2002), p. 702.

[46] Ibid.

certain aspects of this relationship.

bb. Letters of Credit

Another instrument originating from ancient times and invented to facilitate long-distance payments in connection with the sale of goods between distant parties are “letters of credit”. Mugasha (2003) even calls them “the single most important instrument used in international trade to guarantee the payment of money or the performance of other obligations.”[47] Others see them “as the lifeblood of international commerce”[48].

Habitually, a buyer/importer would be hesitant to give away his money until he knew the goods were safely on their way. On the flip side, a seller/exporter would not want to send any goods until he was assured that the money was ready at hand. In general, letters of credit offer the opportunity for the exporter to substitute the credit risk of the buyer with that of his bank.[49] To overcome a potential stalemate, a letter of credit can be issued.[50]

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[47] Mugasha (2003), p. 2. According to a study of the International Monetary Fund-Bankers Association on Finance and Trade/International Financial Services Authority (2011) (quoted in Vaubourg (2016)), letters of credit are the primary tool of intermediated trade finance, which represents approximatively 47% of trade finance, compared to 26% for open account transactions and 27% for cash-in-advance transactions.

[48] D'Arcy, Murray and Cleave (2000), p. 166.

[49] Bergami (2011), p. ii.

[50] There is extensive literature on letters of credit; however, as Bergami (2011, p.83) correctly observes, it mainly stems from a legal angle (see already Finkelstein (1930); but also Carr (1999); Creed (2001); Dolan (2007)) and from the perspective of the banks –as opposed to the seller’s perspective. An early survey is written by Hershley (1918). See also Aicher et al. (2004). More general work has been contributed by Mann (2000). Recent publications on international trade

Simply described, such letters allow the "buyer and seller to contract a trusted intermediary (a bank) that will guarantee full payment to the seller provided that he has shipped the goods and complied with the terms of the agreed-upon letter."[51] The most prominent forms of letters of credit are the commercial letter of credit and the standby letter of credit, as opposed to the instrument of so-called "documentary collections", where the seller keeps control of the documents which reflect control of the goods until payment or assured payment, (irrevocable) letters of credit reduce the risk of shortcomings on the buyer's side.

Nowadays, their practice and standards are governed by the Uniform Customs and Practice for Documentary Credits (UCP). They define a letter of credit as "any arrangement whereby a bank acting at the request and on the instruction of a customer or on its own behalf is to make a payment to or to the order of a third party or to accept and pay a bill of exchange drawn by the beneficiary or authorise another bank to negotiate or make such a payment provided that the stipulated documents are produced to show conditions of credit are complied with."[52]

This description clearly points at the possibility of involving a correspondent bank ("or authorise another bank") to enable far distance (mostly international) transactions.[53] In its minimal form, though, the arrangement of a letter of credit consists of three parties: beneficiary/seller, customer/buyer, and the issuing bank. Legally, the relationship is based

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finance instruments include Foley et al. (2010), and Engemann et al. (2014). See also Niepmann and Schmidt-Eisenlohr (2014a and b).

[51] Giovannucci (2002), p. 3, in a paper for the World Bank.

[52] UCP art 2.

[53] A thorough description of the role, functions, liabilities, and risks of a correspondent bank in a letter of credit relationship offers Dolan (1992).

on at least two contracts (between the buyer and seller and between the buyer and his bank) as well as on one undertaking in which the bank handles the payment to the buyer/beneficiary in case of compliance with the terms of the agreed-upon terms of the credit.

Yet, letters of credit in international trade are regularly organised in four-party procedures. In this constellation, the buyer applies to his (issuing) bank, which issues the letter of credit and forwards it to the so-called advising bank. The advising bank then authenticates the letter of credit and delivers it to the seller. This advising bank is usually a correspondent (if not a branch) of the issuing bank at his or her location.[54]

Historically, it is not clear when letters of credit appeared for the first time. Some scholars, like Ferguson (1983) and Trimble (1947-48) would go as far back as to 3000 BC in ancient Egypt[55] or Babylon. This view needs to be contested as these early forms were regularly

[54] To complete a letter of credit cycle in a four-party arrangement, the next steps would be: seller/beneficiary ships goods to the buyer after having obtained the assurance of payment from the issuing bank; the seller then presents the documents to the negotiating bank in compliance with the conditions in the letter of credit (the negotiating bank is a bank that provides value for documents and drafts under the credit – it is, typically, located at the seller's place); after examining the documents the negotiating bank obtains the necessary funds to pay the seller and facilitates the payment - always matching the terms of the letter of credit. As last steps, the negotiating bank forwards the documents to the issuing bank, which – under the condition it agrees with the negotiating bank that the terms of the letter of credit have been met – receives payment from the buyer/applicant. The issuing bank then forwards the documents to the buyer who uses them to obtain the goods from the carrier/shipper.

[55] Ferguson (1983), p. 381: "The basics of the system – financial accounts, drafts, contracts, letters of credit, credit money and other commercial practices involving international trade and finance – were mentioned by writings on clay tablets dating back to 3000 BC."

“open” (meaning that there was no tender of any documents prerequisite for the management of open credits) or “uncovered”; in addition, they were mainly put in place to commence advances of money.[56] But also, Mugasha (2003) identifies a “strong likelihood” that letters of credit first emerged in ancient Egypt.[57]

In any case, we see at least rudimentary models and nascent intellectual foundations for both, letters of credit and bills of exchange, in ancient Mesopotamia, and step by step, they became more refined in Greece, Rome, and Hellenistic Egypt. Wigmore (1936), for example, points at an agreement from 248 BC in Egypt that asks

> “for the repayment, in wheat, or upon default double its value, of a loan of money from one Zenon, which ends with: ‘and the right of execution shall rest with Zenon and the person bearing the note on behalf of Zenon’”[58].

The fall of the Roman Empire led to a “banking vacuum” - at least on the European continent - until long-distance commerce and trading were re-established in the 12th and 13th centuries AD. Not surprisingly, some recognise the early type of bill of exchange or the letter of payment as we find them in 12th century Mediterranean countries and cities as the prototype of today’s commercial letter of credit.[59] Yet, the question of which point in

[56] Mugasha (2003), pp. 37-8. See also Ellinger (1970), pp. 24-7; Holdsworth (1915), p. 173.

[57] Mugasha (2003), p. 38, referring to Trimble (1948), p. 984. Ellinger (1970, p. 24) notices not sufficient evidence for this position, though.

[58] Wigmore (1928), p. 69.

[59] See Usher (1943), pp. 76 et seq.; Kozolchyk (1965), p. 395.

history the *modern* letter of credit saw the light of day doesn't need to be resolved here as correspondent relationships existed already in the premature forms of letters of credit.[60]

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Back to Babylon and to the question of whether we could find correspondents already in this ancient environment. As just described, bills of exchange and letters of credit as we know them today were not fully developed yet. Still, Trimble (1948) identifies a clay "promissory note" and a clay tablet, exhibited in the University Museum of Philadelphia, resembling an instrument payable to the bearer and assuring repayment of the amount and interest in produce of a loan of money.[61]

There are no indications, though, that correspondents fitting our criteria were in place in ancient Mesopotamia. Yet, in addition to the Assyrian branch and agent networks mentioned above, some sources hint at further examples for the use of agents – mainly

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[60] Byrne (2007), p. 565, footnote 9, sees the evolvement of modern letters of credit coming into extensive use in "post Napoleonic Wars trade between Europe and North America". He distinguishes ancient letters of credit from the modern commercial letter of credit by calling the former "general" letters of credit without a named beneficiary. They were "addressed to correspondents (sic!) and requested payment in favor of the bearer who was a customer of the issuer." Other scholars position the modern letter of credit at the end of the nineteenth century and beginning of the twentieth century (Kozolchyk (1965); Penn et al (1987), p. 292; Finkelstein (1925), p. 724; Biswas (2011), p. 5).

[61] Trimble (1948), p. 982. In New York's Metropolitan Museum we also find a Babylonian Cuneiform tablet serving as a promissory note for silver (Egibi archive, ca. 545 BC), see www.metmuseum.org/art/collection/search/321528.

installed as commercial agents in temples for trade operations abroad[62] and at structures that would be similar to some sort of “commenda contract”[63]. The latter can be seen as a blend of an investment contract, an employment contract, and an agency contract.[64] In the sixth century BC, bankers in Babylon/Mesopotamia had already taken over what we would call today the role of a mediator in commodity purchase-sale operations by helping conclude agreements as well as by accepting interest-bearing deposits, facilitating payments of third parties, and extending loans secured by property.[65]

For those who tie correspondent relationships strictly to banks on both sides of the arrangement (a view we strictly oppose as seen in Chapter 3), ancient Mesopotamia could not be considered a decisive factor for the development of correspondent relationships, as only one side would resemble the characteristics of a bank (mainly the royal palaces and temples). Although most of the older research came to the conclusion that – despite existing payments systems – “banking” did not exist in that era (their main argument is that lending was not made out of deposits yet)[66], we agree with those who would call ancient Mesopotamia not only the cradle of civilisation but even the

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[62] See Moshenskyi (2008), p. 30. Bromberg (1942, p. 84) proves the existence of agents by correctly interpreting the role of a supervisor in a contract from the era of Hammurabi (KU, 857) as acting as an agent.

[63] Bromberg (1942), p. 86.

[64] On the institution of the *commenda,* see in depth the studies of Harris (2008), and Pryor (1977).

[65] Moshenskyi (2008), p. 31.

[66] Bogaert (1965), pp.126-29, who still sees ancient Mesopotamia as the cradle of banking *operations*; Geva (2011), p. 123. A decisively oppositional view offers Davies (2002, Chapter 2), comparing Babylonian banking activities with pawnbrokers in England.

"cradle of banking"[67]. Hudson (2018) is certainly correct when he cautiously states that

> "Mesopotamia did not have banking in the modern sense of taking in deposits and lending them out at a profit" and that "[e]ven in Neo-Babylonian times "banking families" such as the Egibi were simply wealthy families [paying] depositors the same rate (equivalent to 20 percent) as they charged customers, so there was no intermediation markup as in modern banking."[68]

However, not only the invention of record-keeping, accounting and standardization[69], but especially the elements of transaction banking in order to facilitate trading efforts abroad, lead us to the conclusion that at least the basis for a number of future banking operations and methods, including, in a rudimentary way, correspondent banking, was "constructed" in ancient Mesopotamia.

But we share the fate with most researchers in this field, that any attempt to read the banking structures of Mesopotamia in a complete and precise way must remain

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[67] See for instance Geva, ibid.

[68] Hudson (2018), referring to Bogaert (1966).

[69] See on all three topics the important collection of papers on the origins of money and account keeping from Mesopotamia to Mycenean Greece and Egypt by Hudson and Wunsch (2004). The accounting challenge to record not only "[…] a single transfer, but the combination of a multitude of transfers into a summary" is excellently described by Van de Mieroop (2004a, p. 49); in his words: "When information piles up and is not synthesized, it becomes useless: a good bureaucrat needs to be able to compress data. The summary account requires that the scribe combine information from various records."

unfulfilled as many aspects of this ancient civilisation remain vague.[70]

b. Ancient Greece

In ancient Greece, it was the temples, but also civic and private units that offered opportunities for *banking operations* in today's understanding, including currency exchange, deposits, loans, and even a form of credit that allowed the customer to turn a credit note into money in another city. [71] Can we call this practice correspondent banking, as some of today's defining elements might have been already in place (for instance, a direct relationship to participants of the "system", independence of the correspondent, or provision of services on behalf of another "financial institution")[72]?

Let us have a more thorough look into the details. In Athens, the first Greek (deposit) bankers were called "*trapezitai*" (in Greek τραπεζίται; singular: *trapezites,* in Greek τραπεζίτης), a referral to the tables (or "trapezai", in Greek τράπεζαι) that were used on the city's market for money changing purposes. This was rather like the 'banks/banca' (bench or benchtop) of the later European bankers – and like in Western Europe, the expression has stuck so that banks in Greece today are still called trapeza (τράπεζα).[73]

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[70] A wonderful statement of Joan Oates (1979), p. 197 underlines this self-limitation: "Any study of Babylonian civilisation is, and will remain, an amalgam of near-truths, misunderstandings and ignorance, but this can be said of more periods of history than most historians would admit."

[71] For the history of ancient banking, see the monumental (though not always accurate) work of Heichelheim (1938).

[72] See, in greater detail, the findings in Chapter 3.

[73] As indicated, certain banking operations in Ancient Greece were also conducted by temples. However, as Geva (2011, p. 124) points out, these temples preferred to lend out of their capital instead of deposits, and they did not receive orders from their depositors to pay creditors.

And in contrast to a long-standing academic opinion, the *trapizetai* did not only facilitate banking functions on behalf of the public sector.[74] Merchants especially would deposit money in anticipation of the next payment and - as a next step - also for several future payments, where their actual presence in person was no longer necessary. It was more or less a logical development in which trusted moneychangers would attract more deposits than needed for immediate demands by its customers, which led to a "surplus"-situation that allowed "banking" services out of the existing deposits. From approximately the 8th century BC onwards, and in the course of growing and expanding their business outreach, the *trapezetai* positioned themselves between borrowers and creditors to conduct credit movements.[75] Using intermediaries, they worked with instruments that resembled letters of credit, especially if traveling clients shied away from the risks of carrying larger sums of money – in this constellation, an additional party would act as a correspondent being instructed by the banker through the letter to pay a certain sum to the traveller who would have paid beforehand the respective amount to his banker.[76]

But also in comparably simple transactions between a payer and payee, the Greek *trapezetai* appeared as correspondents themselves. Suppose, the *trapezites* of the recipient of a payment (payee) had received an advice note issued to the payee by the *trapezites* of the payer, anticipating the following payment of the payer's *trapezites* (facilitated in coins or in a settlement agreement).[77] In this example, the payee's *trapezites* acted as a correspondent for the payer's "bank". As the acting representatives

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[74] See Gabrielsen (2008), p. 115, and Geva (2011), p. 126, opposing the limited approach of Bogaert (1968), pp. 402-08.

[75] Mugasha (2003), p. 39.

[76] Mugasha (2003), ibid.

[77] Example (without the consequence of a correspondent relationship) taken from Geva (2011), p. 130.

fulfilled their tasks without being linked to each other by mutually dependent structures, the *trapezites* could not be confused with any other form of representation (agent, branch, subsidiary).

Without calling the payee's *trapezites* a "correspondent", Geva (2011, pp. 129-30) identifies a constellation that resembles a correspondent banking relationship as follows:

> "[…] the payee's *trapeza* may have been prepared to credit the payee's account in advance. This could possibly happen on the basis of the advice note issued to the payee by the payer's *trapeza* and presented to the payee's *trapeza* by the payee, and in anticipation of subsequent payment by the payer's *trapeza.* Payment by payer's *trapeza* to the payee's *trapeza* could be effectuated either in coins, or as part of either bilateral or multilateral setoff […]."

Still, Geva (ibid.) recognizes that "neither an intra-city nor an intercity interbank clearing system […] existed in Ancient Greece."[78]

The main difference of this instrument from today's payment method of a cheque was that the written advice note (*diagraphé*, in Greek διαγραφή) was not issued by the payer to the payee, but by the payer's *trapezites* to the payee (rather like a banker's draft); in addition, it wasn't transferable.[79] Voices in the older literature that already saw the emergence of cheques and bills of exchange in Ancient Greece have not found

[78] See also Bogaert (1968), pp. 344-45 and 413.

[79] Geva (2011), p. 130.

overwhelming support.[80] Yet, some academics, like Trimble (1947-48) identify "banks" that prepared letters of credit on correspondents "with the view to obviating the actual transport of specie in payment of accounts."[81] Denzel (2006) mentions the instrument *syngraphe* (in Greek συγγραφή), adopted by the Romans from Greek law and the so-called *chirographum* as a Roman method; both were "documents of claims with the debtor committing in written form to paying a certain amount of money […] supposed to have also served for the transaction of payments from one place to another."[82]

Another refined constellation of payments, respectively, access to existing deposits, can be linked to a correspondent system in Ancient Greece. It was mainly installed for facilitating intercity withdrawals and payments. In the former case, a traveller would seek the opportunity to withdraw money at the city of destination from a correspondent of the *trapeza* of deposit in the city of origin.[83] Cohen (1992) describes this as follows:

> "By guaranteeing payments of funds at far-off locations, the banks […] allowed customers to avoid the dangers and inconvenience inherent in transporting a large amount of coins or bullion. Thus when Stratokles needed funds available at the distant Black Sea, to which he was about to journey, he was able to leave

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[80] Guillard (1875), p. 9; Baskin and Miranti (1997, p. 315) see bills of exchange already clearly existing in Ancient Greece. A different opinion express, for example, Hasebroek (1965, p. 86) and von Reden (2002, p. 59).

[81] Trimble (1947-48), p. 984.

[82] Denzel (2006), p. 1 and Footnote 1.

[83] Geva (2011), p. 131, who doesn't give any indication, though, how the relationship between the *trapeza* in the city of origin and the correspondent was shaped. It is also unclear whether (1) the correspondent necessarily had to be a *trapeza* as well, and (2) how the legal framework of repayment eventually functioned.

> his own money on loan in Athens and carry instead a bank guarantee of payment of principal and interest on 300 Cyzicene staters."[84]

The second case[85] involves a (traveling) lender and a borrower. Suppose, both the lender and borrower are located in the city of origin and the traveling lender is in need of money in the city of destination where the borrower has deposited money at a *trapeza*. In turn, the borrower asks for the same amount of money in the city of origin where the borrower had deposits at his *trapeza*. To fulfil both demands the *trapezetai* at both places would act as correspondents for the *trapeza* of the lender and the borrower, whereas the lender would also rely on a guarantee of a *trapeza* at the place of origin in case the payment at the destination would have failed.[86]

How do these Greek "correspondents" fit into our parameters of correspondent banking? Looking at the *trapeza* that conducted the services, all seven factors (access and influence; savings; networks; efficiency; interconnectivity; business accelerator and predictable revenue) are more or less given. Only the "predictable revenue" factor might be considered as rudimentarily developed at this early stage of a new banking model. Furthermore, none of the aforementioned eleven criteria of correspondent banking is obsolete.

The point in question is whether the *trapezai* that acted like correspondents were correspondents of another *trapeza* or only a "helpful hand" for the payer and payee or borrower and lender. In the first example, where the payer's *trapeza* issued an advice note to the payees's *trapeza* we face a clear analogy to the four-party model of a correspondent banking relationship. There is no evidence that similar advice notes existed in the borrower-lender relationships between the involved *trapezai*. But it seems

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[84] Cohen (1992), pp. 15-6.

[85] Again, see Geva (2011), p. 131, and Footnote 85.

[86] See also Westermann (1930-31), p. 41.

highly likely that the experience of the payment example led to comparable methods, where the lender would present a guarantee of the borrower's *trapeza* at the place of origin.

Athens emerged into a financial and commercial hub with some similarities to centers in subsequent eras like Antwerp, Bruges, Amsterdam, London, and New York, just to name a few; based on experiences in Mesopotamia, but also in Egypt, Athens developed more than just "embryonic forms" of banking, insurance and even joint-stock ventures.[87] And it grew into the European birthplace of financial intermediation (before banking even implied methods to facilitate money supply as well).

Let us also look at Egypt in the fourth century BC. Under the rule of the Greek dynasty of the Ptolemies (following the death of Alexander the Great in 323 BC and the break-up of his empire until the Roman conquest in 30 BC) warehouse banking turned into a new organisation, that already had components of a network of banks tied to a central bank (in Alexandria), where the main accounts from the grain banks were documented.[88] This system also showed characteristics of a correspondent approach as many payments took place between different accounts without physically transferring money. It is understood as the first giro system in banking history.[89] Rostovtzeff (1941) describes the accounting methods of the grain banks as "payments [that] were effected by transfer from one account to another without money passing."[90] There is further

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[87] Cameron (1993), p. 35.

[88] On the Ptolemaic economy, see Manning (2006).

[89] Davies (2002), pp. 52-55. See also the eminent work of Preisigke (1910).

[90] Rostovtzeff (1941), p. 1285.

documentation that even hints at the existence of nostro/vostro accounts.[91] Regardless of whether we see some of the well preserved fragments of payment orders from the Ptolemaic period only as mere advice or control notes or even as first verification of a cheque system[92], a correspondent relationship is the only viable solution when a payee of a payment order would have advised the payer's bank to process the payment into the payee's account at his bank. Such a practice would have only functioned, if the payer's bank kept funds in an account held by the payee's bank.[93]

Additionally, in the late third and second century BC, the island of Delos played a noteworthy role as a "banking center" that set standards for bridging the western and eastern Mediterranean banking activities and proved to be "both a historical and geographical link in the wider and more flexible development of banking business"[94]. Delos should finally be the model widely imitated by Roman banks, not least because two of its commercial rivals, Corinth and Carthage, were both devastated by Rome during the Third Punic War in 146 BC.

c. Ancient Rome

In ancient Rome, transactions of large amounts of money took place on a very regular basis, regardless of whether it was the purchase of valuable real estate, investments in

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[91] Referring to the extensive work of Bogaert (1998), Geva (2011, p. 147) presumes the "existence of bilateral correspondent relations between private banks, namely instances where one bank holds an account with another; this could support inter-bank non-cash funds transfers." See also Geva (2011), p. 153, who also draws analogies to today's instrument of cheques.

[92] Bogaert (1998 and 1968); Geva (2011), pp. 144-55.

[93] Geva (2011), p. 153.

[94] Davies (2002), p. 79.

provinces or even trade finance.[95] Rome certainly profited from the Greek banking experiences and inventions.[96] We already referred to the so-called *syngraphe*, implemented by the Romans and based on experiences from Greek law, as well as the *chirographum*.[97] And although Rome stands for one of the earliest examples of an international coinage system (and, thereby, limiting the emergence of a foreign exchange practice), the increase of far-reaching trade and other business activities led to refined payment and financial intermediation methods.

Just take the example where Marcus Tullius Cicero boasted that he had "bought that very house for 3.5 million sesterces", and "Gaius Albanius is the nearest neighbor: he bought 1,000 iugera [625 acres] of C. Pilius, as far as I can remember, for 11.5 million sesterces"[98] Imagine the wearisome transport of such a sum from buyer to seller. Within the borders of the city of Rome, maybe a group of Cicero's slaves would have taken care of delivering (in the first example) 3.5 tons of silver coins[99]; however, these clumsy procedures were not only time-consuming and expensive but also prone to cause losses in case of long-distance payments. The lack of archaeological and written evidence for long-distance transfers of bullion coins underlines the conclusion of Toutain (1927, p. 320) - who correctly stated that commercial transactions between

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[95] See the excellent works of Barlow (1978); Harris (2008); Andreau (1999). For further contextual questions, see Del Negro and Tao (2013).

[96] Grossmann (2010, Chapter 2), notes that it is "[...] unlikely that Roman bankers evolved out of money changers, but rather emulated the existing Greek model."

[97] Denzel (2006), p. 1 Footnote 1, also referring to the early work of Grünhut (1897), p. 22.

[98] *Epistulae ad Familiares 5.6* and *Epistulae ad Atticum 13.31.4.*, as quoted in Cicero (1926).

[99] See the calculation of Harris (2011).

long distances "were […] settled less by payments in hard cash than by banking operations" - and the view of Harris (2011) that payments of this dimension must have been "for the most part paper, or rather documentary, transactions."[100]

Rome already had a rather advanced credit system;[101] loaning money - also within the wider borders of the Empire - happened with great frequency (Temin, 2004). In the beginning, temples conducted transactions and held deposits, before the so-called *argentarii* (originally money-changers succeeding the Greek example of the *trapizites*) took over major parts of the deposit and (private and commercial) transaction business as private "entities". Later, the *argentarii* were also involved in lending operations, auctions, and the task to determine the value of money as well as circulating newly minted coins[102]. All in all, we witness already a remarkable spectrum of activities that mirror today's banking processes.[103]

According to Harris (2011, p. 225) "[t]he commonest procedure for large property

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[100] See also Tan (2007), who puts this Ciceronian anecdote in a wider context of commercial banking and financial markets in the mid to late Roman republic.

[101] Harris (2008); Andreau (1999).

[102] New coins were also circulated by the so-called *nummularii*. On the Roman coinage and money system, see the significant work of Crawford (1974 and 1985); Peruzzi (1985); von Reden (2010). See also Verboven (2009); Woytek (2014).

[103] As early as from the mid fourth century BC, the so-called *mensarii*, as public bankers (*mensa* means "bank" in Latin), appointed by the state, coexisted in times of economic troubles or complications (for example triggered by a war). Their role differed, some of them were known for covering citizens who provided securities, see, in more detail, Bernard (2012), pp. 108-16. For Temin (2013a) Rome certainly had private banks, and also private long-term securities resembling mortgage bonds; however, he doesn't identify any public debt to be traded; see also Neal (2015), pp. 50-1.

purchases in this period was the one casually alluded to by Cicero" [*De Officiis 3.59*] where someone "[…] '*nomina facit, negotium conficit*' provides the credits [or 'bonds'–*nomina*], and so completes the purchase."[104]

Harris (2008, p. 192) reflects : "*Nomina* were transferable, and by the second century B.C., if not earlier, were routinely used as a means of payment for other assets […] The Latin term for the procedure by which the payer transferred a *nomen* that was owed to him to the seller was *delegatio.*" As a consequence, the Romans eventually found a method to settle payments by transferring "nomina".[105] This found its close parallel in grammar, where the *nomen* is declinated in the various cases, such that genitive and dative served as a de facto double-entry bookkeeping device (Werner, 2005).

Still, how would the transfer of money be organized between different geographical parts of the Roman Empire? Out of necessity, the Romans turned out to be creative in this field as well. They came up with the concept of *permutatio* – the transfer of funds through paper transactions - which Barlow called "Rome's great contribution to ancient banking"[106]. Rome's tax collectors (the so-called *publicani*) who kept branches in the provinces served more as correspondents than as (dependent) agents when they traded claims on taxes to allow transferring funds throughout the Roman Empire (and partially beyond). In today's terms, these *publicani* would have a double role – agents for their governmental institution and correspondents for a private (or even public) entity. The young Marcus Tullius Cicero obviously also relied on a "banking correspondent" for money transactions from his family in Rome while he studied in

[104] Barlow (1978), pp. 156-7. Harris (2008, p. 184) observes that "debt was in fact the lifeblood of the Roman economy, at all levels."

[105] Del Negro and Tao (2013).

[106] Barlow (1978, p. 168) comes to the conclusion that "nomina" could mean "debt"

Athens.[107]

Having mentioned "settlements" in the context of Roman financial services, the question occurs, whether we already see clearing and settlement processes in ancient Rome that would come close to what many correspondent relationships in our modern times stand for.

For some historians, the depth and skillset of Roman financial structures are tied to the extent of existing banks.[108] Others acknowledge mechanisms that are similar to the clearing procedures of today, but don't fall into the trap of seeking "modern institutions in antiquity"[109]. Del Negro and Tao (2013), somehow falling into this very trap, compare Roman finance to a "shadow banking system" while also quoting Verboven (2008), who sees Roman high finance as functioning "primarily on the basis of brokerage". On the one hand, there were no institutionalized clearing and settlement houses. However, clearing and settlement took place in a rather informal, or even semi-formal (through the "publicani") way. Or, in other words, the early Roman Empire had (necessary) clearing and settlement knowledge, but no monolithic structures yet.

Geva (2011) values attempts in the literature to recognize clearing and settlement systems among bankers in the Roman period as "premature"[110]; however, he confirms that

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[107] See the commentaries of Arthur Patch McKinlay in Cicero (1926), p. 191.

[108] See, for instance, Temin (2004) and the debate covered in Del Negro and Tao, ibid. A few voices incorrectly state that there were no banks in Rome, see, e.g., Bürge (1987), p. 508: "[…] there were no banks in Rome; the Roman bank is a modern fiction" (translated from German); Johnston (1999), p. 86.

[109] Harris (2008).

[110] Geva (2011), pp. 241-2: "Throughout that entire time, neither an inter-city nor intra-city multilateral interbank clearing or settlement system had existed."

“[i]nterbank payments took place through correspondent accounts, namely deposit accounts held by one banker with another, particularly in the same city, but […] also in different cities.”[111]

We need to explore whether original text fragments support this statement. There is evidence in primary sources that an interbank payment system existed within the wide borders of the Roman empire of the 2nd century AD. Papyri of the Fayûm towns in the year 155 AD include receipts for certain sums paid into a local bank in the Fayûm was to be paid out to another individual at Alexandria (*Figure 2)*:

Ἔτους ιη Αὐτοκράτορος Καίσαρος Τίτου Αἰλί[ο]υ
Ἁδριανοῦ Ἀντωνείνου Σεβαστοῦ Εὐσεβοῦς,
Μεχ(εὶρ) κζ. ἐποίησεν ἐπὶ τ(ὴν) Τίτου Φλ(αουίου) Εὐτυχ(ίδου) τράπ(εζαν) Εὐ-
δαίμων Σαραπίωνος κ(αὶ) μέτοχ(οι) ἐπιτηρηταὶ
ὑπαρχόντων οἴκου πόλεως Ἀλεξανδρέων
(πρότερον) Ἰουλίου Ἀσκληπιάδου φιλοσόφο(υ) ὄντων περὶ
κώμ(ην) Εὐημερείαν εἰς φόρο(ν) ιζ (ἔτους) τάλαντ[ο]ν
ἓν καὶ δραχ(μὰς) τετρακισχειλίας ἐπὶ τῷ τὸ
ἴσον ἐν Ἀλεξανδρείᾳ δοθῆναι τῷ ἐπὶ τῶν
στεμμάτων προκεχι(ρισμένῳ), / (τάλαντον) α (δραχμαὶ) ʼΔ.
Ἐπεὶφ η, ὁ αὐτ(ὸς) κ(αὶ) μέτοχ(οι) ὁμ(οίως) εἰς φόρο(ν) ιζ (ἔτους)
τάλαντον ἓν κ(αὶ) δραχ(μὰς) χειλίας τετρα-
κοσίας, / ὡς πρόκ(ειται) (τάλαντον) α (δραχμαὶ) ʼΑυ.
ιθ (ἔτους), Φαῶφι ι, ὁ αὐτ(ὸς) κ(αὶ) μέτοχ(οι) ὁμ(οίως) εἰς
φόρο(ν) ιη (ἔτους) δραχ(μὰς) χειλίας, / ὡς πρόκ(ειται) (δραχμαὶ) ʼΑ.
Ἁδριανοῦ η ὁ αὐτ(ὸς) κ(αὶ) μ̣έτοχ(οι) ὁμ(οίως) εἰς φόρο(ν)
[ιη (ἔτους) δ]ραχ(μὰς) χειλίας ὀκ[τακ]οσίας, / ὡς πρόκ(ειται) [(δραχμαὶ) ʼΑω.
[Φαμε]νὼ[θ] ζ, [ὁ αὐτ(ὸς) κ(αὶ) μέ]τοχ(οι) ε[ἰς φό]ρ[ο(ν)
ιη (ἔτους) [δρα]χ(μὰς) δισχ[ε]ιλία[ς, / ὡ]ς πρόκ(ειται) (δραχμαὶ) ʼΒ.
Ἐπεὶφ ε, ὁ αὐτ(ὸς) κ(αὶ) μέτ[οχ(οι)] εἰς φόρο(ν) ιη (ἔτους) δρα[χ(μὰς)
δισχειλίας, / ὡς πρόκ(ειται) (δραχμαὶ) ʼΒ.

Figure 2: Papyrus of the Fayûm (155 AD), as printed in Grenfall et al. (1900)

As printed and translated in Grenfell et al. (1900), pp. 220-1:

[111] Ibid., p. 242. See also already Humbert (1887), p. 407.

> "In the 18th year of the Emperor Caesar Titus Aelius Hadrianus Antonius Augustus Pius, Mecheir 27.Paid into the bank of Titus Flavius Eutychides by Eudaemon, son of Sarapion, and partners, overseers of the property belonging to the corporation of the city of Alexandria and formerly to Julius Asclepiades the philosopher, situated at the village of Euhemeria, for the rent of the 17th year, one talent and four thousand drachmae, on condition that an equivalent amount should be paid at Alexandria to the official in charge of the stemmata, total 1 tal. 4000 dr. Epeiph 8, by the same person and his partners, as before for the rent of the 17th year, one talent one thousand four hundred drachmae, total as above written 1 tal. 1400 dr.' &c."

In addition to obviously mentioning the existence of banks and interbank transactions, this example comes closer to a correspondent network than to an arrangement of branches.[112] The latter would have lacked the independence of correspondents. According to our findings in Chapter 3, foreign branches are regularly defined as legal and operational extensions of their parent foreign bank. They are not separate legal entities under the law of the host country. A correspondent bank, in contrast, is based in and legally tied to the host country.

Already, Grenfell (1900) came to the conclusion that "[t]he mutual relations and organization of the local bank and the bank at the capital were such that money paid into the one could be drawn at the other."[113]

Analogous to our findings in ancient Greece the criteria and parameters of correspondent

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[112] Temin (2013b, p. 179), who also quotes this example, keeps both options open: "This transfer might have been accomplished by the bank sending the money to its branch in Alexandria or by having a correspondent bank in Alexandria that was willing to honor obligations from the bank of Titus […], possibly because the Fayum bank held a balance in Alexandra for that purpose."

[113] Grenfell et al. (1900), p. 220.

relationships can also be adapted to the Roman structures. However, more multifaceted institutional configurations in the Roman empire have not led to a leapfrog in bank practices compared to the Greek era.[114]

In conclusion, and widening Geva's view (2011, p. 139) who affirmed that Roman banking developed "nascent interbank correspondent arrangements, under which one bank held funds in account with the other" into standard practice, we already see mature elements of correspondent relationships and even correspondent banking in ancient Rome.

d. Near Eastern Parallels and Post Roman Developments

The fall of the (Western) Roman Empire in 476 AD led to a long-lasting halt[115], not only of further advances in banking but to banking itself.[116] For centuries, financial services were reduced to pawn-broking, money changing, and some small scale lending procedures – at least within today's European borderlines. Still, ecclesiastics preserved the old Greco-Roman knowledge of banking throughout the early middle ages. A combination of economic recovery and surging trade between southern and northern Europe in the later Middle Ages led to a revival of the financial procedures of the past.[117] Yet, we must not

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[114] Andreau (1999, p. 582) and Geva (2011, p. 137) identify an even wider scope in terminology and technical vocabulary in classical Greece.

[115] Much earlier, another "halt" in the development of international trade and finance was caused by the volcanic eruption of Thera around 1628 BC that not only destroyed the Minoan civilization but also interrupted existing trading networks. Many of the Mesopotamian inventions came to a standstill in other areas around that time; see also Neal (2015), p. 42.

[116] Orsingher (1967), p. 10.

[117] See Baskin et al (1997), p. 29.

neglect – as many scholars do – earlier innovative developments in the Near East.

During the Sasanian Empire (224-651 AD), the Persians developed the sakk[118] or cheque system, an innovative form of letters of credit[119] issued throughout their geographical influence; this detail often escapes historians' notice when they draw an outline of major steps of the development in international banking.[120] It is known that around the ninth century AD Muslim traders used this approach in an even wider spectrum that allowed them to cash credit letters in China that were drawn on sources some thousand miles away in their home city.[121] The *sakk* is a true cheque in today's understanding as an order of payment originating from a banker where the drawer keeps an account. According to Ashtor (1972) "[…] the Muslims were actually using

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[118] Also known as "ruq'a" which stands for an order for the delivery of goods, but also for a payment order – issued to a payee - for someone to facilitate a payment after having been shown the ruq'a by a person authorised to receive payment (Geva, 2011, p. 277).

[119] Denzel (2006, p. 1 Footnote 3) is correct when he criticises researchers like Jakob (1925, pp. 280s.) who see the *sakk* as an equal instrument to the bill of exchange. It resembles most elements of a letter of credit.

[120] See Skeen (2008): "International banks were established for the first time and spread the model of the Sassanian (ancient Persian) banking system. In the Islamic world a bank could accept a deposit in Baghdad and pay out a promissory note or check (derived from the Persian word *sakk*, transmitted to the West as an Arabic loanword) issued against the same deposit at a bank in Córdoba or in China." On the instrument of the "sakk", see Goitein (1967), p. 245; Bosworth (1969), p. 125 and 140.

[121] In China, paper-based banking, government promissory note issuance and related accounting systems have existed at least since the 10th century Song Dynasty. A further enhanced system was handled by the Mongols in the 12th and 13th century AD, as described, among others, by Marco Polo (see Werner, 2005).

an instrument inherited from the Byzantines, an instrument already widespread in Egypt some centuries before the Arab conquest."[122]

Chester (1896) also refers to the fact that the Arabs, during the time of Mu'awiya in the late seventh century, had already cultivated a system of financial transactions, entailing the instrument of a promissory note.[123]

In addition, Geva (2011, p. 278) recognizes another payment instrument, the so-called "*suftaja*."[124] According to his findings, it "contains an obligation of a paymaster or his correspondent to pay at a place other than that of the issue of the document." As opposed to the "*hawala*" (the transfer of a debt from one debtor's charge to another's[125]), there is only scarce literature about *suftaja*. Although the *hawala* mirrored the use of bills of exchange[126], the *suftaja* is probably the most noteworthy transaction model for our history of correspondent banking as it resembles essential elements of the letter of credit[127] and, as we shall see, core parameters of correspondent

[122] Ashtor (1972), p. 555.

[123] Chester (1896), and Ray (1997), p. 67.

[124] Geva (ibid.) uses the term "*suftaj*". Ashtor (1972) and Denzel (2006), amongst others, speak of "*suftadja".* We will adhere to the more common "*suftaja*".

[125] Ray (1997), p. 61.

[126] Neal (2015), p. 56, who also mentions the so-called *hundi* by Indian traders as models resembling the bill of exchange system.

[127] Ray (1997, p. 64, Footnote 89) correctly dismisses the analogy to bills of exchange (but see Goitein (1967), p. 242), which frequently would entail different currencies; the *suftaja*, in turn, was tied to the same currency on both ends. See also Ashtor (1972), p. 572: "The *suftadja* is a banking instrument used in a monetary system and an economic life very different from that of the Christian

relationships. According to Ray's (1997, p. 64) definition "the *suftaja* is a loan of currency to be repaid by the borrower (banker, or in all likelihood, his associate) in a different place. Its purpose is to avoid the risks of transport. The *suftaja* can be paid to either the original lender (who would then have carried the note with him) or to a third party (in which case the *suftaja* would have to be sent)." Not only is this a description of an instrument that mirrors a letter of credit, but it also incorporates the option of a correspondent in a typical long-distance situation. Goitein (1967) comes up with a similar description in which "*suftajas* [sic] […] were issued and drawn upon well-known bankers or representatives of merchants […]."[128] Again, the restriction to representatives (or agents) of merchants is insufficient as other historians describe correspondent relationships.

References can be found in works about the Abbasid period (750-1517 AD). Here we have to rely on almost only secondary sources, mainly collected by Mez (1937), Fischel (1937) and Ray (1997). The latter draws attention to (Arab and Jewish) middlemen in financial transactions[129] whose functions were, besides the administration of funds, also

West. […] The *suftadja*, a banking instrument totally distinct from the bill of exchange, was a transaction in which three persons took part and the repayment of the loan was established in the same kind of money originally paid. The *suftadja* was often followed by endorsement." Lieber (1968, p. 233) opposes to this view and speaks of the suftaja "as a draft which was sometimes also a true bill of exchange", although without further explanation. Udovitch (1979, p. 263) is undecided, describing the *suftaja* as "a letter of credit or a bill of exchange". Denzel (2006, p. 1, Footnote 2) also touches on the dispute without taking sides.

[128] Goitein (1967), p. 243.

[129] See Ray (1997), p. 68: "[…] the historian Miskawaih recounts in the *Tadjarib al-Umam* that in the year 931 the vizier 'Ubaidallah b. Muhammad al-Kalwadhani received a loan from the Baridis

the transfer of funds from province to province by *safatij* (plural of *suftaja*)[130], and he also proofs the existence of "representatives"[131]. The question remains whether we would find the more independent model of correspondents as well. In order to fulfil long-distance transactions, court bankers (*jahabidhat al-hadra*) relied on a widespread network of merchants, money-changers, and money-lenders.[132]

Goitein (1967, p. 244) quotes a letter from the beginning of the 11th century - addressed to the Tustari brothers in Old Cairo - according to which a man from northern Iran traveled to Egypt, "however, the Baghdad correspondent of the Tustarīs issued him a *suftaja* on 100 dinars drawn on the latter, and one on 50 dinars on another, also a well-known Fustad banker." But Goitein also points at "representatives" in the same letter: "For Damascus, which the traveler had to pass on his journey, he did not receive a *suftaja* at all, but was advised to produce one drawn on the Tustarīs to their representative in that city, who would pay him after having contacted his business

[…] through the intermediary Abu Bakr b. Qaraba." (see Miskawaih, *Kitab Tajarib al-Umam*, trans. by Amedroz and Margoliouth, Eclipse of the Abbasid Caliphate, Oxford, 1922, 7 vols.).

[130] Ray (ibid., p. 69) identifies two Jewish court bankers ("jahabidhat al-hadra") dealing with such operations.

[131] Ibid., p. 70: "[…] but it was of a different sort, namely *safatij*, letters of credit, from other provinces, which had not yet reached maturity. This quotation is from at-Tanukhi: When the Vizier 'Ali b. 'Isa had to make payments for which he had no funds, he would take from the merchants a loan of 10,000 dinars, the security for which consisted of letters of credit (*suftaja*) which had come in from the provinces but were not yet due, and by giving interest at the rate of 1 ½ silver danaqs on the dinar, which made the amount of 2,500 dirhams a month. This arrangement was made with Joseph b. Phineas and Aaron b. Amram and their representatives for the period of sixteen years and after their death."

[132] Fischel (1937), p. 29.

friends."[133] This distinction does not seem arbitrary as the business ties of the Tustarīs to Damascus and Baghdad differed significantly. As we have seen in Chapter 3, a representative would be fully dependent on the parent bank as opposed to a more or less autonomous correspondent.

With respect to the *suftaja* system, a tripartite (when the issuer of a *suftaja* acts as a single intermediary) and multipartite arrangement is possible. Geva (2011) comes to the conclusion that in the latter form the issuer (which he calls "paymaster") "located at the place of the loan, may employ an agent or business associate, such as another merchant with whom he has ongoing dealings, as a correspondent"[134]. This finding is only correct in relation to the business associate because an agent would lack the necessary independence to the issuer of the *suftaja*. However, in this model, we encounter many components of our parameters for a correspondent relationship. All seven factors are relevant: (1) the access and influence factor, (2) the savings factor, (3) the local and global networks factor, (4) the efficiency factor, (5) the interconnectivity factor, (6) the business accelerator factor and (7) the predictable revenue factor. Although most scholars who shed light on the early Islamic payment instruments (correctly) acknowledge the existence of correspondents[135], none of them puts the findings into a wider contextual correlation and distinguishes them from other forms of payment relationships (such as agencies and business representatives).

But just like in ancient Greece, Rome, and Greco-Roman Egypt, a multilateral clearing and settlement system with reciprocal accounts (nostro/vostro) was not in place yet. Correspondent and issuer (paymaster) of the *suftaja* would settle during their ongoing

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[133] Goitein (1967), p. 244.

[134] Geva (2011), p. 291.

[135] See only Grasshoff (1899); Huvelin (1901); Udovitch (1967); Goitein (1973); Geva (2011); Remde (1967).

business relationship.[136]

This and further evidence of correspondent relationships in the later medieval Islamic economies originate from the so-called "Geniza papers"[137], which include letters of credit, promissory notes, letters, and transaction records of merchants and banking records from accounts of merchant bankers. In his "Letters of Medieval Jewish Traders", Goitein (1973) recurrently points at business correspondent relationships depicted in the Geniza papers.

As innovative the *suftaj*-system may seem, it remained in a niche. Influential Islamic schools opposed the instrument and limited its wider circulation (Hanafi and Maliki law), as they considered it as "an abomination founded on a loan conferring profit on the lender"[138].

However, the method of using *suftaja* for multipartite trade and business arrangements cannot be overestimated. Certainly, there is no reason to marginalize later innovative and groundbreaking steps made by bankers in Renaissance Italy; yet Florence, Genoa, Venice, or the fairs in southern and central Europe are far from being birthplaces for correspondent

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[136] According to some authors, the relationship between paymaster and correspondent was framed and governed by the so-called "*qirâd*" (Grasshoff (1899), pp. 24-9, and Huvelin (1901), pp. 24-5), a bilateral profit-sharing agreement under which one party gives capital to another party in order to conduct businesses; the profit would be shared and the loss would be at the investor's risk (Udovitch (1967), p. 261, footnote 12, and Geva (2011), ibid.).

[137] These documents were found in the nineteenth century in the Cairo Geniza – covering a time frame from the eleventh century to modern times. Especially Goitein (1955, 1967 and 1970) extensively researched the papers and their relevance for the history of Islamic trade.

[138] Geva (2011), p. 298.

relationships, letters of credit, or bills of exchange.

e. Correspondent Banking in the Name of Christendom: The Crusaders

Our excursion into early Islamic trade and transaction methods gives us meaningful hints for categorizing the relevance of another widely neglected medieval group that was involved in international transactions: The Crusaders. Although commercial interests were not the predominant motivation for the Crusades, we are reminded that between ca. 1095 and 1291AD, new and expanded markets were created for Eastern goods and "merchants from the Italian city-states [took] advantage of new opportunities for West-East trade and seaborne transport"[139].

There is a high probability that these Italians – and Crusaders from across Europe - gained knowledge from Jewish and Arab merchants about the instruments "*hawala*" and "*suftaja*" and therefore could build a sound and eclectic basis of financial knowledge. The Crusaders needed to remit funds, and they were dependent on different methods to facilitate long-distance payments.

Some still enthusiastically call the Knights Templars, whose order was founded in 1119, the first "international bankers"[140]. This may be seen as hyperbole if we take the aforementioned ancient developments into consideration. Nevertheless, around 1300, their network consisted of at least 870 branches and two financial headquarters, namely in Paris

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[139] Reinert and Fredona (2017), p. 4, referring to the important works of Abulafia (1993) and Phillips (1988).

[140] On the "banking system" of the Templars, see Génestal (1901); Piquet (1939). Generally on the different efforts to finance the Crusades, see the dissertation of Grossman (1965).

and London.[141] The Order was initially established to protect trade routes from Europe to the Holy Land, where they also assisted pilgrims financially. Their network was geographically organized in provinces (commandoria) where each of them ran sales offices.[142]

The costs of the crusades led, on the one hand, to the necessity to transfer significant amounts of money over wide distances. Secondly, the Templars had vast financial resources that resulted from inheritances they obtained from high-ranking families and from the loot they made on their missions.[143] As they were widely perceived as trustworthy custodians for deposits, the Templars expanded the banking business by also taking deposits from individuals while asking for a fee for safekeeping.[144]

Let us illustrate the crusaders' role with an example: In the year 1166, King Louis VII of France and a little later the English King Henry II imposed a tax to buttress the crusades and to finance fortifications.[145] In a wider sense, Templars and Hospitallers could be seen as the monarch's bankers abroad in the Holy Land, especially the Templars had obtained "holdings" across the European continent. In exchange for currency they would offer their

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[141] See Furger (2011).

[142] Moshenskyi (2008), p. 15.

[143] There are no concise studies of the financing of the crusades yet. An overview on "The Financing of the Crusades in the Twelfth Century" is offered by Constable (1982), though. Indirectly, we find evidence in the secondary work that concentrates on ecclesiastical ties: see the ground-breaking monographies of Lunt (1926, 1934, 1939 and 1962), and Gottlob (1892).

[144] De Soto (2009), p. 59.

[145] After Andrea (2003), pp. 104-5; Blaydes and Paik (2016), p. 9.

traveling counterpart a "demand note" at one fortress or castle, which, in turn, would be useable for the agreed-upon amount of money at another place.

De Soto (2009) also points at a remarkable range of businesses that were conducted by the Templars: they were responsible for transfers of funds, charging a certain fee for security and transportation and developed a system of credit notes that gave the opportunity to withdraw the money at different places. Piquet (1939) identifies a variety of financial tools and procedures in his work about the business methods of the Knight Templars: money transfers, account operations, the use of securities, and credits. According to Kohn (1999, p. 10), they frequently combined remittance with finance by borrowing from merchant banks in Italy against repayments by their agents at the Fairs of Champagne.

While it is controversial whether the Knights Templars could already be seen as the pioneers for the accounting practice of modern-style explicit double-entry bookkeeping (as opposed to the Roman grammar-based version)[146], the members of the order also made loans and kept the safekeeping principles on demand deposits.[147]

As stated by Rajan and Zingales (2003), the castles of the Templars "formed a network of "branch offices" which meant they could make cash available at both ends of the

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[146] Although de Soto and many others (e.g. Arlinghaus (2004)) connect the invention of double-entry bookkeeping with Italy in the 1300s (with the first printed description by the monk Luca Pacioli in 1494), there are more and more hints that double-entry records have been created some time before. Under the premises that it could have been invented to some extent already in the early Islamic state (Zaid (2004) in opposition to Nobes (2001)) and by Jewish merchants in 12th century Cairo (Parker (1989) and Scorgie (1994)) from whom Italians learned the technique, it is not out of the question that the Knights Templars had knowledge of double-entry bookkeeping. For a thorough literature overview on Islamic accounting methods and their influence, see Napier (2009).

[147] De Soto (2009), p. 59.

Mediterranean, as well as in Paris or London, when needed and in the form that was locally accepted"[148] This intra-Templar network indeed comes closest to the format of a branch system. The inherent organisational dependence is an important factor for this classification. However, as these branches also served as point of investment for European (mainly French and English) aristocracy who "entrusted them with tax receipts, bill of exchange payments, and money transfers"[149], some elements of correspondent arrangements were clearly established, if we take into account that "the Templars also became involved in the net that Italian merchants and bankers had spun around Europe and the Levant."[150] Neal (2015) describes another level of interconnection between merchants, the Crusades and the clergy, when he points at agents of the papacy who collected Peter's Pence across Europe and remitted them back to Rome; these agents, however, "enlisted experienced merchant-sailors to support the pilgrimages and the intermittent Crusades […]"[151] Many of the (Italian) merchants who engaged in remittance payments and "logistical support" had trading posts and bases ranging all the way to the Eastern Mediterranean and were skilled in using bills of exchange. Such an agent-merchant relationship can also be perceived as a correspondent arrangement according to our preconditions.

For Davies (2002, p. 156), "[t]he growth in the use of bills of exchange was therefore

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[148] Rajan and Zingales (2003), p. 5. See also Haag (2009), p. 141: "With their branch offices, so to speak, at both ends of the Mediterranean, and with major strongholds at the Paris and London Temples, not only could they take deposits but they could also make funds internationally available where and when they were needed."

[149] Ibid.

[150] Haag (2009), ibid.

[151] Neal (2015), pp. 53-4.

coincident with, but never exclusively confined to the rapid expansion in the transfers of the large amounts of capital required to finance the Crusades. Although a very considerable number of merchant bankers were involved in such transfers – at a time when most merchants were forced to act partly as bankers, and most bankers were similarly involved in wholesale trading – the two main intermediaries, so far as their direct involvement with the Crusades was concerned, were the Knights Templar and the Hospitallers."

But calling the Templars the inventors of modern-style banking would be an exaggeration.[152] Newman (2007) correctly states that "the Templars were simply one group among many" while pointing at the trading empires of the Italian city-states and at monasteries that conducted certain banking businesses, even with the restrictions on usury.[153] Neal (2015, pp. 53-9), even sees the popes (from Gregory VII to Urban IV) as the main drivers of financial innovation during the times of the Crusades. We, however, propose a view that doesn't neglect complementary influences, and, as mentioned above, the achievements by early Persian, Jewish and Muslim cultures must not be underestimated.[154] Still, as Abu-Lughod argues in her impressive reinterpretation of global trade evolutions in the 13th and 14th centuries, the expanded horizons of the

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[152] Though Haag (2009, p. 137) sees them as "Europe's first bankers".

[153] Newman (2007), p. 201. For further details, see the thorough study of Barber (1994), pp. 264-279.

[154] See Islahi (2009), p. 54: "Borrowing for business purposes has been a current practice in all ages. Instances are available that Christians borrowed money from the Treasury. They also borrowed from their Muslim brethrens) [...]. There are reasons to believe that Muslims too borrowed from them and from their own people. However, we could not trace any institutional arrangement for this purpose during our study period. It may be noted that this was the period when foundations for modern banking was being laid down in Europe along with the maritime trading companies. It is no surprise if, like foreign monopoly trading companies, this institution too was ignored by Muslim world."

Crusaders led to a reintegration of northwestern Europe “into a world system from which [it] had become detached after the ‘fall of Rome.’”[155] They, therefore, fostered commercial and trade activities as well as banking methods in underdeveloped parts of Europe and also tied elements of correspondent banking to war finance – a model that should be used with more and more refined methods across Europe over the following centuries.[156] In Chapters 5 and 6, we show how correspondent relationships were crucial factors for the British Crown to fund its troops abroad.

3. Renaissance Italy as the (second) birthplace of correspondent banking?

While shifting our perspective back to Continental Europe, the next important chapter in banking history is being written by medieval Italy and exported from there to other European places between the 12th and 15th centuries.[157]

It was precisely Renaissance Europe that refined upon a correspondent banking network to structures that are comparable to those today. Historians are divided on the question of which Italian city-state could claim the crown for being the decisive source of financial innovation.[158] For many researchers, Florence remains to be the most

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[155] Abu-Lughod (1989), p. 47. See also Blaydes and Paik (2016), p. 11.

[156] On different financial innovations in European war finance (especially during the Thirty Years’ War), see the recent essay of Neal (2018).

[157] For Geva (2011, p. 353), “[t]here is […] no disagreement that ‘banking’ in Continental Europe was reborn in Italy”. See also, in more detail, Sayous (1932); Usher (1943); de Roover (1942 and 1948a); Prestwich (1979); Le Goff (2012).

[158] On this debate, see Neal (2015), pp. 52-3.

significant driving force for banking in Renaissance Italy and abroad.[159] Other scholars point primarily at the importance of Venetian impulses[160], while a third group concentrates on Genoa and its *Casa delle Compere e Banco di San Giorgio* (founded in 1408)[161]. Indeed, reliably good records and information on early banking in Europe stem from the 11th and 12th centuries. A thorough schematic of banking has been formed by historians on the basis of Genoese notarial records (those, which still exist start in the year 1154).[162] Reynolds (1938) mentions witness statements in a lawsuit in Genoa in 1200, where three illuminating elements of Genoese banking operations were articulated: first, merchants who not only kept bank accounts, but also operated them as payment platforms using book transfers; secondly, depositors could overdraw their accounts through credit extensions by the bank; finally, and in our context most importantly, banks had installed inter-bank arrangements to enable non-cash payments between different accounts held at other banks.[163] Although this interbank method reflected a narrow geographical context within the city's walls, it is already a *local* correspondent system based on accounts held by banks for other banks, mainly

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[159] The profound work of de Roover, especially on the undoubtedly powerful and highly influential House of Medici (see for instance de Roover, 1966), had long lasting impact on future generations of researchers.

[160] See, especially, the thorough research by Mueller (1979 and 1997); Lane and Mueller (1985); Pezzolo (2013a and 2013b).

[161] See, for example, Fratianni and Spinelli (2006); Felloni (2006 and 2014); Marsilio (2013).

[162] Hall (1935), and Lothian (2002), p. 701, referring to de Roover (1974b), Chapter 5.

[163] Reynolds (1938), pp. 165, 171-2. See also Geva (2011), p. 359. However, up until today, there is not more evidence regarding the details of how payments and settlements were ultimately processed, see Geva, ibid., referring to de Roover (1974a), p. 202.

conducted by moneychangers.[164] In the late 13th and early 14th centuries, moneychangers in Venice refined the system.[165] After the inception of the Casa di San Giorgio in the early 15th century Genoese bankers could build on the experiences gained in their local correspondent system; when they expanded their operations across Europe their (trans)actions were coordinated through respective accounts in the Casa.[166]

The advanced Genoese system for long-distance shipping in the 12th and 13th centuries is thoroughly explained by Byrne (1930), and it shows some similarities to the institutions and procedures that were earlier on already in place in the Muslim world.[167] Until the third crusade (1187 AD), the leading families in Genoa conducted their operations abroad, most notably in Syria, mainly through professional factors and agents who had the necessary expertise of the region[168]; most of them lacked the independence that would qualify them as correspondents. International trade mechanisms were, as we have seen above, not a ground-breaking invention of Italian merchants.[169] They borrowed existing methods and practices from their Muslim

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[164] Hall (1935).

[165] Geva (2011, pp. 359-60) assumes that at this time and place (and also in Genoa) not only the parties (payer and payee) of a transaction had to appear in person at the involved banks but also the bankers, which is – due to a lack of conflicting evidence – probably true.

[166] Neal (2015), pp. 69-71, calling the *Casa* "a state within a state", and Neal (2018), p. 140.

[167] Abu-Lughod (1989), p. 17.

[168] Byrne (1920), pp. 208-9.

[169] Most Italian scholars, of course, leave this impression, see for example the otherwise instructive essay of Fratianni and Soinelli (2006).

counterparts in the Middle East who were accustomed to trade systems for centuries[170] and they profited from trade knowhow the crusaders gained travelling to the Holy Land on Italian vessels. Besides innovative efforts to expand trade opportunities across Europe and to the East, Northern Italian city-states had to come up with additional creative solutions for war finance. For both aspects, they built on the aforementioned experiences.

Therefore, and regardless of the academic dispute about the decisive influential factors of Italian banking for modern structures[171], Renaissance Italian bankers cannot be perceived as inventors of correspondent relationships. As shown above, non-cash monetary payments existed already in Ancient Greece and Rome and Greco-Roman times, as well as in the area of today's Middle East and the wider medieval Arab and Jewish world. Over the centuries, and, in the case of Mesopotamia, millennia, these cultures had interrelations in trade and learned from each other's experiences. Italian merchants and banking institutions had well-established ties into the region, and it would be unrealistic to assume that forgotten practices and institutional structures were re-created due to similar circumstances.[172]

a. Transaction structures – from guilds to fairs

After touching upon Genoese factors of inspiration let us have a look at the municipality or guild funds in the mid-thirteenth century. It would be premature to already consider them as parts of a correspondent system. Although some trust institutions like the renowned Venetian *Procuratoria di San Marco* admitted escrow

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[170] See Abu-Lughod (1989), p. 15.

[171] See Geva (2011), p. 353, who offers practices from Antiquity, influences from the East or even "new creativity" as alternatives.

[172] But see Bogaert (1966), pp. 159-70, with an emphasis on deposit banking.

accounts and were used by foreigners as some sort of a “Swiss bank account”[173], keeping cash and valuables from individuals and the respective city governments, they did not act as correspondents in the context of our definition as there were no relationships between two or more financial institutions.[174] Also, the weighty *financiers d’Arras* were not part of an arrangement that could be categorised as a correspondent system, where bankers acted for other bankers. Still, in contrast to de Roover (1942)[175], it cannot be excluded that the financiers d’Arras formed certain partnerships, accepted deposits, and were in – at least loose - relations with Italian merchant bankers, also at the fairs of Champagne.[176]

Particularly in Tuscany, several banks increasingly focused on a wider outreach than the town borders of mainly Florence[177], Siena, and Lucca. While starting with a local perspective, some influential families soon developed an approach to internationally transfer capital for trade and other reasons.[178]

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[173] Kohn (1999a), p. 7. For a detailed survey on the *Procuratoria di San Marco,* see Mueller (1977).

[174] But, as we will see below, Venice developed correspondent structures in the late 13th and early 14th centuries.

[175] De Roover (1942), p. 53.

[176] See only Reynolds (1930), p. 518: “Once or twice they formed *societates* for trade *ultramontes*, accepting capital from merchants domiciled in Genoa. These *societas* contracts were identical with those the Italian merchants in the same trade sometimes had drawn.”

[177] On the unique creativity of the banking sector in Renaissance Florence, see the remarkable article of Padgett and McLean (2006). Aside from de Roover’s ground-breaking work on banking in Renaissance Italy, it was Melis (1962, 1991), who gave detailed historical insights on this period.

[178] See Kindleberger (1984), p. 43.

An early example involved the papacy, particularly the one of Pope Urban IV (1261-1264). In the context of the Crusades, we already hinted at the role of the Roman clergy. Neal (2015) lays out the impulses of the popes for trans-European financial structures. He describes the desperate, but successful, attempts of Urban IV to fund troops against the Emperor by convincing Italian merchant bankers to get involved.[179] Urban turned to Florentine merchant banking families and asked them "to become organized as joint-stock companies with specific charters rather than occasional partnerships, while arranging that they would have permanent rights for staying in both France and England in order to collect the papal tithes"[180]. This "societas" established by the "pope's bankers" was a permanent legal entity with *filiali* across Europe and not only a conglomerate of individual partners; a permanent presence in Rome with accounts at the pope's camera was regularly managed by a former partner or relative of the merchant banking family.[181] These *filiali*, as well as the representation in Rome are a classical case of a an early *branch*-system. The dependence of the players involved, but also the permanent structures and legal personality, do not resemble correspondent relations.

Above, when we described some stages of the development of bills of exchange we already shed some light on a few methods that (re-)emerged in Europe around the second half of the

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[179] Neal (2015), pp. 57-9. He also underlines that Genoese merchant bankers would have been a good choice on first sight as they "dominated the exchange fairs in Champagne and were better situated to arrange the funds necessary for the French troops, but at the time the Genoese were arranging the finances for the Emperor" (ibid, p. 58) and therefore could not take part in the papal plot.

[180] Neal (2015), pp. 58-9.

[181] Ibid.

12th century: the *lettres de foire* of the fairs at Champagne and the *instrumentum ex causa cambii*.[182] Although regularly two- or three-party arrangements, they already included representatives abroad, which were either agents or correspondents. Face (1957-1958) reminds us that the settlement of accounts was already fully developed as early as in the year 1180.[183]

Even before Giovanni di Bicci de' Medici set up the Medici Bank in 1397, nowadays, less famous Tuscan and especially Florentine families of the Mozzi, Acciaiuoli, Peruzzi, and Bardi built up a system of bank "agencies"[184] in other parts of Europe – just to name a few, Avignon, Barcelona, Bruges, the Champagne fairs, and later in Lyons, Besancon, Antwerp, Amsterdam, London, and Hamburg.[185] Padgett and McLean (2006) refer to the year 1382 as the starting point for the establishment of wider, diversified partnerships. However, the

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[182] See, in more detail, Denzel (2006), pp. 4-5, who refers to de Roover (1974a), p. 203, who described the *instrumentum ex causa cambii* as "the prototype of the bill of exchange". On the instrumentum, see Munro (1995). On the lettres, see de Roover (1953); Face (1957 and 1957-1958); Edwards and Ogilvie (2012) with a thorough Literature review.

[183] Face (1957-1958), pp. 428, 437; Denzel (2006), p. 12 Footnote 50. Denzel (ibid., pp. 12-3), widens the view when he states that not only at the Champagne fairs but also "[…] later at the Geneva fairs, the Castilian fairs, the Lyons fairs and, finally, at the Genoese Bisenzone fairs international payments were mainly settled during the fair business through the settlement of accounts. Provided that the creditor of the bill of exchange was at the same time debtor of another bill, creditor and debtor would both write mutually off their debts in the participating merchants' accounting books, i.e. all claims and debts were settled in a circle ('giro') of transfer and resulting compensation, if there were ideally equally high debts."

[184] De Roover (1942), p. 54.

[185] Kindleberger (1984), p. 43.

example of the Peruzzi network shows that they were still far from a correspondent banking relationship. Their representations were administered by salaried, dependent employees[186] and can be structurally compared to a blend of today's *representative offices* of a bank and its *branches*. The terminology regarding "correspondents" is also all too often confusing and even misleading among historians. De Roover (1942) uses the term "agencies" for Florentine's focus abroad, whereas Kindleberger (1984) generalises and – incorrectly – calls the units across Europe "correspondents" without making a differentiation.

A notable case was the merchant banker Francesco di Marco Datini (1335-1410), who held control over a remarkable network of branches with distinct partnerships with each of his branch managers.[187] This example has to be put in context with a development within the business of merchant banking in the late 13th and 14th centuries, when merchant bankers and expressly the families Bardi and Peruzzi started to lend not only their own money, but also that of others. Nevertheless, they mainly appeared as "intermediaries" and not yet as "correspondents" for other financial institutions. Although they – as merchant bankers - mobilized funds from other merchants[188], most of these "investors" were banks as well – and even if some of them appeared as merchant bankers, a correspondent banking relationship was unlikely, because of the competitive relationship within the banking community of that time and for the reason that they did not conduct businesses for the other merchant banker (and, if at all, indirectly).

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[186] De Roover (1942), p. 54.

[187] De Roover (1966), p. 77. See, also, on Datini, Nigro (2010). It has to be stated that Datini is one out of many exceptional bankers in Renaissance Florence. His relevance also arises from the fact that the quality of the still existing documentation is outstanding.

[188] Kohn (1999a), pp. 4-5.

In contrast to Padgett and McLean (2006)[189], it is also clear that the aforementioned Francesco Datini did not have “correspondents” (which fit into our definition) in other cities. Both authors also correctly explain that “there was no doubt that the entire system of legally autonomous companies was centrally controlled and dominated by one man alone: Francesco di Marco Datini.”[190] His array of seven organizational tools[191], demonstrates the difference between a partnership system of agencies, branches and/or representative offices on one hand and correspondents on the other: Datini held (1) legally distinct partnerships with branch managers or the owner in each location. In case of a partnership with the owner or the branch managers of other bank(er)s this point also correlates with a requirement for correspondent banking. The same is true for Datini’s preconditions to have (2) separate sets of account books for each partner[192], (3) double-entry bookkeeping in bilateral format, (4) a diversification of companies into multiple industries and (5) current accounts both among partnership-system companies and with major trading partners. However, the main difference of correspondent banking from other representations lies in Datini’s requirement (6) to provide a “holding company” arrangement, in which Datini’s Florentine partnership owned parts of other partnerships and (7) to install a centralised oversight of partners through vast numbers of business letters between Datini and his branch partners. In modern terms of international banking and trade financing, Datini’s representatives resembled almost all characteristics of a subsidiary, especially due to their legal autonomy (see Chapter 3).

However, Datini was also involved in correspondent arrangements, but not in the role of a

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[189] Padgett and McLean (2006), p. 1475. See also the abridged version of Padgett and McLean (2006) in Padgett and Powell (2012), pp. 168-207.

[190] Ibid., footnote 15.

[191] Quoted after ibid., p. 1476.

[192] Padgett and McLean (2006, p. 1476), of course, use the unmasking term “branch” instead of “partner”.

respondent or a correspondent; as an example, *Figure 3* shows a bill of exchange from 1398 when a merchant in Bruges who owed money in Barcelona paid into a bank in Bruges, which then sent the bill to its (correspondent) bank in Barcelona that paid the merchant's creditor in local currency.

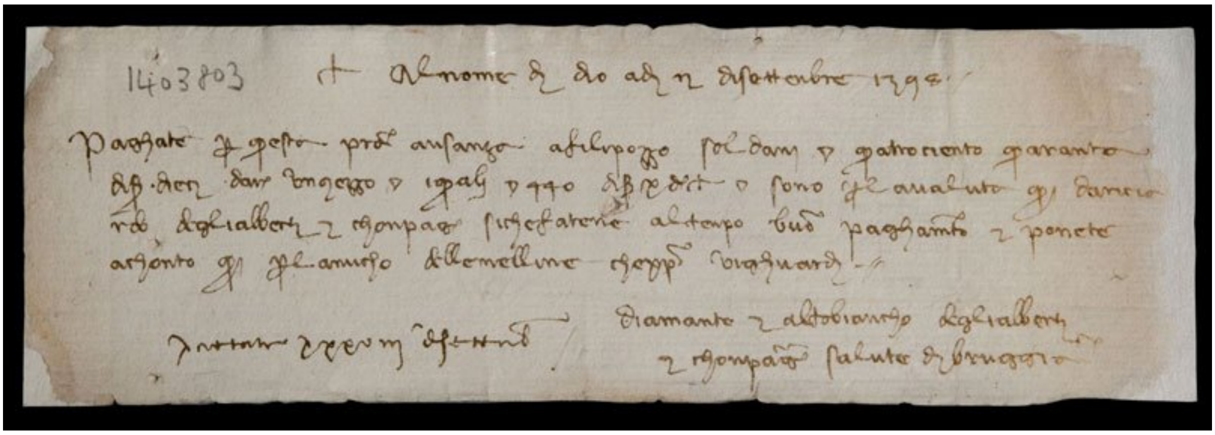

Figure 3: Bill of exchange from Diamante and Altobianco degli Alberti to Francesco di Marco Datini and Luca del Sera, Bruges-Barcelona, September 2, 1398. Source: Prato, Archivio di Stato

Another relevant factor for the expansion of banking networks and partnerships were the intense credit relations among Florentine merchant-bankers. Padgett and McLean (2002 and 2006) show the "historical connection between the rise of intercompany credit and the invention and spread of partnership systems as new nodes of exchange in that credit". From a macroeconomic point of view, the partnership system as an industrial structure turned out to be "an innovative route to the financial integration of multiple industries"[193].

One might feel tempted to see the *retail sector* of that time as early correspondent

[193] Padgett and McLean (2006), p. 1485.

bankers. The fact is that in 15th century-Italy, more and more craftsmen, shop- and innkeepers held accounts for customers and offered credits.[194] And they could be seen clearly as financial institutions in a wider sense. However, they were basically not providing services on behalf of another financial institution as it is common nowadays.

Also noteworthy is the development of *pawnbroking*. For some, it may sound surprising that the increase of pawnbrokers led to models that come close to the financing relationships of merchant bankers and retailers. Two different approaches deserve consideration: on the one hand, private pawnbrokers not only financed their business out of their own funds, but also often with external means, e.g., time deposits of friends or business partners from abroad. Secondly, the example of municipal pawn banks that originated in Perugia (*Monte di Pietà* – founded by the Franciscans in 1462) and dispersed even to Northern Europe in the following two centuries. Ironically, they turned from non-profit institutions for the poor to banks accepting time posits and serving as savings banks[195], which eventually led to highly profitable loans to high-ranking business borrowers, culminating in a loan of 300,000 ducats to Philipp II by the Florentine Monte di Pietà. But even their rise in numbers to numerous such banks (89 alone in Italy in 1509) across Europe does not justify calling it a correspondent banking network, as they mainly operated like business correspondents as described in Chapter 3. Still, Geva's (2011, p. 353) statement that pawnbrokers didn't accept deposits and "played no role in the development of the payment system" needs to be partially corrected in the light of the described expansion of their original business model. [196] He is accurate, though, in his observation that pawnbrokers didn't "provide non-cash

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[194] See Kohn (1999a), p. 13.

[195] Ibid, p. 17.

[196] Somehow paradoxically, Geva (2011, p. 422) also mentions subgroups of pawnbrokers, who accepted time-deposits; referring to de Roover (1948b), pp. 1-2.

monetary payment systems" or book transfers[197], which underscores our conclusion of their irrelevance for the emergence of correspondent relations.

Lombard banks that developed from pawnbroking mainly worked with agents in many economically important cities of Europe, but were not part of any correspondent system - and they concentrated on consumers' credit. Yet, as they mainly remained pawnbrokers, their significance for further major development of banking was comparatively limited.

However, a considerable pioneer function for correspondent banking can be seen in the setting up of fairs to which we alluded already. They began to flourish in medieval times in Champagne and Brie, before they later moved to Geneva, Lyon, Besançon, and – among other places – in the 16th century to Piacenza. They were places where payment settlement took place via currency or bills of exchange and where bankers and merchants agreed on more or less the whole variety of financial transactions. The fairs quickly became centres of foreign exchange activities. Some protagonists exchanged specie for bills of exchange, while others negotiated transfers of money to other cities.[198] Already in the 13th century, some Italian merchant bankers borrowed money at lower interest rates in the financial market at the fairs in Champagne. For this purpose, they sold bills of exchange in their Italian hometown drawn on Champagne and used agents at the fair who borrowed funds for paying the bills when they became due.[199]

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[197] Geva (2011), p. 422, Footnote 17.

[198] Kindleberger (1984), p. 36-37, who (ibid, p. 37) also states: "In due course, all kinds of financial transactions came to be handled at fairs, not only foreign exchange but real estate, banking, early forms of insurance, lotteries."

[199] Kohn (1999b), p. 6. Further examples by Spufford (1988), pp. 393-96. The bill of exchange as a financial instrument in late medieval Italy has been covered extensively in the context of a potential

Given the relation of Italian merchant bankers to agents and their roles as “bankers abroad”, this system already comes close to correspondent banking, though these agents were not equivalent to independent financial institutions of today. Nevertheless, it cannot be excluded that some of these “agents” were merchant bankers themselves with a higher or entire degree of independence. Moreover, payment obligations in deals that combined elements of foreign trade and currency exchange were settled by procedures that foreshadowed today’s multilateral structures of interbank clearing and settlement.[200] Consequently, a good number of what we described so far as “agents” can be perceived as international correspondents: not fully reflecting the modern type, but certainly distinct from other forms of representation.

Already in the late 12th century *money changers* acted as bankers. They were dealing with deposit banking in combination with exchange business and offered bank accounts and book transfers also to regular clients.[201] These clients, of course, were mainly inhabitants of the city where the money-changer was situated. But the customers were in some cases other banks and (for instance in Bruges) all the money changers were in account with one another. In addition, money changers often entered into partnerships with merchants.[202] For an international correspondent banking network, the preconditions may not have been fulfilled as one partner is typically located abroad. However, significant elements of a local correspondent arrangement were in place. The

circumvention of the Christian prohibition of usury, see Munro (2003), and already de Roover (1966).

[200] Geva (2011), p. 356.

[201] De Roover (1942), p. 60, who even describes the offices of the money changers as “commercial banks which operated on a fractional reserve principle

[202] See De Roover (1942), p. 64.

examples of Genoa and Venice show that such geographically limited systems were not automatically doomed to fail - and sometimes even the precursor of remarkable expansions abroad at a later stage.

A general distinction, systematically described by Geva (2011, pp. 352-7), is instructive for our view on historical developments in transaction banking and sophisticated payment systems. He differentiates between the rise of deposit bankers and merchant bankers. The former concentrated (originally as money changers who initially also dealt with bills of exchange) on deposit-taking, facilitating loans, book transfers, and occasionally even chequing services until they gradually declined toward the 16th century.[203] Merchant bankers, in turn, who had created a significant business size, relied on branch and correspondent networks across Europe – initiated in the 14th and 15th centuries mainly from Italian families before the focus gradually shifted further north. Bills of exchange, though, had been in use by Italian merchants as early as in the 12th century.[204]

b. The ubiquitous Medici

Hardly any other name is mentioned more inflationary than the Medici when the question arises as to who the most influential characters and pioneers in international banking history are. However, in the light of our findings, we have to be careful with our answer regarding correspondent banking.

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[203] Geva (2011), pp. 356-7, also pointing at public banks that took over many of the functions (if not barred from credit and loan businesses) of these deposit bankers.

[204] Ibid.

The Medici Bank[205] formed two groups of comparably independent subsidiary units. In contrast to having only a cumbersome centralized organisation, suffering communication difficulties, and delays with partners and clients in important cities, the Medici Bank preferred to establish branches, for instance, in Rome (as an itinerant branch that followed the Pope), London, Geneva, Bruges, Milan, or Venice, aside from its head office in Florence. They were individual legal entities with separate management, capital, and books.[206] Ferguson (2008) sees the key to the Medicis' accomplishments in diversification, referring to the Medici bank as "multiple related partnerships, each based on a special, regularly renegotiated contract".[207] In today's typology of multinational banking this construct has components of *foreign branches* and *agencies*.

When it turned out to be too complex to found a branch, the Medici Bank also relied on correspondents, for example in Lübeck (the branch managers were rather autonomous because of the distance to Florence, though the general managers tried to keep them under tight supervision – and eventually failed in the generation after the strict reign of

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[205] It is widely unknown that several Family members aside from Giovanni di Bicci founded different banks that emerged from the dissolution of Messer Vieri di Cambio's (1323-1395) bank under the Medici "brand" (so Francesco di Bicci de' Medici (c. 1350-1412), before he became Giovanni's partner, and Antonio di Giovanni di Cambio de' Medici (died 1396) with two partners (de Roover, 1966, pp. 36-7). However, before the 1390s, the Medici could be considered as a merely criminal clan; Ferguson (2008, p. 42) speaks of "gangsters", as no less than five family members were executed for capital crimes between 1343 and 1360. See also Brucker (1957), p. 13.

[206] In the famous case of Ruffinari *vs.* Portinari (1455), the Bruges municipal court dismissed the plea, which was based on the assumption that the De Medici branches in London and Bruges were an entity, see de Roover (1946), p. 31.

[207] Ferguson (2008), p. 44.

Cosimo di Giovanni de' Medici[208]). De Roover (1966), mentions two more correspondent relationship that could be perceived as an early, yet not very successful form of today's models: at least from 1416, probably even earlier, the Medici expanded their business to Flanders and England, where they didn't have branches, but used "correspondents"; in Bruges and London, around 1430, their representative partners were the firms of the Bardi and the Borromei.[209] As the Medici weren't satisfied with the way these firms conducted their services, they consequently changed and cut some business ties and established their own branches instead. A key figure in selecting correspondents was the head of the London branch, Gierozzo de' Pigli, who had the authority to choose persons he considered as being trustworthy and capable of acting as correspondents in places where the Medici Bank had no branches.[210] Occasionally, Pigli even acted as the correspondents' agent in London.

The Medici realized that the risk of a sudden collapse through the default of a debtor could be diminished by a network of interrelated branches and contractors that were tied to Florence with individually negotiated contracts. They were not employed, but attracted to a share of the profits and as junior partners.[211] The seven organizational principles that described Francesco Datini's system (see above) were also relevant for the Medici network, except for the fact that the Medici preferred to involve a group of

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[208] See de Roover (1966), p. 6-7, who ascribes the evolution of commercial capitalism to the age of the Medici, and contradicts Max Weber's thesis that the spirit of capitalism is a product of Calvinistic Reformation, idem, p. 7.

[209] De Roover (1966), p. 59.

[210] De Roover (1946), p. 43.

[211] Ferguson (2008), p. 44.

general managers into their "holding" instead of relying on a single dominant person.[212]

Diversification, flexibility, and growth were the pulses of the Medici organism. It was their way to minimize and spread their risk factors – a method that sounds familiar in our days. The Medici were truly international bankers.

Interestingly enough, de Roover (1966) doesn't tie the establishment of a clearing system to the Medici, as it was put in place in Bruges[213] and Venice. He sees "the Florentine banks [as] too numerous to permit the organization of an efficient clearing system"[214]. We disagree with de Roover's assessment: it is true that – somehow as a place holder - a public transfer bank was formed in Florence around 1432.[215] But it cannot be denied that even the Medici settled their payment obligations in fairs and at other trading hubs abroad with "mechanisms that heralded organized interbank clearing and settlement systems in a multilateral setting."[216]

Of course, regulation of correspondent banking was difficult in the Renaissance. The establishment of a money-changers guild (*Arte del Cambio*) in Florence allowed certain forms of jurisdiction over some types of banks (the *banchi grossi* and the smaller *banchi a minuto*). Nevertheless, the possibility to regulate, also by the Florentine government (*Signoria*), was generally limited to local banking. The guild's regulatory

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[212] Padgett and McLean (2006), p. 1477.

[213] According to de Roover (1942), settlement of banks' net positions would occur only occasionally.

[214] De Roover (1966), p. 19.

[215] Ibid.

[216] Geva (2011), p. 356, offering further evidence in his research.

arm could not reach out to foreign banking, which was ruled solely by merchant custom.[217] However, the Italian "banking network" faced severe regulation and restrictions in other parts of Europe, though. Particularly in England, strict measures were imposed on foreign merchants who were involved in the banking business. Several bans, e.g., on the use of credit in foreign trade, were part of England's legislation in the 15th and early 16th centuries.[218]

c. Venice and its correspondents

It would be insufficient to only concentrate on Tuscan bankers whithout briefly looking at Venetian merchants and financiers. We have to distinguish between developments *intra-muros*- and *extra-muros*-Venetia. Within the city walls moneychangers (*campsores*) turned into bankers between the late 13th and early 14th centuries, after they shifted to deposit banking with additional services like offering payment services not only to, but also from accounts held with them.[219] Mueller (1979) and Geva (2011) assert interbank transfers in Venice. The latter even points at multi-party correspondent chains (banks "holding an account for the customer's banker […] [and] correspondents holding an account for the correspondent of the customer's banker"[220]).

But the Venetians were also involved in international financial transactions and often acted independently as creditors and exchangers with business ties to other Venetian

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217 De Roover (1966), p. 17.

218 See Munro (1979), pp. 205-8, who also points at further controls, especially of foreign exchange practices, until the 17th century, ibid., pp.208-15.

219 Geva (2011), p. 359, and, in depth, Mueller (1979 and 1997).

220 Geva, ibid., pp. 360-1; see also Müller (1979), pp. 74-6.

merchants. Worth mentioning in this context is the role of Venetian creditors in 14th century Dubrovnik.[221] In contrast to the later involvement of Tuscan bankers' families, who had *agents* and *representatives* in Dubrovnik[222] (as in many other places), the Venetian financial network was based on a certain amount of independence of the respective actors. Mueller (1997, pp. 84-5) offers another illustrative example when he mentions "at least three banks" operating in the early 1340s in Constantinople and managed by Venetian bankers (called "bancherius" and "campsor"). These banks were connected with "interlocking accounts" and bill of exchange operations. As these banks were obviously tied to the jurisdiction of the *bailo* (the principal authority of the Venetian quarter) and Venetian merchant bankers at home, the structure resembles the elements of a *branch* architecture. However, within the bill of exchange cycles in Constantinople, the banks very well acted as correspondents. A hundred years later, we find a good number of banks in Constantinople, which must be called correspondents, even in their relation to Venice, as we find evidence of up to 10 banks in the mid-15th century interacting with Giacomo Badoer, a Venetian banker, and "operated by persons with local interests" and non-Venetian background.[223] The fact that we encounter

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[221] See Krekić (1979), pp. 243-46.

[222] Krekić (1979, p. 246) does not distinct between *agents* and *representatives*, but meticulously describes the players involved as well as the structures and forms of conduct of the financial businesses. He even points at a notable aspect of the Florentine banking network in Dubrovnik, ibid.: "[…] the loyalties of all these [agents] shifted and were sometimes divided among several companies. With one exception, all the agents were Florentines […]."

[223] Mueller (1997), p. 85, based on his interpretation of ledgers kept by Badoer in Constantinople. Some of these representatives even acted in a hybrid form as agents or branch managers and correspondent, when it touched their private merchant-banking interest. Mueller (ibid., pp. 85-6) refers to the example of Badoer's "principal banker" Carlo Capello. We find similar structures in the

mainly local bankers with the necessary independence, who - embedded in local legal structures – offered a spectrum of autonomous activities without the imposing influence of a parent bank in Venice, clearly points to correspondent arrangements.

Moreover, noteworthy is the fact that the most important Florentine merchant bankers chose Venice as a core element of their international activities and exchange networks. It was again Mueller (1997) who widened the scope of historians, such as de Roover and others, when he states that ”[e]xchange between some Italian markets, including Florence, and those of northwestern Europe, was for a long time channelled primarily through Venice.”

In reaction to instabilities in the banking sector, Venice (and other cities) formed municipal exchange banks without the capacity to lend reserves; therefore the system of payments based on bills of exchange was built on a firm monetary fundament.[224] However, in the second half of the 15th century, the growing importance of fairs at places like Geneva and Lyon led to a more and more contracted role of Venice for Florentine merchant families as they shifted their exchange procedures to these places.

4. Conclusions and selected historical consequences

The *re-invention* of bills of exchange in Renaissance Italy successively unfolded across Europe and surely contributed to fostering international financial services as they were created as a legal instrument to allow safer international trade. Although they were

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Venetian Black Sea colony Tana (ibid., pp. 86-7), although they mainly reflect agent-principal relationships.

[224] Quinn and Roberds (2006), p. 18. According to Geva (2011, p. 365), “Venice gave rise to a ‘distinctive style’ of banking, referred to as giro banking, under which the primary purpose of banks was the making of payments on behalf of customers rather than making loans.”

primarily devices that were drawn by a person or business, with a bank involved as drawee and a third party in whose favour the bill was issued, this innovation laid a foundation stone for correspondent networks which were developed later to deal with cheque transactions and bank drafts that were increasingly operated on an interbank level.[225]

Italian banking of the Renaissance certainly promoted and widened the establishment of multinational banking. They created and used some state-of-the-art elements of correspondent banking, but only, if no other and better controllable alternative, like dependent agents or branches, would have been possible or feasible. The birth hour of *modern* correspondent banking is hard to detect, as some developments from the 11th century onward took centuries while others happened quickly in parallel. It could be seen in the first steps Venetians have undertaken at home and abroad, as well as in some early local arrangements by Genoese bankers and money changers. In any case, especially newly established mechanisms, namely forerunners of "interbank clearing" and certain settlement procedures, should be valued as unique contributions to our history of correspondent relationships. Here the involvement of some prominent Tuscan families in Lübeck, Flanders, and England, but specifically in medieval Bruges, or even earlier at the fairs (as long as bills of exchange in the described sense were involved), proved to be a game changer.

But, again, we need to remind ourselves of the fact that the fundaments of correspondent arrangements had been already laid in ancient times. Some earliest methods are very similar to the correspondent banking system that should emerge in the United States in the 19th century to deal with the cheque payment system. The link becomes especially apparent when one realizes that at law in England, a bank cheque

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[225] James and Weiman (2010), for example, give an in-depth examination of how in the United States the "draft and check payment systems" necessarily led to the evolution of correspondent banking networks.

is, in fact, nothing but a bill of exchange (Bill of Exchange Act 1882).

Almost 4,000 years earlier, we face elements of transaction banking in Mesopotamia and surprisingly innovative facets of structures which we would later call letters of credit and bills of exchange. Building on these experiences and regional interactions (bellicose as well as peaceful and trade-related) the concept of banking was continuously refined in Greece from eighth century BC onwards, later in fourth century-Egypt under the rule of the Ptolemies and on the island of Delos, places where we already clearly detect indicators of correspondent arrangements. These were adopted by Roman bankers and merchants whose correspondent relations grew conceptually (and geographically) into advanced payment and financial intermediation methods used far beyond the city walls of ancient Rome. However, there was not a direct path of influence from imperial Rome to medieval Italy. Highly underestimated is another impulse coming from the Near East, namely the innovative payment instruments stemming from the Persian Sasanian Empire (the development of a cheque system) and Arab, respectively Jewish, merchants (the *suftaja* and *hawala*). Historically, the missing link in the history of correspondent arrangements between Near Eastern merchants and medieval Tuscan merchant bankers are the Crusaders, who gained knowledge of payment systems that were either forgotten or undeveloped in the medieval "Western world". Supported by the Curia, they used correspondent arrangements mainly for remittances, but also for trade relations. All those who still applaud Renaissance Italy for "creating" correspondent banking, need to be reminded that the clergy and crusaders – many of them with family ties to influential Italian families – learned about long-existing payment systems even from their own relatives. Regarding correspondent banking, Italian merchant bankers were not protagonists of a financial *revolution*, rather stirrup holders of an *evolution*.

In Chapter 3, we found evidence that modern correspondent banking fulfill the criteria of two *functional approaches to finance*[226]. As we identified a plethora of timeless criteria, factors and parameters of correspondent relationships which more or less entirely materialized between ancient Babylon, respectively Assur and Renaissance Italy, the question arises whether the *functions* performed by a financial system already apply much earlier in history. Iqbal and Llewellyn's (2002) four preconditions are, for the most part, fulfilled. However, there is no precise date to which we can tie the completion of the criteria, but they clearly appear in a procedural way before medieval Italy. The first function (*intermediation function*), namely providing financial intermediation services, thereby, channeling "funds from ultimate savers to ultimate borrowers and removing budget constraints" during this process, can already be seen in Mesopotamia and doubtlessly, in Greece and Rome. Resources were moved between representatives (agents, branches, and later correspondents) over time and across regions far apart from each other. Accounting methods that served correspondent relationships were only rudimentarily developed in Mesopotamia, but in its basic structures invented there. The necessary preconditions to fulfil the third (*asset and liability*) function were only partially covered in those times; a wide spectrum of assets and liabilities with distinct characteristics for liquidity or certain risk-sharing elements were mainly put in place and refined in ancient Greece and Rome. We come to the same conclusion regarding the second (*financial services*) function: although we see early payment services and transaction services by the temples and some other players, more sophisticated trade-related services, clearing, and cash management began to flourish only in ancient Greece and later in Rome. Finally, the fourth function, the "creation of incentives for an efficient allocation of resources" within an existing economy as well as the distribution of scarce financial and real resources between competing ends (*allocation function*) cannot be seen as fully advanced in Mesopotamian times. In Greece and especially Rome the organization of long-distance

[226] The following (four) definitions and quotes describing the *functions* are from Iqbal and Llewellyn (2002, pp. 3-4), the more detailed version, with six instead of four functions, derives from Merton (1995, pp. 23-4); see, in more detail, above Chapter 3 6.

remittances and of options to optimize trade using correspondents and early models of bills of exchange and letters of credit reached a level that came close to the highly praised banking activities in the Renaissance. A financial system in the shape of correspondent relations was therefore created much earlier than in modern times or even late medieval Italy.

Merton's (1995, pp. 23-4) *six core functions performed by the financial system* that are linked to the basic understanding that the primary function of any financial system "is to facilitate the allocation and deployment of economic resources, both spatially and temporally, in an uncertain environment" don't contradict this conclusion. On the contrary, they are even strengthening our argument. Function 1 in Merton's theoretical scheme[227], namely that a financial system offers a payments system for the exchange of goods and services and Function 3, the provision of a way to transfer economic resources through time and across geographic regions and industries are both reflected by the earliest forms of correspondent arrangements, emerging the latest in 6th century BC Mesopotamia and Greece. Any early form of representation in long-distance trade and payments relations logically served Functions 4 and 6 - providing ways to manage uncertainty and control risk as well as to deal with the asymmetric-information and incentive problems when one party to a financial transaction has information that the other party does not. Slightly more difficult is the adaptation of Function 2 in our historical context: the establishment of a mechanism for the pooling of funds to undertake large-scale indivisible enterprise. However, correspondents in ancient times had to have sufficient resources to facilitate the payments between different parties who – especially in trade-related matters – would regularly stand for large-scale merchant activities. The least fitting is probably Function 5, according to which price information that helps coordinate decentralized decision-making in various sectors of the economy has to be given. There is sparse evidence for the fulfilment of this function in ancient times, but - for instance - reliable fee structures had to be in place to facilitate payments via correspondent structures.

[227] We quote Merton (1995) when describing the functions.

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Regardless of ancient correspondent schemes, Italian merchant-bankers undeniably initiated the “export” and improvement of merchant- and transaction-banking across Europe, with innovative payment, settlement, and foreign exchange activities. Consequentially, it needed places far north of the Alps – like Bruges – to bring the enhanced idea of far-ranging trading and payment networks to its realization and at some point to shifting spheres of regional influence. Let us have a closer look at some selected stages and elements of correspondent banking in other parts of Europe.

North of Italy, financial services and banking developed heterogeneously. In contrast to the described southern European steps in the development of banking, the economically rather successful Hanseatic League stood for institutional stagnation. The Hansa evidently conducted its trade businesses differently as they chose not to build up a banking structure and mainly relied on bilateral agreements.[228] Yet, in the sixteenth century the creative forces in international banking shifted from Italy to the north. The triumphant progress of the bill of exchange not only revolutionized payments in Europe[229], but it also transformed the methods of trade and led to a remarkable increase respectively geographical expansion of correspondent relationships. Aside from the usually mentioned banking progress in southern Germany which are tied to the Fuggers of Augsburg, but also to the bankers’ dynasties Welser, Seiler, and Höchstetter, the relevance of Antwerp is often underestimated (Kindleberger, 1984). It served as a pivotal point of European banking in the 16th century and emerged from one out of many places where fairs were held to an important permanent international marketplace

[228] See Kindleberger (1984), p. 44.

[229] Denzel (2006), p. 12; Spufford (1988), pp. 262-3.

for money.[230] It is known that the Fuggers and Welsers had branches or factories there[231], but the interdependence has to be seen in a wider context, because the southern German families were part of a network connected *to and with* Antwerp as the renowned example of the Fugger's support of Charles V shows when the Fuggers were borrowing money in Antwerp for the sake of re-lending it to the Hapsburg royal, then King of Spain, Archduke of Austria, and negotiating to become King and Kaiser of the Holy Roman Empire of German Nation. The focus and locus of banking had transformed under southern German influence.

During this time, the idea and concept of intermediary became a core aim and Kindleberger's (1984) description gives us another cornerstone for the development of correspondent banking as it is known nowadays:

> "The economic role of intermediary was partly borrowing at retail and lending at the wholesale, with a return based on the saving in transaction cost for the borrowing government, the fiscal apparatus of which was typically rudimentary. To a considerable extent, however, the small lender needed the security of the intermediary's bargaining power since the latter was much better placed as a rule to collect repayment in the event of difficulty."[232]

Somehow comparable to Antwerp was the development of an "international bankers' scene" in Bruges. This financial hub replaced in the early 13th century - together with

[230] We will look at Antwerp's role regarding the development of correspondent relationships in England in more detail in Chapter 5.

[231] The Fuggers had eventually eighteen such factories across Europe. The Welsers spread from Genoa to Antwerp, and from Bohemia to Lyon.

[232] Kindleberger (1984), p. 45.

Ypres and Ghent - the Champagne fairs and grew into an increasingly significant platform for Italian merchant banking houses who not only used their own staff abroad for cashless payments, but integrated more and more merchants and other individuals from the north in their (clearing) network.[233] Another important change in the banking procedures took place after merchants in Bruges and Antwerp refined the practice of endorsing bills of exchange. This step considerably lowered the standing of the fairs as financial centres as the monopoly for accepting and clearing bills of exchange, as well as for settling accounts shifted to a more flexible construct.[234] In other words, merchants no longer needed to see their permanent bankers at the fairs for the sake of cashing bills and settling their accounts.[235] Consequentially, merchants that worked with the technique of endorsements substituted the procedures and traditions of the fair bankers. After the siege of Antwerp at the end of the 16th century, the main protagonists of international (and Flemish) banking moved to Amsterdam that shortly thereafter arose to become the new, innovative European financial centre for the following one and a half centuries.

It was the Wisselbank (in low German; "Wechselbank" in high German), also known as "Bank of Amsterdam" or "Amsterdam Exchange Bank") – set up in 1609 - that can be perceived as a pioneer for some more major changes in modern banking history.[236] Its name referred to bills of exchange ("Wechsel" in German, sometimes spelled "Weksel"

[233] Denzel (2014), p. 256.

[234] Van der Wee (1977, p. 328, Footnote 2) sees early "primitive" forms of endorsement already in Venice and Prato in the late 14th century; Denzel (2006), pp. 14-5.

[235] See, in more detail, Denzel (2014), p. 260; and, in the German literature, especially, Schneider (1989).

[236] More on the Wisselbank, Cassis and Cottrell (2015), pp. 18-24.

in the Yiddish idiom, see Moshenskyi, 2008, and thus literally meant the "Bill of Exchange Bank"). In many respects, it superseded (and for some time even prohibited) the operations and the system of the money changers.[237] There was the idea of installing a public bank with elements of central banking as we know it today[238]. The Bank of Amsterdam allowed merchants to set up accounts that were denominated in a single, standardized currency, which finally led to the system of cheques and direct debits or transfers that we similarly use today.[239] At the Bank of Amsterdam, multilateral settlements were conducted on a daily basis, whereby merchants were obliged to use accounts with the Bank of Amsterdam.[240]

The Bank of England, founded in 1694 as a privately-owned and profit-oriented enterprise and the first chartered bank in the United Kingdom, was also part of a

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[237] Dehing and 't Hart (1997), pp. 43-4.

[238] See Quinn and Roberds (2005). They also state that "the Wisselbank formed the crucial link between exchange banks and central banks that would follow", ibid., p. 35. On the development of Central Banks, see also Capie et al. (1994); however, they don't even mention the Bank of Amsterdam.

[239] Ferguson (2008), p. 48.

[240] Geva (2011), p. 366. As a consequence of its decision to hold a 100 per cent reserve ratio, the Wisselbank was not involved in credit creation in its early years - as opposed to the Swedish Stockholm Banco, later styled Riksbank, almost fifty years later. The oldest central bank in the sense of continuous operations, the Swedish Riksbank, was originally founded as a private concern in 1656 by Johan Palmstruch from Amsterdam. After its bankruptcy, it was not closed, but taken over by the state in 1668, as the potential of such an institution caught the eye of state-level decision-makers. The Riksbank was involved in clearing payments in commerce, though not significantly; Swedish bills of exchange were drawn on Amsterdam and also Hamburg, see Kindleberger (1984), p. 50.

correspondent banking system. It mainly used correspondents for remitting cash abroad; during the wars against Louis XIV of France, necessary payments in Flanders and other places were conducted through correspondent relations with Dutch banks[241] and merchants. Due to the multi-national and long-lasting impact of the design of modern English banking that largely started with the founding of the Bank of England, this important, and later even globally dominant bank serves as an important case study to explore the early modern archival evidence for correspondent banking relationships and transactions.[242] We shall return to this case in the following Chapters 5 and 6.

[241] Capie et al. (1994), p. 127.

[242] In the 18th century, smaller Scottish banks, but also public banks in Scotland relied on their London correspondents (see Cowen and Kroszner (1989), p. 227) as they were not allowed to establish or operate their own offices in London. Cowen and Kroszner (ibid., pp. 227-8) point out that "London correspondent banks were crucial to the Scottish banks' operation" because the discounting of bills that were drawn on City of London banks formed a considerable part of the business of banks in Scotland. In this context, it is notable that the small number of bank runs and defaults in Scotland had their origin in the crashes of London correspondents.

Chapter 5 Paving the way for the Bank of England over Five Centuries - with Bills, Correspondents and Agents

1. 1694: a bankrupt crown at war - with the enemy and its remittance system

At the close of the 17th century, England was at war. Again. This time with France, the War of the Grand Alliance, also known as the Nine Years' War.[1] The Crown ran out of money. Again. Strained commerce, high prices and what some might identify as underdeveloped skillsets of the Exchequer-Treasury led to what Charles Kindleberger (1984) called a chaotic assortment of obligations issued by the English government.[2] How could England cover the massive surge of government expenditure during the first six years of the Nine Years' War (1688-1697)?

William III (1650-1702) needed the impressive sum of £3,481,585 for his armed forces between November 5, 1688 and September 29, 1691.[3] This came after comparatively modest yearly costs of £283,000 for the – admittedly - much smaller army of Charles II (1630-1685) in 1684 and annual spending of £620,322 for the troops of James II (1633-1701[4]) (the latter not having proven to be money well spent, as his troops deserted him to join William, the foreign invader). The expenditures under William III were immense and Childs (1987, p. 153) is correct when he calls this surge in costs a seismic shock to the political and financial system. William Blathwait's (1649-1717) correspondence reflects

[1] We find different names for this war: most common in British literature, and neutral in its tone, is the term "Nine Years' War". Others speak of the "War of the League of Augsburg" or, especially American scholars, of "King William's War"; see, in more detail, Childs (1991), p. 5.

[2] Kindleberger (1984), p. 75.

[3] Kleer (2017, p. 32) reminds us of even more substantial total expenses of the Crown between the years 1693-1697 of £ 6.9 million per year with an average annual income of only £ 4.0 million (as opposed to costs of circa £ 2.1 million per year before the Nine Years' War); see also Chandaman (1975), p. 361, and Jones (1988), pp. 70-1.

[4] James II was deposed in 1688.

the despair of the acting Secretary at War liaising between the King and the Treasury. In a letter to him, Sidney Godolphin (1645-1712), the First Lord of the Treasury, urged Blathwait on June 28, 1692 to

> "provide for the subsistence of the Hanover troops in our weekly returns. All I can say to that matter is that this being still another extraordinary [...] and the funds for the public service of this year falling extremely short of the necessary charge of the ordinary estimates given to the parliament, we must endeavour, and with no small difficulty, to run the king in debt as far as we can and anticipate his whole revenue anew."[5]

Over decades, English kings had depended on traditional methods to fund their expenses: Only relying on taxation, debasing coinage, and borrowing. This ceased to be a success model already years before, as Charles I (1600-1649) desperately tried to avoid complete ruin of the crown.[6] Unforgotten, also, the financial embarrassments of the illustrious Charles II[7], who owed goldsmiths the remarkable sum of more than 1,300,000 pounds in 1672, causing a financial crisis after the Treasury halted payment for 12 months, and bankers suspended their payments as well.

Finally, after years of intense debates, an innovative idea turned into reality, when, allegedly based on thoughts of William Paterson (1658-1719), some wealthy London

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[5] The correspondence can be found in the British Library, Add.MSS. 9,735, f. 57, 28 June 1692. See also Childs (1987), p. 153.

[6] Andréadès (1909, p. 20) identifies a certain irony in the erratic moves of Charles I, especially in his decision to seize bullion which had been deposited by merchants in the London's Tower; this move finally led, according to Andréadès, "to the rise of banking" and it "delayed the foundation of a national bank".

[7] See, for example, the description of banking under the reign of Charles II after the Restoration by Andréadès (1909), pp. 32-42.

merchants around Michael Godfrey (1658-1695)[8] aligned public needs for war loans with monetary modernism and, unsurprisingly, explicit private profit expectations: It was the hour of birth for the Bank of England, established in 1694, on the business model that it would create the money that the government would then borrow at interest.[9].

The interaction of public and private desires that led to the instalment of the Bank of England was facilitated by assisting the government's urgent need of marketing national debt in war times, whereas the business interests of some clever individuals should be fulfilled by issuing and lending newly issued banknotes.[10] The Bank of England in its early years was repeatedly praised for its innovations and pioneering ventures; many authors draw attention to the moment when the Bank of England was granted parliamentary authority to issue bank notes, although we must not disregard that the Swedish Bank of Stockholm received a royal charter to issue paper money decades earlier to replace the infamously cumbersome Swedish copper coinage (a fact less known, as the original

[8] On Michael Godfrey's role, see Andréadès (1909), Chapter IV, Jones (1972); but also Kleer (2017), pp. 47-51, who convincingly explains why Paterson ultimately cannot be seen as the Bank's inventor since his original proposals differed quite significantly from Godfrey's final design that prevailed in the end (contrasting, among others, Kindleberger (1984, p. 53) who saw Paterson as the one that led the "men who started the Bank").

[9] Lovell (1957, p. 8) speaks of a "financially embarrassed crown". The Bank of England was officially founded through the Ways and Means Act of June 1694, confirmed on July 27, 1694, by a Royal Charter of Incorporation. Davies (2002, p. 259) suggests that "[t]he Act makes it clear that its real purpose was to raise money for the War of the League of Augsburg by taxation and by the novel device of a permanent loan, the bank being very much a secondary matter, though essential to guarantee the success of the main purpose."

[10] Kindleberger (1984), pp. 52-3. Moshenskyi (2008, p. 164) correctly remarks that the Bank of England successfully avoided some mistakes of Italian and German bankers in the 16th century, such as combining short-term credits to private individuals – lent through buying of merchant notes – and long-term credits offered to the government or state.

Stockholm Banco fell into bankruptcy in 1661 only three years after being established).[11]

The plan of forming a "public" bank in London, with branches in some other important towns was already heavily debated for several decades.[12] The London merchant Samuel Lambe, for example, proposed the outline of a bank to Oliver Cromwell already in 1658.[13] Many other plans, probably more than a hundred, for a national bank were circulated in the years after 1640[14] – though partly with highly questionable intellectual quality[15]. Thus, the idea of London's first public bank was certainly not revolutionary for the late 17th century. Ironically, the driving force for the men who set up the Bank of England was individual profit - far from the noble idea of public service. This may explain the reluctance of the Stuart kings to agree to any and all of these proposals.

The freshly installed Dutch monarch took a different view. The ways, options and procedures of the newly established bank to accumulate the urgently needed funds (by subscription) in order to generate funds for William III's government have repeatedly been

[11] See Van der Wee (1997), p. 185.

[12] Rogers (1887, pp. vii-viii) points at different models ranging from a bank under the management of the City that would have resembled the Bank of Amsterdam to institutions based on existing (manufacturing) companies. The general idea of public banks is of much older origin. It saw parallels in the services of the Templars and the Knights of St John and Jerusalem (see also Chapter 4); it started to flourish from the 11th century in Italy (most notably with the Venetian Rialto bank), see Kerridge (1988), p. 1.

[13] See Rogers (1887), p. vii, who incorrectly attributes the first name "John" to Lambe.

[14] See the comprehensive analysis of Horsefield (1960).

[15] Andréadès (1909, p. 9, Footnote 3) values in his unmistakable attitude many of the "pamphlets devoted to the Bank of England [as] absurd or childish from an economic point of view". An early, though incomplete bibliography of works relating to the Bank of England was published by Stephens (1897).

described elsewhere.[16]

However, the crown not only needed money but also faced the very practical problem of paying the troops in the Netherlands, which was not directly resolved by just creating a privately held financial institution in the City of London. A system had to be put in place that allowed reliable long-distance funds remittances to pay the army abroad. In other words, a process was needed to provide local currencies for the English troops abroad.

2. Centuries XIII-XVII: Eclecticism, adaptation or innovation?

Up until the formation of the Bank of England, it was common practice by the Treasury to find contractors for their remittance efforts. Kleer (2017, p. 89) refers to two goldsmiths, Sir Stephen Evance and Sir Josiah (or Joseph) Herne[17], who were the Treasury's preferred experts to carry out its remittance obligations. However, both long-standing contractors lost their positions in a bidding competition with delegates of the Bank of England.[18] Yet, was the new institution inclined to come up with a new, innovative concept? Not exactly.

In order to fulfil its obligations to its soldiers on the European continent, England, and especially the Bank of England, had to fall back upon well-known models like using bills of exchange and representation through agencies and correspondents. Were they prepared for this? In the archive of the Bank of England we find a highly informative ledger with the records of the remittances, or "remises", from October 1694 to June 1700 as well as a collection of "Receipts for money paid beyond Sea for acco^{t}. of the Bank of England" that

[16] Richards (1929); Acres (1931); Clapham (1944), Vol. I; Horsefield (1960); Rubini (1970); Kleer (2017), pp. 47-71; Kynaston (2017). But also already Francis (1847), pp. 37-54; Rogers (1887); and, as eminent primary sources, Paterson (1694), and Godfrey (1695).

[17] From 1690 to 1692, Herne also served as Governor of the East India Company.

[18] See Kleer (2017), pp. 89-90, referring to Treasury Minutes of September 1694 (BL, Lansdowne MS 1215).

comprises of 83 receipts of the years 1694-1698 (*Figure 4)*.

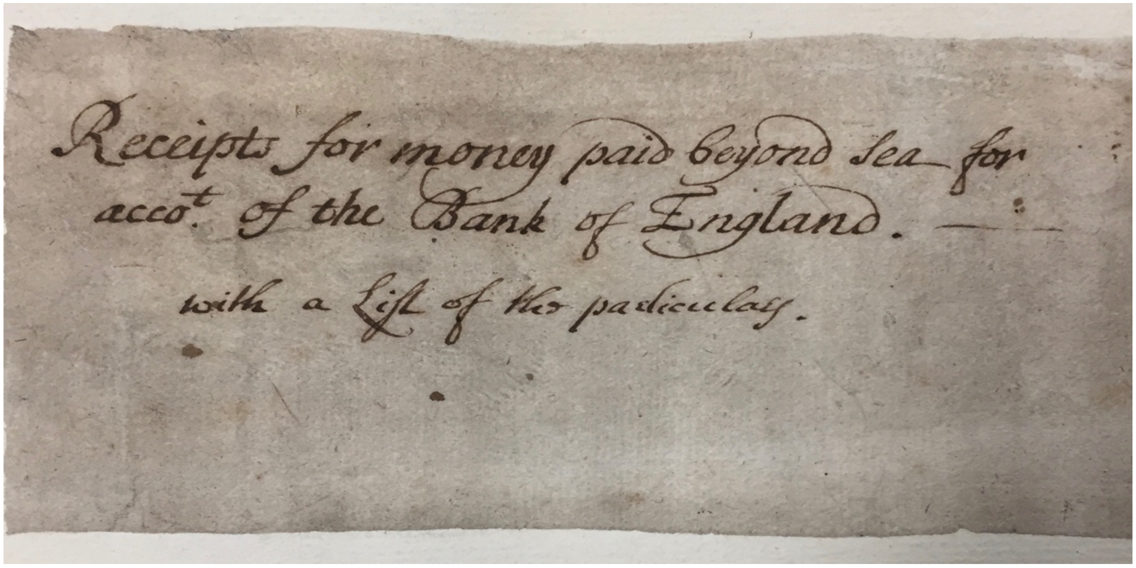

Figure 4: Receipts for money paid abroad on account of the Bank of England, 1694-1698, Archives of the Bank of England

a. Bills of Exchange in England – imported for export

These receipts bring to light that the preferred method to transfer funds to armed forces out of area were bills of exchange[19], an instrument initially developed to give merchants an option to clear overseas debts and to optimize far-distance transactions without the necessity to ship specie.

We may call it a *reciprocal historical development* that England paid its soldiers in the Netherlands using financial instruments that, to a wide extent, came to London via Dutch and Italian merchants. England's pride in its merchant bankers has been expressed in many colourful ways. Yet often these praises suppress the fact that the modern roots of this banking method do not lie in London of the 17th and 18th centuries, but in medieval continental cities and trading centres.

[19] To a certain extent, the Bank of England also used a combination of letters of credit and bills of exchange in dual letter-bill cycles. See, in great detail, Chapter 6.

The financial methods and interactions between London and the Netherlands were influenced by models that had been (re)developed in continental Europe by Italian merchants from cities like Genoa, Florence, and Venice. Merchant banking arrived in England along the trade routes that spanned from northern Italy to the Netherlands and eventually across the Channel. As a consequence of this commercial revolution that manifested no later than in the 13th century, merchants in Genoa, Florence, and other northern Italian financial hubs (re)invented the bill of exchange, an instrument that had ancient roots. Cashless payment via bills of exchange was one of the most influential "export products" of Italian merchants outside their own borders.[20] It appeared in the North, via the fairs of Champagne in the financial centres of Bruges, Paris, Geneva, Lyon, and London not only by the 14th century at the latest[21], but already in the 13th century. We will look at a bill of exchange structure between England and Rome dating back to 1235 in more detail below.[22]

Especially in the context of the wool trade, England encountered (and learned from) the skillset of Italian firms or syndicates who acted as royal bankers from the time of Edward I (1239-1307).[23]

However, Moshenskyi (2008) and already Postan (1930) remind us of so-called letters of commitment, or "*littera obligatores*", respectively "recognisances", that developed independently of continental influence and can be traced back to at least the 13th century.[24]

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[20] Some German historians see a separate form of "northern bill" that was created by merchants from the Hanseatic League since the 13th century, see Neumann (1863) and Stobbe (1865).

[21] Thomas (1932); Denzel (2014), p. 256. Especially during the second half of the so-called *Commercial Revolution* or, as some historians would call it, "the long 13th century", from around 1180 to around 1320, European fairs "proliferated and flourished" (Munro, 2001, p. 4).

[22] See 2.a.bb.

[23] Power (1941), p. 33, pointing at the Riccardi of Lucca, the Frescobaldi of Florence, as well as the Bardi and Peruzzi of Florence.

[24] The Acton Burnell's Statute (1283), for instance, alludes to letters of commitment in its last clause, see Postan (1930), pp. 38-40, who also generally refers to the Letter Books A and B in the London City

They are not to be confused with bills of exchange, despite the regular use of the term "bill". In this early form, it regularly meant informal "bills obligatory" or an informal promissory note.[25]

In 1622, Gerard Malynes explained in his "Lex Mercatoria" such bills as follows:

> "The most usuall buying and selling of Commodities beyond the seas, in the course of Traffick, is by Bills of Dept, or Obligations, called Bills Obligatory, which one merchant giveth unto another, for Commodities bought or sold, which is altogether used by the Merchants Adventurers of *Amsterdam, Middleborough, Hamborough*,

Records, where hundreds of "recognisances [were] enroled in the last quarter of the thirteenth century." In more detail Sharpe (1899), who states that "[t]hese recognizances, however, have their value as illustrating the commercial intercourse of the citizens of London with Gascony and Spain in the thirteenth and fourteenth centuries, more especially in connexion with wine and leather." We find further clarifications in commentaries to Letter Book A, e.g., Folio 36b, Footnote 24: "The Stat. 11 Edward I., ordaining the *Statute Merchant* for recovery of debts. It enacted (*inter alia*) that recognizances of debts should be taken before the Mayor and a clerk appointed by the King, and that the recognizances should bear the debtor's seal and also the 'King's seal," to be provided for the purpose." See also Moshenskyi (2008), pp. 159-60, who also references to the Statute.

[25] Some of the earliest (European) paper instruments to facilitate commercial transactions were the *instrumentum ex causa cambii*, a promise to pay, formally notarized, see in more detail Blomquist (1990), and Moshenskyi (2008), pp. 85-98. The *cambium* contract can be distinguished from a bill of exchange by its "due date" (the latter usually became due at a fixed period of time after issuing, the former was due during the settlement phase of the next fair), and, generally, by its goal (the cambium contract was a promise to pay whereas the bill of exchange could be called an order to pay), see Kohn (1999b). Some authors see the so-called *lettres de foire* of the Champagne fairs as even earlier cashless transaction methods (Denzel, 2006, p. 4; Goldschmidt, 1892) placing their emergence into the second half of the 12th century. However, see de Roover (1974), p. 203: "In my opinion, the instrumentum ex causa cambii is undoubtedly the prototype of the bill of exchange, for it fulfilled exactly the same function. True, the instrumentum took the form of a promise to pay, whereas the bill of exchange is an order to pay, but this distinction, being purely formal, is more superficial than real."

and other places [...]"[26].

Usually, this payment-promise only involved two or three people, although it could also entail representatives of both parties: the merchant who borrowed the money could use an agent to pay it back at a later fair, and the lending merchant could ask a representative to collect the payment.[27] However, in general none of them would be a correspondent, as these third parties lacked the necessary independence for this form of representation.[28] The bill obligatory was widely used until the end of the 16th century before being superseded step by step by the bill of exchange for international transactions. It remained relevant on the domestic level, though, but, due to its structure, not for the (international) remittance payments in question.

The simple model of a bill of exchange, in turn, comprises four parties (*Illustration 1*). Suppose we have merchant A in London who wants to pay his supplier B in Hamburg. In order to avoid shipping commodities with all risks implied, A could find another merchant C (or bank) in London who was owed by a party D in Hamburg at least as much as A could demand from B. Then C could draw a bill on D with the instruction that D had to pay B in Hamburg the currency equivalent of what A owed B. C would sell the bill to A, who would remit the bill to B who, in turn, would present the bill to D and eventually get paid the owed amount.

The instrument of bills of exchange was well known and widely used in 17th-century Europe, and it was not surprising that astute and knowledgeable individuals would use different versions of the model to facilitate funding of troops in missions abroad. Letters of credit had also been used for trade procedures since ancient times (incorporating correspondents and other representatives), but these did not serve as primary role models

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[26] Malynes (1622), p. 71. On page 72, he also mentions "Antuerp" (Antwerp) as a place where this custom is "much practised".

[27] Denzel (2006), p. 3, Footnote 8.

[28] We describe exceptions to this observation below, Chapter 5 2.b.aa.

for England's remittance challenges prior to and during the 17th century.[29]

A method that, over the centuries, had proven to be the safer option for long-distance payments in times of peace was, not surprisingly, also the preferred way to transact remittances during wartime.

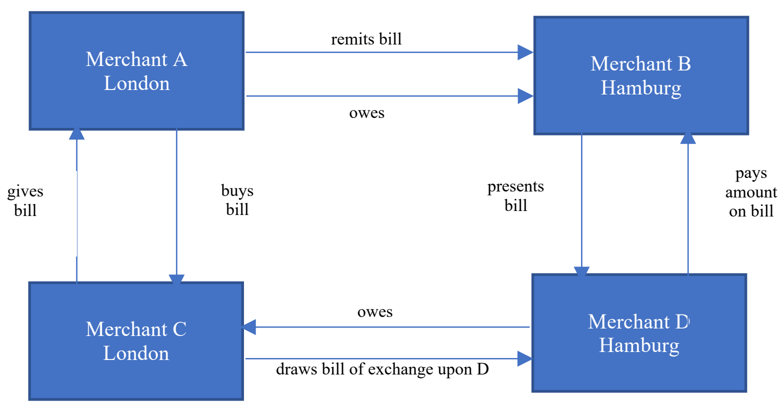

Illustration 1: Basic model of a bill of exchange including four parties at two different locations.

aa. London and Antwerp – brothers in arms – a special relationship

In England, from medieval times until the mid-17th century, foreign bills of exchange were mainly negotiated by merchants from Italy and the Netherlands.[30] Until the reign of James VI and I (1566-1625), the kingdoms of England and Scotland had to rely on banking that was still without bankers, as Kerridge (1988, p. 47) so uncompromisingly articulated. Still, it is worth noting that England developed its own law of bills and notes without borrowing

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[29] Letters of credit were only used occasionally for England's remittance challenges in the 17th century, and mostly in combination with bills of exchange that were needed to compensate representatives abroad, see in detail Chapter 6.

[30] Carlos and Neal (2011), p. 25. On the early use of bills of exchange in England, see also the important work of Munro (1979 and 1990).

the rules from foreign sources.[31]

But it was on the other side of the Channel again - in Bruges and Antwerp - where we find the innovative breeding grounds for the idea that bills of exchange could be tradable, fungible goods. The method of enabling a third party not involved in the original transaction to present the bill and accept payment (endorsement) had been cultivated in these financial centres.[32] Since the second half of the 15th century - together with Lyon - Antwerp had become the most eminent financial hub and market on the continent, taking over this role from Bruges.[33] In the 16th century, Antwerp needed to find innovative financial instruments to support the flourishing international trade in and from the city.[34] Denzel (2014, p. 260) identifies endorsed bills as early as 1436 in London court records, and in 1507 in Antwerp[35].

A long-standing myth, namely that the English banking system was largely inspired by the Bank of Amsterdam and its early stimulus from the Bank of Venice and the Genoese Casa di San Giorgio[36] needs to be corrected. Van der Wee (1997) points at a more decisive influence finding its way from Antwerp to London.[37] Even Amsterdam's private bankers got their main

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[31] See, in general, the insightful work of Rogers (1995), here, especially, p. 2; Moshenskyi (2008), pp. 159-68.

[32] Denzel (2014), pp. 258-9.

[33] See Denzel (2014), p. 257, who emphasises that the decline of Bruges was caused by the war between Maximilian I of Habsburg (1459-1519) and France, which forced Bruges' merchants to abandon the city between 1484 and 1517.

[34] Van der Wee (1963) offers an in-depth description of Antwerp's innovative and standard setting steps in financing trade.

[35] The evidence can be found in London court records and in the Antwerp Municipal Law Court.

[36] See on this connection, for instance, Kindleberger (1984), p. 52.

[37] In his early and standard setting work, van der Wee (1963), gives a thorough description of how Antwerp developed in the 16th century modern and innovative financial instruments to finance the expansion of its international trade.

impulses from earlier inventions made in Antwerp.

In the 16th century, close ties between London and Antwerp already existed. Examples are the interaction between London Merchant Adventurers and the market of Antwerp, connections of the crown to the Antwerp money market, the fact that the Royal Exchange, established in London in 1571, fully resembled the Antwerp Exchange and the movement of many Protestant Antwerp merchants and bankers to London who were forced to leave the Low Countries in the late 1500s.[38] Their influence on English banking techniques is undeniable.

Refinements like the transferability, the negotiability and the discounting of commercial paper were in its combination novel ideas created in Antwerp and brought to London where they grew over time into improved forms.[39] It is noteworthy that neither the Netherlands nor Britain was influenced by the Spanish empire under Philipp II (before they were able to emancipate with the British victory over the Spanish Armada (1588) and the Netherlands' Eighty Years War (1568-1648)[40]).

Although these banking methods advanced *private* clearing of payments, they were broadly adopted by England. The Netherlands finally set up the scheme of *public* clearing through the newly formed Bank of Amsterdam, established in 1609 taking the Rialto Bank of Venice as its model. The importance of Amsterdam grew after Antwerp became isolated through the closure of the river Scheldt in the wake of the siege and reconquest of Antwerp by Alexander Farnèse for Spain during the Eighty Years War (1585). The majority of Antwerp merchants had to conduct their trading activities now from Amsterdam.

In order to facilitate the merchant adventurers of England their transnational business (public) banks in Delft, Rotterdam and Hamburg provided facilities for payment on bills of

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[38] Van der Wee (1997), p. 184.

[39] See van der Wee (1993), p. 145 and (1997), p. 187. Denzel (2006, pp. 12-8) offers a concise description of the historic development of the "endorsement" of bills of exchange.

[40] Precisely, it was a revolt of the Seventeen Provinces, which we know today as Belgium, the Netherlands, Luxemburg, and France's Haute-de-France against Philipp II, then the sovereign of the Habsburg Netherlands, see, in detail, Israel (1995), and, already, Motley (1883).

exchange.[41]

Let us look again at the system of remittance payments to the troops in Flanders at the end of the 17th century.

One may wonder why the Bank of England first used and installed ties in Antwerp and not in Amsterdam to organize its remittance procedures. The Amsterdam banking system that was created in 1609, based to a wide extent on the tradition of the famous Italian banking houses, was an important milestone for multilateral clearing by concentrating all accounts in one institution and, therefore, a significant step forward in comparison to the procedures at the fairs from Lyon to Geneva or Bruges. [42]

However, despite all early successes of the Amsterdamsche Wisselbank (bank for bills of exchange), it lost its unique standing and influence for clearing and deposit banking in the late 17th century – while still keeping a dynamic and effective position as a money and capital market.[43] More importantly, the network of agents and correspondents between London and Antwerp had been developed over centuries. Especially from a (geo)strategic perspective, military payments via intermediaries located in Antwerp made more geographical sense due to the proximity to the troops and the major battle sites during the Nine Years War at Fleurus, Mons, Namur, Neerwinden, Liege, Charleroi, Brussels, and Oostende. Therefore, Amsterdam was a significant hub for clearing procedures, but in its early years the Bank of England chose Antwerp as its pivotal point for remittance payments.

Worth mentioning in the context of these payment arrangements is that the interaction of bankers on both sides of the Channel included the task of combining two distinct systems, the bank-oriented system of the Netherlands and the market-oriented system of Britain; both of them ascended in the 17th century and were destined to emerge into a symbiotic relationship in

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[41] Kerridge (1988), p. 2.

[42] Van der Wee (1997), pp. 179-80.

[43] Ibid., p. 180.

the 18th century.[44]

Not surprisingly, not a few scholars see the influence of Dutch financial advisers on Dutchman William III as decisive for Britain's financial reforms at the end of the 17th century.[45]

bb. England's early exposure to bills – trading with the continent

However, aside from the Low Countries' trade efforts in and with England, we encounter other early international trade relationships where London was involved in bill of exchange constellations. As mentioned above, bills of exchange derived from Italy and the continent before it became a common method for cashless payments by English merchants at the beginning of the 14th century. At that time, English merchants with business ties across the channel were well aware and acquainted with the benefits and advantages of this new payment model.[46]

Yet the general concept of this method was already known well before, as an (almost forgotten and morally quite questionable) example from 1235 lucidly demonstrates. Lawson (1850) reminds us, in his not entirely flawless History of Banking, of an episode that evolved between England's King Henry III (1207-1272, also known as Henry of

[44] In more detail, Carlos and Neal (2011), p. 24.

[45] Dickson (1967); Neal (1990); however, both underline London's innovative techniques to refine and improve the Dutch heritage. Earlier reforms of Britain's financial sector from Cromwell to Charles II are highlighted by Ashley (1934); Chandaman (1975); Braddick (1996); see Carlos and Neal (2011), p. 29. But see also, on the importance of mercantilism for the Anglo-Dutch relations in the 17th century, the highly instructive article by Rommelse (2010).

[46] Even other practices, where the bill of exchange was used solely for financial purposes, for instance, borrowing at one place and relending at another or as a method of credit via "exchange and rechange" (Kohn, 1999, p. 7), came to the attention of English merchants. Mueller (1997, Chapter 8) points at the common practice of Venetian merchants to travel to London in the 15th century. They saw London as a significant hub for Venetian exchange efforts as they were looking for credit lines longer than the typical forty-day period of a "cambium ad Venetias" through Florence, and the back and forth trip to England created a loan of six months.

Winchester) and Pope Gregory IX (c. 1145-1241). King Henry, significantly indebted to a growingly impatient Pope, adhered to the advice of the Bishop of Hereford who suggested the following remarkably wicked arrangement to secure the settlement with Rome: Italian merchants should be asked to draw bills upon wealthy clerics in England for money allegedly borrowed by them from creditors of the Italian merchants. After the bills were remitted to the Pope's legate in London, the English representatives of the church mentioned in the bills were forced to pay after being threatened to be excommunicated.[47]

Matthew Paris, the illustrious Benedictine monk and English Chronicler (c. 1200-1259), offers in his famous Chronica Majora an interesting and telling example of a letter that reflects the bill scheme as well as the fraudulent and deceitful plan behind it (*Figure 5*). For Paris, the strategy was mainly driven by "the horrible nuisance of the Caursines"[48], a term used for the Italian merchants in London at that time.

[47] Lawson (1850), pp. 36-7.

[48] Translated after Paris (1235/1571), p. 417: "Invaluit autem his diebus adeò Caursinorum pestis abominanda […]."

Quicquid agant homines intentio judicet omnes.

Debitores autem suos sub tali obligatione sibi obligaverunt: *Universis præsens scriptum visuris,* N. *Prior, & Conventus* N. *salutem in Domino. Noveritis nos mutuò recepisse apud* Londinum, *pro nostris & ecclesiæ nostræ negotiis utiliter expediendis, ab illo* N. *& illo* N. *pro se & sociis suis, civibus & mercatoribus civitatis* N. *centum & quatuor marcas bonorum & legalium esterlingorum, tredecim solidis & quatuor sterlingis pro marca qualibet computatis. De quibus centum & quatuor marcis, nomine nostro & ecclesiæ nostræ, benè nos vocamus quietos & integrè protestamus pacatos: exceptioni non numeratæ, non solutæ, & non traditæ nobis pecuniæ, ac etiam exceptioni, quòd dicta pecunia in usus nostros & ecclesiæ nostræ non sit conversa, omninò renunciantes. Quas prætaxatas centum & quatuor marcas sterlingorum, prædicto modo & numero computandas dictis mercatoribus, vel uni ipsorum, vel eorum certo nuncio, qui præsentes literas secum attulerit, in festo sancti* Petri *ad vincula, scilicet prima die mensis Augusti, apud* Novum Templum Londini, *anno Dominicæ incarnationis millesimo ducentesimo trigesimo quinto, per legitimam stipulationem promittimus, & tenemur nomine nostro & ecclesiæ nostræ, nos integrè soluturos, & reddituros. Tali tenore adjuncto, quòd si dicta pecunia prædictis loco & termino, sicut dictum est, non fuerit persoluta & reddita, ex tunc in anteà semper transacto termino promittimus, & tenemur per eandem stipulationem, dare & reddere prædictis mercatoribus, aut uni eorum, vel eorum certo nuncio, per singulos menses duos, pro singulis decem marcis, unam marcam dictæ monetæ, pro recompensatione damnorum, quæ damna & expensas ipsi mercatores ex hoc possent incurrere vel habere: ita quòd damna & expensæ & sors cum effectu peti possint, ut superiùs sunt expressa, & expensas unius mercatoris cum uno equo & cum uno serviente, ubicunque fuerit mercator, usque ad plenam solutionem omnium prædictorum. Expensas etiam factas & faciendas, pro ipsa pecunia recuperanda, reddemus & restaurabimus eisdem mercatoribus, vel uni eorum, vel eorum certo nuncio. Quam recompensationem damnorum interesse, & expensarum, promittimus dictis mercatoribus in sortem dicti debiti nullatenùs computari; ac non detinere dictum debitum sub prætextu recompensationis memoratæ, contra voluntatem prædictorum mercatorum, ultra terminum antedictum. Pro quibus omnibus antedictis, firmiter & plenariè adimplendis, & inviolabiliter observandis, obligamus nos & ecclesiam nostram, & successores nostros, & omnia bona nostra & ecclesiæ nostræ, mobilia & immobilia, ecclesiastica & mundana, habita & habenda, ubicunque fuerint inventa, mercatoribus antedictis, & eorum hæredibus, usque ad plenam solutionem omnium prædictorum, quæ bona ab eis precario nomine recognoscimus possidere. Et volumus super omnibus antedictis ubique & in omni foro conveniri, renunciando pro omnibus antedictis, pro nobis & successoribus nostris, omni juris auxilio canonici & civilis, privilegio clericatus & fori, epistolæ Divi* Adriani, *omni consuetudine & statuto, omnibus literis, indulgentiis, privilegiis, pro Rege* Angliæ *& omnibus regni sui à sede Apostolica impetratis & impetrandis, constitutioni de duabus dietis beneficio restitutionis in integrum, beneficio appellationis & recusationis, literis inhibitionis Regis* Angliæ, *& omni alii exceptioni reali & personali, quæ posset objici contra hoc instrumentum vel factum. Omnia ista promittimus fideliter observanda. In cujus rei testimonium, præsenti scripto sigilla nostra duximus apponenda. Acta die quinta Ælphegi, anno gratiæ M.C C. xxxv.* Talibus igitur inextri-

Figure 5: Facsimile of a description of a form used by Italian merchants in England to pay debts via a (deceitful) bill of exchange arrangement that occurred in the year 1235 in order to settle debts of King Henry III with the Pope, in: Matthew Paris' Chronica Majora (1235/1571, p. 418).[49]

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[49] Giles' (1852, pp. 2-4) translation of Paris's text from Latin into (19th century) English reads as follows: "The form by which the Caursines bound their debtors. " To all who shall see the present writings — the Prior and Convent of , Health in the Lord. — Be it known to you that we have received on loan, at London, for the purpose of use fully settling matters concerning us and our church, from such an one, and such an one, for themselves and their partners, citizens and merchants of the city of Milan, 104 marks of good and lawful money sterling, each mark being computed at 13 shillings and 4 pence sterling. For which 104 marks, we, in our own name and in the name of our church, do declare that we are quit, and do protest that we are fully paid, altogether renouncing any exception of the money not being reckoned, and paid, and handed over to us, and

also the exception that the said money has not been converted to our own uses and to the uses of our church. And the aforesaid one hundred and four marks sterling, in the manner and to the number aforesaid, to be reckoned to the said merchants, or to one of them, or to their certain emissary, who shall bring with him these present letters, on the feast of St. Peter ad Vincula, namely, the first day of the month of August, at the New Temple, London, in the year of our Lord's incarnation one thousand two hundred and thirty-five, we promise by lawful covenant, and bind ourselves, in our own name and in that of our church, that we will pay and discharge in full. Adding moreover this condition, that if the aforesaid money shall not be paid and discharged at the place and term aforesaid, as has been said, we promise from that time, at the term always before completed, and bind ourselves by the same covenant, to give and render to the aforesaid merchants, or their certain emissary, every two months, for every ten marks, one mark of the said money, in recompense for losses, which losses and expenses these merchants might incur or receive therefrom, so that the losses and expenses and principal may effectually be claimed, as they have been stated above, and the expenses of one merchant, with one horse and one servant, wherever the merchant shall be, until the full payment of all the aforesaid. And the expenses incurred and to be incurred, for recovering the same money, we will render and restore to the same merchants, or one of them, or their certain emissary. Which recompense for losses, interest, and expenses, we promise the said merchants in no wise shall be reckoned towards the principal of the said debt ; and not to keep back the said debt under pretence of the above-mentioned recompense, against the will of the aforesaid merchants, beyond the term aforesaid. For all which articles aforesaid, firmly and wholly to be fulfilled, and inviolably to be observed, we bind ourselves and our church, and our successors, and all our goods and those of our church, moveable and immoveable, ecclesiastical and temporal, in possession and hereafter to be in possession, wherever they shall be found, to the said merchants and their heirs, until the full payment of all the aforesaid; which goods we hereby recognise that we possess from them by a precarious tenure. And we consent on all the aforesaid to be convened in all places, and before any tribunal, and do renounce, for all the afore said, for ourselves and our successors, all the aid of law, both canon and civil, the privilege both of clerkship and of court, the letter of Saint Adrian, every custom and statute, all letters, indulgences, and privileges obtained, or to be here after obtained from the Apostolic See for the king of England and all the people of his kingdom, the constitution *De duabus dietis*, the benefit of full repayment, the benefit of appeal and of recusation, the inhibitory letters of the king of England, and all other exception, real and personal, which might be objected against this instrument or deed. All these things we promise faithfully shall be observed. In testimony of which matter we have thought it right to affix our seals to this present writing. Done on the fifth day of Elphege, in the year of grace

Many hidden treasures of medieval English adaptations of continental models can be found in the Calendar of Early Mayor's Court Rolls (1298-1307)[50] and the Calendar of the Plea and Memoranda Rolls of the City of London.[51] In the former, we find a highly illustrative description of a bill being used (not issued) by an Englishman in 1300. It seems obvious that more or less all bills of exchange around 1300 were still issued by Italians, though it did not exclude English merchants (or in our case a rector) to be the recipient of a letter of payment:

> "Geoffrey Beble, chaplain, complained to the Mayor and Aldermen that Antony, rector of the Church of Hurtts in the Archbishopric of Canterbury, who dwelt in his house as a member of his household, had stolen £17 out of his chamber and taken it to the house of Brachius Lumbard of the Society of Puche, to be paid out to him by the Society at Paris, and had received a letter addressed to the Society at Paris. The above Brachius was summoned and admitted the receipt of the money, and said that it had not been paid out in London or Paris, but that he did not know whether it had been paid by the Society elsewhere. As the said Antony was not in Court, and as the Society in Paris had written to the other Societies not to pay the money, and as it was not known whether any other Society had already paid, Brachius was forbidden to pay the money until further orders."[52]

In simple words, an English rector who had stolen money with the intention to flee out of

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MCCXXXV."

[50] Originally published by His Majesty's Stationery Office, London, 1924.

[51] The Calendar of Plea and Memoranda Rolls is preserved among the archives of the Corporation of the City of London at the Guildhall; edited by A. H. Thomas (Vols. 5 and 6 ed. by Philip E Jones) and printed by order of the Corporation under the direction of the Library Committee (Cambridge University Press, 1926-61). It consists of 6 Volumes and covers the years 1323-1482. Vol. 3 has the title: Calendar of select pleas and memoranda of the city of London preserved among the archives of the Corporation of the city of London at the Guildhall.

[52] Calendar of Early Mayor's Court Rolls (1298-1307), Membr. 1b (4 Oct. 1300), translated by the publishers of the 1924 edition.

the country gave the money to a member of the Italian merchant company of Pulci ("Puche") in order to receive a bill advising an agent or a branch (most probably not an autonomous correspondent as the wording "Society in Paris" suggests) to pay out the money to the rector. Although we obviously encounter a three-party arrangement in this case with the distinguishing factor that the drawer, and not the creditor, would have been the beneficiary (a structure that comes close to a letter of credit), it is not excluded that a fourth party could have used the letter to cash in the letter, as another example from the Calendar of Early Mayor's Court Rolls only a few years later exemplifies:

> "Vilanus Stolde and his companions of the Society of Perouche were attached to answer Peter de Maners for detinue of 100 marks which he entrusted to them, to be paid out at Andvers in Brabant a week later, or failing that, in London at Midlent, which money they now refuse to pay.
>
> The defendant admitted that some of his partners had received the money, but they had sent a letter to a partner, John Vyleyn, at Andvers by John de Maners, the plaintiff's brother, to pay the money, which they supposed had been done; but if the plaintiff would return the letter and prove that payment had not been made, they would satisfy him. As the plaintiff could not produce the letter and the defendants could not prove that payment had been made, a day was given to the parties to certify in Court on the above matters."[53]

In this constellation, the drawer of the bill - the company of the famous Italian merchant family Peruzzi ("Perouche") - was sued for failing payment after the brother (sic!) of the English purchaser of the bill had presented it in Antwerp ("Anvers").

Combining merchant activities between Italy, the Low Countries, and England via bills of exchange, became common practice early on as the Calendar of the Plea and Memoranda Rolls of the 14th century illustrate in addition to the Mayor's court cases:

> "John Botiller, hostiller, on behalf of himself and his partner Matthew Johan, paid in court to Peter Mark the sum of £100 on account of a certain exchange made at Bruges

[53] Ibid., Membr. 10b (8 July 1305).

> by William Agland, servant of Roger Morton of York, with Reyner Domenyk of Florence. It was agreed that the money should be repaid if the letter from the said William, presented by Peter Mark, should prove to be false."[54]

Here, in 1373, the court had to decide upon a typical case involving a bill of exchange, where an Italian (Johan) had to pay a sum drawn on him by another Italian in Bruges (Domenyk) to the recipient of a bill (Mark) in order to facilitate a business deal in the same city with the English representative (Agland) of a master (Morton) located in England.

The involvement of English merchants in such arrangements was not limited to the aforementioned regional area, though. Trade connections with German counterparts, for instance, became increasingly important as well. Not surprisingly, the parties relied on similar instruments to facilitate cashless long-distance transactions. Again, it is worthwhile to have a look at the Plea and Memoranda Rolls, where we find an interesting case that occurred in 1345, which, although it does not explicitly mention a bill, offers enough hints that this method of payment was used between two German ("of Almaine") merchants, one of them located in Bruges and the other one in England, and an English merchant and his representative in Bruges, who obviously issued a bill without the necessary power of attorney:

> "Simon de Brounesford, pepperer, was attached to answer Aluin Glemerod in a plea of debt owed to the plaintiff and to a certain Godescalcus Ludeleskete, merchants of Almaine. The plaintiff declared that he lent to Nicholas Elys, attorney of the defendant, the sum of £90 at Bruges, which the defendant refused to pay. The latter denied that the said Nicholas was his attorney, or his factor or apprentice, but had merely been sent to him by William de Edyndon, the King's Treasurer, on trial, to discover whether he was able to learn the defendant's trade, and thus he was not entitled to borrow on his behalf."[55]

Irsigler (1972) describes the case of a merchant of Cologne, Johann Rosenkrantz, who in the 1430s financed the acquisition of English cloth at the fairs in Antwerp by drawing bills

[54] Calendar of Plea and Memoranda Rolls, Vol. 2, Roll A18, Membr. 5b (19 May 1373).

[55] Calendar of Plea and Memoranda Rolls, Vol. 1, Roll A 5, Membr. 25b (4. February 1345).

of exchange on his uncle and principal Gerhard von dem Viehof (also based in Cologne), who sold the cloth and paid off his nephew's bills upon maturity.[56] This again entailed reciprocal bonds between merchants of Cologne and mercers from London who created a trading cycle with bills of exchange between the continent (Cologne and Antwerp) and England. Jenks (2017, p. 46) illustrates it as follows: Cologne merchants who needed funds to purchase English cloth for shipment to the fairs in Antwerp sold bills of exchange payable in Antwerp to the London mercers, who had surplus funds that they planned to remit to Antwerp for the fairs; after buying the cloth and shipping it to Antwerp, the Cologne merchants settled the bills there and remitted the left-over funds back to London by buying bills from the English mercers, who in turn used this money for their purchases at the Antwerp fairs before shipping them back to England, selling them there and paying off the bills, which routinely led to the next trading cycle with bills of exchange – almost a Perpetuum mobile of bills.

Another good impression of the growing importance of bills of exchange – used on both sides of the channel, in Calais and London - is given by the letters and papers of the wool merchants Cely & Sons. These cover the years 1472-1488 and can be found in the Public Record Office of Chancery.[57]

Figure 6 is one out of many examples in the collection of the Cely papers where we encounter references to the use of bills. In this letter (No. 37) of the younger Richard Cely to his brother George, we read about a directive where "Planttan pays you to delyver thys byll to hys brother Nowell zer se cum to Bolen."

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[56] Jenks (2017), pp. 45-6.

[57] The Cely papers consist of two volumes with numerous letters (The National Archives, Special Collections, Ancient Correspondence, SC 1/53 (1472-88), SC 1/59 (1476-79)), nine files entailing accounts and memoranda (Chancery Miscellanea C 47/37, Files 10-16, 20-1 (mainly 1481-89, some dates are unknown), three more letters/references are in SC 1/60/94 (1482), SC 1/60/89 (1491) and SC 1/63/309 (1480). The papers were published and edited by Hanham (1975), who also offers an in-depth analysis of the interactions and transactions of the Cely family. See also Thomas (1999), pp. 41-2.

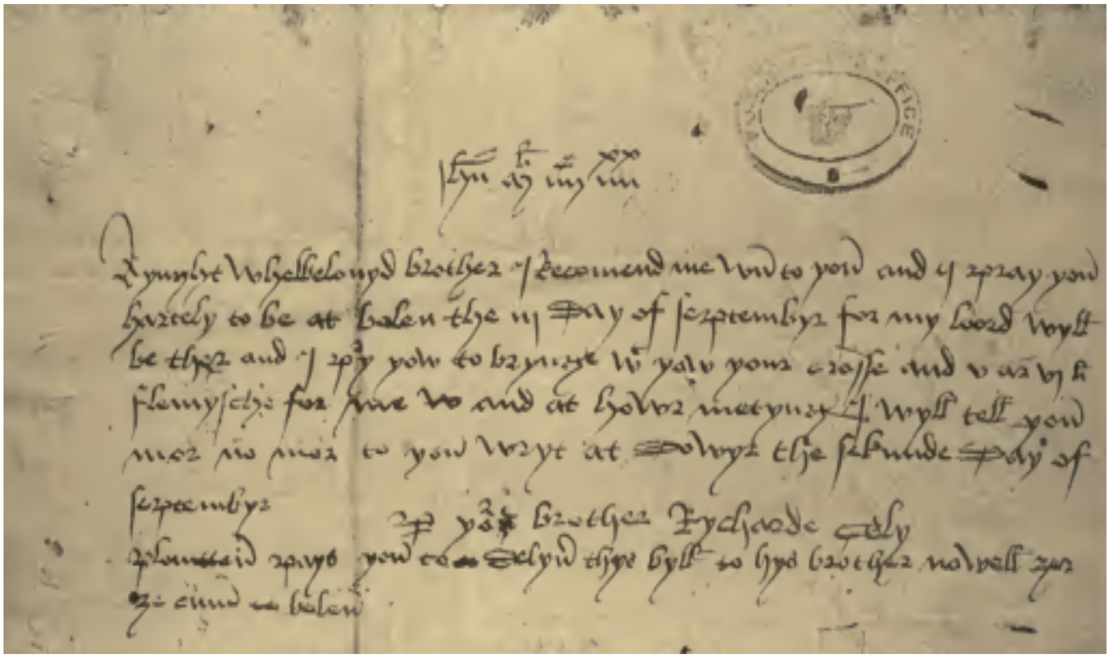

Figure 6: Facsimile of one of the Cely Papers, No 37, Dated September 2nd, 1480[58]

The Cely letters also exemplify the early business connections between England and Flanders – reflecting parts of a logistical fundament for the payment methods in the late 17^{th} century. Malden (1900), who edited the Cely Papers for the Royal Historical Society, sees Flanders as "the real market" for English merchants in the 15^{th} and most of the 16^{th}

[58] The text of letter No. 37 reads as follows:

Rychard Cely the younger

Jhesu $M^{l}iiij^{c}iiij^{xx}$

Ryught whelbelovyd brother I recomend me unto you and I pray you hartely to be at Bolen the iij day of Septembyr for my loord wyll be ther and I $pr^{a}y$ you to brynge w^{t} you your crosse and v ar vj li. Flemysche for me and howr metyng I wyll tell yow mor. No mor to you. Wryt at Dowyr the sekunde day of Septembyr.

per youre brother Rycharde Cely

Planttan pays you to delyver thys byll to hys brother Nowell zer se cum to Bolen.

Addressed: A my whelbelovyd brother George Cely at Calles so hit dd.

century, more than the other well-known trade centres of that time. In his words, "[i]t is scarcely too much to say that [England's] relations with Flanders were the dominant influence in English foreign politics […]"[59].

Yet the Cely papers uncover another surprise: The English Crown that kept a military garrison at Calais in those years needed to pay its troops in Flanders – a situation, obviously analogous to the malaise the Crown faced during the Nine Years' War in the late 17th century. Do we also encounter structural similarities regarding the resolution of this task? A letter from May 8, 1478, written by George Cely, who conducted the family business in Calais, to his father Richard, addresses the payment of English soldiers in foreign currency (as opposed to sterling) at the base in Calais. Collecting revenue in Flanders was a useful tool that would allow the Crown to pay its soldiers. The aforementioned letter may serve as evidence that both the collection and the payment, were – most likely not always, but in certain circumstances – conducted by merchants using bills:

"Jhesu M^{l}iiij^{c}lxxviij

> Ryght whorshypfull Fadyr aftyr all dew recomendassyon pretendyng I recomewnd me unto yow in the loliest whisse that I con or may Fordyr mor plesyth yt to undyrstone y resseywyd an lettyr from yow wrytt at London the forst day of May the whech lettyr I hawe rede and do whell undyrstonde I fell be yowre sayd lettyr ytt ys conclewdyd w^{t} the Kyng and hys counsell that whe shall pay the soudyar starlyng mony whe wher at losse ynowe affore thow ytt be no mor mony ys styll at Calles ij^{s} ij^{d} lowar than ytt ys in Flaundyrsse and now starleng mony to that ytt ys to grett an losse whe most soffyr ytt whe may nott chesse me semyth yff ytt could be browght anbowght that whe myght have an quyne at Callez agen and let non hoder many go in the town of Calles but starlyng mony than showld whe make bettyr shyfft and ytt showld nott torne us to so grett losse for now as the casse stondythe at thys tyme ther ys no merchant that spende an grott in the towne of Calles but they lesse an halpeny and men of the stapell breng the mony to Calles that ys browght ze may se what losse ys in grett somys but yff the

[59] Malden (1900), p. xiv.

> mayer and the fellyschup seke an remedy herfor ytt wyll be for the fellyschyp to grett an loss &c. Plesyth ytt yow to whett y felle by yowr wryttyng the schyp at London and ze wold shyp and se myght hawe any comefortt in good fayth ytt wher whell done that ze sheppyd also ze shall stonde in as good casse as any hothyr men & whan ytt ys at Calles the venter ys borne I thanke God ze hawe growyn at Calles to answer the costes & charagys of the same and hovyr and above that I trost to God to make yow hovyr at thys marte c^{li} ster: and mor and I may be whell payd as my hoppe ys y shall be in any whysse lett yowr felles come thys next sheppyng and yowr xix sarplers and a koke and aftyr yff God send fayr whedyr and good tydynges ze may dayly send mor &c. I woll be the grace of God unto thys syngsyon martte and ther I woll speke w^t John Vandyrhay and seche merchantes as I am acostomed to delle w^t y moste do as hothyr men dothe ar elles y most kepe stylle y undyrstode by John Daltonys wryttyng at London whan ytt come to me ther that he myght an sowlde all yowr wolle halfe in honde the tothyr halfe at Whyttsontyde ytt whas no mor but all your howlde woll knowe hym ryght whell that shall hawe any at that day y shall se at the marte what y may do yff I can do none bettyr I most do as hothyr men dothe &c whe have chossyn Robard Tate to be howyr lefftennawnt and he most be at Calles w^t in thys monyth no mor unto you at thys tyme but Jhesu have you and all yowrs in hys blssyd kepyng Amen wrytt at Calles the $viij^{th}$ of May lxxviij
>
> per yowr son
> G. Cely.
>
> *Addressed:* Unto my ryght whorshypfull Fadyr Rychard Cely merchant of the Stapell off Calles Dewellyng at London yn Martte Lane so it come."[60]

This example from the Cely Papers (which, despite its challenging syntax, is easy to comprehend) gives us an indication that the remittance system of the Bank of England - installed to serve the payment duties for the troops in Flanders in the 1690s - was far from being overwhelmingly innovative. The scheme of paying soldiers abroad via bills of exchange and of having merchants involved as intermediaries has its creative roots – at

[60] Primary source at The National Archives, SC 1/53/12 (Special Collections: Ancient Correspondence of the Chancery and the Exchequer). See also Malden (1900), pp. 6-7.

least for England – already in the 15th century.

b. Representation abroad – agents, branches and correspondents

Before we touch upon the Bank of England's early remittance procedures, mostly within the framework of bills of exchange (Chapter 6), a question arises regarding the form of overseas representation that the bank's first leadership would have considered and, again, how much creativity the solution would display.

Richards (1929, p. 25) places the origins of English banking in the transactions of merchants, brokers, scriveners, and goldsmiths with their financial intermediary skills, seeing them as "pioneers of the banker's trade in England".

The logical step from using bills of exchange to having correspondents on both sides of the transaction was, superficially, short. However, there have always been constellations within the model of drawing bills that allow "only" agents, servants, or other representatives with lesser independence than correspondents. We will see that the Bank of England installed an "Agency" in Antwerp in May 1695, and in the foreword to the receipts for payments abroad on the account of the Bank of England from 1694-1698 (Archives of the Bank of England), the unnamed author only refers to "agents". The receipts themselves, written in English, French, Italian, and Dutch do not contain any terms that stand for third party representation at all (like "agent", "correspondent", "factor", or "representative"). However, some of the receipts clearly describe the type of relationship between the player involved in the remittance efforts. And we shall see below that a good number of the so-called "agents" actually acted as correspondents.[61]

aa. Acting for merchants in medieval times

Before we draw this conclusion it has to be noted that the practice of using representatives like agents or branches to conduct business operations were well known and traditional procedures among English merchants even before bills of exchange were fully established.

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[61] In Chapter 6, we prove that even the so-called "Agency" at Antwerp cannot hold up to the preconditions of an agency. It, actually, was a branch of the Bank of England.

Above, we had already touched upon the method of letters of commitment. In general, the instruments of a cambium[62], letter obligatory, and letters of credit as orders or promises of payment in the future at a certain time and place, allowed the fulfilment by the drawer or his representative.

Kohn (1999, p. 4) ties the use of letters obligatory to regions where larger international trading companies were not prevalent and where smaller merchants would dominate long-distance trade. Particularly in areas that had no or only little involvement of Italian merchants, like in the Baltics, the letter obligatory became a preferred means of cashless remittance, and by the 14th century, it was in widespread use in England, France, and the Low Countries (in Antwerp, it kept its relevance well into the 16th century), before it expanded to the Hansa (that league of German-speaking city states) and Spain.[63]

The historian, Michael Postan (1930, p. 43), portrays the position of a person assigned by a merchant (creditor) to third parties for debt collection - described in records of the 14th and 15th centuries. However, Postan is sceptical about whether that assignee was solely asked for cashing in of debts. We share these doubts, especially if we read the primary sources of the example correctly. He refers to two quotes from the London City Records, Plea and Memoranda Rolls, as well as (vaguely) from the Public Record Office, Early Chancery Proceedings[64], from 1429 and 1431:

> "[On 15th November 1429] came [Bartolomew Contaryne], merchant of Venice and gave evidence that he had assigned to Stephen Forster, citizen and fishmonger, a debt of £ 152 10s 6d which was owed to him by Saier Acre and Nicholas Wyford, citizens and grocers, on an obligation of 2 April 1429 payable on

[62] On the northern Italian roots of the instrumentum ex causa cambii or cambium, see Blomquist (1990).

[63] Kohn (1999), pp. 4-5.

[64] The years 1429-31 are covered in the Early Chancery Proceedings C1/1/8, 16-7, and partly 68-75.

> 14 May 1430."[65]
>
> "[…]assignment by Baptista de Nigris, merchant of Genoa […], to William Estfeld, mercer, in payment of certain moneys owed to him, of a debt of £223 4s 2d due to himself and Laurence Markysano, merchant of Genoa, from Peter Jamys, burgess and merchant of Southampton, and John Wayther of Winchester […]".[66]

Postan assumes that these assignments were part of a wider scheme leading to the settlement of other debts. According to existing networks of Italian merchant families that, in the 14th century, already entailed agents and servants across Europe, Postan's speculation that there was no necessity of further special assignments is not unfeasible. In his words:

> "The usual purpose for which debts were assigned was the settlement of other debts. A merchant contracting an obligation to somebody else would 'set over' to him his own debts, and thus effect a payment without the actual employment of coin."

The fact that we are facing cashless settlements in at least three-party constellations conducted by merchants from another country shows an amount of independence of these intermediaries that distinguishes them clearly from a mere "agent" or "servant" relationship. This rather is a very early form of a correspondent relationship between Italian and English merchants.

Yet, in contrast to Postan, we find already much earlier evidence of such or similar arrangements:

Around 1380, court papers and letters that can be found in the Calendar of the Plea and

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[65] Calendar of the Plea and Memoranda Rolls of the City of London, Thomas (ed.) (1943), Roll A 58 (1429-30), Membr. 1b (15 November 1429). Postan (1930, p. 40), quotes the source incorrectly, as he places it in 1430 and in Roll A 57.

[66] Calendar of the Plea and Memoranda Rolls of the City of London, Thomas (ed.) (1943), A 59 (1430-31), Membr. 8 (27 September 1431); again, Postan (ibid.) was imprecise in his citation.

Memoranda Rolls of the City of London indicate a slow shift from mainly agent relationships between merchants from Southern Europe and their representatives in England to structures that come closer to correspondent liaisons. Aside from letters of attorney for businesses between Tuscany and London, for example, "from Affricanus de Piere, merchant of Sienna, to Bernard Antoigne and James Dyne, merchants of Florence" (29 December 1380) that resemble most likely the installation of an agent,[67] we encounter two letters of attorney from 1383 that are obviously reflections of a modification from a purely agent structure (both parties are still from the same Italian cities) to features of more independently acting correspondents (one representative for two different parties – all from the same city):

> "Letter of attorney from Jerome Arigi of Boloigne le Crasse (Bologna) to Saint de Bartilmeu de Saint of Bologna to receive and sue for debts due to him and to transact business on his behalf. Similar letter from Thomasin Lippy, merchant of Bologna."[68]

In addition, and only a month later, we come across a letter of attorney at the same court with explicitly less strict rules of engagement:

> "Letter of attorney from Cosmas de Aurea, merchant of Genoa, to John de Carlo, merchant of Genoa, to receive all sums due to him, both from his debtors and by way of exchange, and to transmit them to Genoa, and further to charge him with the payment of sums received on exchange, but this power of attorney was not to extend to binding the said Cosmas by obligations or making further payments than as expressed above."[69]

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[67] Calendar of the Plea and Memoranda Rolls of the City of London, Plea and Memoranda Rolls, Vol. 2, Roll A 24, Membr. 5 (29 December 1380).

[68] Calendar of the Plea and Memoranda Rolls of the City of London, Plea and Memoranda Rolls, Vol. 3, Roll A 26, Vol. 3 (1381-1412), Membr. 4 (9 June 1383).

[69] Ibid., Membr. 5b (2 July 1383).

In most cases it is extremely difficult to draw a clear line between the different forms of (international) representation and interaction of merchants in these times, as another court record of the year 1382 lucidly shows:

A Venetian merchant, Luke Bragadyn, “was summoned to answer Richard Morell and Henry Pensehurst, partners and merchants of London, in a plea for the payment of [a certain sum],

> […] as set forth in two bills, that by the immemorial custom of London and the law merchant a principal was bound to satisfy debts incurred by his recognised agent for merchandise bought on his behalf, where such merchandise accrued to his use and profit, and that the said Luke at Calais on 1 Jan. 1380(1) in the house of Paul Fraunceys, a common broker of the Staple there, inquired from the plaintiff Henry as to divers sorts of Coteswold wool which he and his partner had in Calais, and then showed him his signet and requested him, when his son Nicholas or some other agent should arrive bearing the signet, to deliver the wool to him and to take from him bonds for payment under the said signet, and that on 8 Jan. the said Nicholas arrived and took delivery of the wool, giving bonds for payment of the above amounts […], and that afterwards the said wool accrued to the use and profit of the defendant at Bruges […] in Flanders, but nevertheless the defendant refused to pay the above sums, to the plaintiffs' damage […]. After process continued, the defendant […] admitted the debt. He informed the court that he had sued a certain Peter Gracian to render account of business dealings between them […]. He was willing, if […] he had not paid to Peter the abovementioned sums of money, that he would himself pay them immediately to Nicholas Brembre, knight and merchant, to whom they had been assigned by the plaintiffs in satisfaction for debts owed by them to Nicholas.”[70]

In this example, we hear about the use of bills, bonds, agents and potential beneficiaries on both sides of the channel and the use of another merchant assigned to collect the debts in order to clear other debts. The description comes close to the structure of a bill of exchange;

[70] Ibid., Roll A 25, Membr. 13 (8 June 1382). Nicholas Brembre was Lord Mayor of London in 1377, and from 1383-1385.

however, the “bonds”, respectively “bills” that had been used are still lacking some signature elements of the typical four-party composition and interrelations of a bill of exchange.

As hard as it may seem to distinguish between agents and correspondents in medieval times, one example, mainly established in 15th-century England, stands out as an obvious and translucent case: in those years, England’s trade relations with the Low Countries were mainly formed and influenced by three groups, the Staplers, the Mercers, and the Merchant Adventurers. The latter sold cloth in Antwerp; the Staplers traded with wool in Calais, cashing it in at a later point at fairs in Bruges or Brabant; and the Mercers imported fabrics from the Low Countries to England.[71] The Mercers had to keep funds for payments on the continent, whereas the Staplers and Merchant Adventurers needed a way to facilitate the remittance of their funds in the Low Countries to England. The ideal method for coping with the reciprocal overseas transactions were bills of exchange, which allowed the respective players in the trade community to intertwine their business interests. Kohn (1999) correctly reminds us of the multiple roles played by the exponents of the different merchant groups: not only did they lend to each other, but - as takers of bills – they also provided remittance services.[72]

The interaction among Staplers, Merchant Adventurers, and Mercers was, due to the nature of their connection - echoing the independence of these merchant groups - a correspondent relationship and not an agent-principal arrangement.

bb. Goldsmiths – financial all-rounders as representatives

As indicated, trade in medieval England was mainly conducted by foreign merchants using foreign capital. The systematic approach of installing agents was as usual in London as in other trade centres across Europe. Some of these agents became independent merchants when the Crown indirectly forced agencies to leave by not fulfilling its payment obligations. Until the end of the 16th century, English goldsmiths, step by step, took over the role of these merchants that was predominantly defined by money lending and less by a

[71] Kohn (1999), p. 5

[72] Ibid., pp. 5-6.

role as an intermediary.[73]

In the 17th century, before the foundation of the Bank of England, goldsmiths were providing a remarkable spectrum of services to businesses in and from London and the countryside. They drew, accumulated, and discounted inland bills of exchange, and – according to Kerridge (1988, p. 70) – supplied their customers with bills on correspondents and agents in all the main towns.[74]

Both relationships with agents and correspondents existed already for quite some time, internationally and domestically. However, goldsmiths also appeared as correspondents themselves as some examples shall illustrate.

For domestic transactions, the goldsmiths had developed something we categorize as an *intra-goldsmith correspondent network*. Take, for instance, the Devon Estate and Personal Accounts of Sir Courtenay Pole (1619-1695), a member of Parliament, over the period from 1650-1658,[75] where he thoroughly describes the interaction of goldsmiths, mainly related to transactions within his own family. In many cases, money needed to be transferred from the estate in the countryside to Pole's father in London via bills of exchange. Some of these (twenty) bills were returned by Edward Anthony, who was a goldsmith from Exeter, and Ralph Herman, also a goldsmith, upon Nathaniel Potter, a goldsmith himself. Kerridge (1988, p. 70), who also reports about Pole's accounts in a different context, was still unsure of whether Ralph Herman could be called a goldsmith. However, there is ample evidence for this assumption. Chanter (1912) mentions Herman in

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[73] Bisschop (1910), pp. 15-6.

[74] In the course of the 17th century, goldsmith bankers from London began discounting bills of exchange; however, only in 1704, the so called Promissory Notes Act led to legal protection of the transferability of bills by endorsement, as Denzel (2014, p. 258, Footnote 3) points out; in more detail, see Rogers (1995), pp. 151-85.

[75] NRA 4613 Devon RO, 237M (1650-58). The accounts are held by the Devon Archives and Local Studies Service (South West Heritage Trust).

his extensive list of Exeter goldsmiths offering further primary sources.[76] A post-nuptial settlement note of Ralph and Jane Herman to Abraham and George Bryant of 1642 explicitly mentions Herman as "Exeter goldsmith" as well.[77]

Nathaniel Potter not only acted as a correspondent of Ralph Herman in London, but Herman was also a recurring correspondent of Potter.[78] In Sir Courtenay Pole's accounts, we find phrasing that typically stands for correspondent relationships as for example: "[…] returned of William Searles money by Mr Anthonie of Exeter goldsmith upon Mr Nathaniel Potter goldsmith […] by bill dated September 16th."

Another example of domestic correspondent relationships is the connection between Thomas Smith (1631-1699), founder of the Smith Bank in Nottingham (established around 1658), and the London goldsmith bankers, Edward Backwell and Gilbert Whitehall.[79] Inter-goldsmiths relationships also occurred when London-based goldsmiths obtained estates outside London and became remitters for their rural neighbours.[80] At the same time these protagonists potentially acted as *dual correspondents* in two different locations.

After the founding of the Bank of England, the Smith Bank in Nottingham held an agent in London (most notably Thomas Smith's brother, Samuel, who remained a partner in the Nottingham "headquarters", but became a goldsmith in London). According to his degree of dependence and personal ties to the bank in Nottingham, he clearly was no correspondent, but he held with his house in London an account at the Bank of England –

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[76] Chanter (1912, p. 440) identifies goldsmiths in Exeter already in the 14th century

[77] The original of this settlement note ("Post Nuptial Settlement – Ralph Herman, Exeter goldsmith and Jane his wife to Abraham Bryant of Burton, Dorset, gent and George Bryant of Broadwinsor, Dorset, gent., brothers of Jane Herman") can also be found at Devon Archives and Local Studies Service (South West Heritage Trust).

[78] See the Devon Estate and Personal Accounts of Sir Courtenay Pole, NRA 4613 Devon RO, 237M (1650-58), and Kerridge (1988), ibid., mentioning other correspondents in Exeter and Cornhill.

[79] Kerridge (1988), pp. 70-1.

[80] Ibid.

and so did the house in Nottingham, both using the Bank of England as a correspondent for certain businesses.[81]

Country banks in England regularly kept their liquid reserves as deposit balances with their correspondent banks in London, settling payments through transfers among these accounts.[82]

In the English system of tax collection in the 17th century, we know about local collectors and – hierarchically higher – receiver-generals who were responsible for paying land taxes into the Exchequer's accounts. These receiver-generals facilitated this duty themselves or used London-based correspondents – they were also allowed to use "inland bills of exchange" and to send them to their correspondents.[83] To some extent, the receiver general himself acted as a correspondent of the government by not only accepting payments on behalf of the government, but also making payments to the government on behalf of third parties.

But also, and in our context more importantly, *international* correspondent networks had been well known in England even before structures were to be installed to remit money to the troops in Flanders.

An example from the 17th century: The aforementioned goldsmith Edward Backwell not only was aware of the advantages of a domestic correspondent network but also undertook wide-ranging exchange transactions overseas by using correspondents in a foreign bill of exchange model. To find evidence of the goldsmiths' ways to conduct their businesses as well as their transaction methods, it is worthwhile looking into the Exchequer of Receipt's

[81] Cassis and Cottrell (2015), pp. 47-8.

[82] Hotson (2017), pp. 121-2.

[83] Kleer (2017), p. 39, who confuses "agents" and "correspondents" in this context; the correspondents of the receiver-generals, or "Excise cashiers", eventually – according to their title – cashed the inland bills before paying in specie to the Exchequer.

records,[84] especially the so-called "The Bankers Booke of Interest"[85] and "A Booke for entringe of the Accompts of Goldsmiths and others."[86] In the 1670s, Backwell was, along with the goldsmith banker Sir Robert Vyner, the government's main creditor.[87] His international correspondent network is mentioned, for instance, in the second of the accounts encompassing Backwell's loans recorded in "The Bankers Booke of Interest", where we find a payment in Cadiz of £10,508 11*s.* 6*d.* of a loan of £16,000 to the Treasurers of the Navy

> "in peeces of eight to Sir Edward Spragg the 21st of February 1671 by John Mathew, Edward Backwell's correspondent there, and charged on him here by two bills of exchange dated the same day." [88]

This primary source is of interest for two reasons: first, it reflects the use of correspondents by British goldsmiths in foreign bills of exchange arrangements. Second, it is a pre-Nine Year War example of remittances to troops overseas.

Clapham (1944, Vol 1, p. 10) affirms that goldsmith bankers "[i]n the early years of the Restoration […] had correspondents for foreign exchange business" with funds at their disposal to discount bills and obligations. In an interesting comment he uses a term, "bankers' bankers" that became very common in later decades to describe the role of correspondents.[89] Some of these early goldsmiths' correspondents have been identified,

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[84] Richards (1929, Chapter III) offers an in depth analysis of the relationship and transactions between the goldsmiths bankers and the Exchequer, in the second half of the 17th century, based on the Exchequer books.

[85] Public Record Office, Records of the Exchequer of Receipt, E 403/3019.

[86] Ibid., E 407/33-34, two parts.

[87] Richards (1929), p. 93.

[88] Public Record Office, Records of the Exchequer of Receipt, E 403/3019/154.

[89] Clapham (1944), Vol 1, p. 10: "And since "at least two" of them held money for others, it is not fantastic to speak of "bankers' bankers"; though to speak of central banking would be excessive."

often goldsmiths themselves, such as, for instance, Edward Backwell and Sir Robert Vyner.[90]

In his “Essay on Banking”, Thomas Joplin (1822, pp. 1-2) sees banks not only as “the fountains of our currency, the depositories of our capital”, but also as “the wheels and pillars of our trade” where “[m]erchants and traders of every denomination are enabled through them to send money to, and receive it from the most distant places, to raise money when in want of it upon the Bills which they receive from their customers, to have those Bills presented for payment through a channel which in general secures their being duly honoured […].”

Let us look again at the remittance system used by the Treasury before the establishment of the Bank of England. We mentioned above that goldsmiths were in charge of facilitating the Treasury’s obligations towards the troops abroad. The question that arises regards the type of representation that these goldsmiths reflected: Were they agents or correspondents?

Generally, and also in relation to early British financial history, agents could conduct and even finance specific transactions as they had the ability, for example, to accept bills of exchange or to honour and issue letters of credit; but an agent normally must be considered as an operational and legal extension of a “parent” institution without being a separately capitalized cooperation in the host country.[91] Often, an agent would hold a title that echoed his relationship – and his restrictions - to the principal, for example, “Royal Agent” or “the King’s Commissioner”. Illustrative examples from the 16th century are Sir Stephen Vaughan, who led loan negotiations in Flanders for King Henry VIII, and Sir Thomas Gresham, who acted as agent for the Crown for Henry VIII, Edward VI, Mary I and as

[90] See Richards (1928), p. 336, and Clapham (1944), Vol. 1, p. 10 Fn. 2. Vyner (alternatively Viner) was chosen Lord Mayor of the City of London in 1674. Before that, he was a partner in his uncle’s business as a goldsmith banker.

[91] See our typology of international banking offices in Chapter 3, with further literature.

"Court banker of [Queen] Elizabeth" in Antwerp.[92]

We have laid out already that goldsmiths acted as correspondents in certain transactional situations. And we have referred to the necessary aspect of independence in order to characterize a correspondent. Goldsmiths as private bankers traditionally fulfil this precondition of individuality and "transaction sovereignty". From the late Tudor period, when they appeared as bullion merchants and moneylenders, to the bankers of Stuart times, when they became deposit keepers, dealers in bills of exchange and important issuers of promissory notes, until the importance of their financial services declined for a while during the periods of Elizabeth and James I, goldsmiths incarnated independence, carrying out banking businesses on their own account.[93] As primary bankers of England (before the founding of the Bank of England) goldsmiths would not fit into the standard definition of an "agent". Even in times of great financial despair of the Crown, they were not hired or employed by the king, but asked to raise money for the standing army of Charles II. Later, the same erratic king would close the Exchequer in 1672 and seize the funds belonging to the goldsmiths, driving many of them into ruin.[94] Goldsmiths gradually replaced the business operations of the Lombards in the 16th century, who themselves evolved from agents of Florentine banking families into independent merchants.[95]

Back to the two goldsmith bankers, Sir Stephen Evance and Sir Joseph Herne, who were involved in the remittance operations to the armed forces in Flanders. On the one hand, calling them *agents* sounds almost absurd. Why would the Treasury or England's paymaster of the army employ agents who would be paid for bills of exchange drawn upon

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[92] See Richards (1929), pp. 26-8. A thorough portrayal of Sir Thomas Gresham was already drawn by Burgon (1839), and Salter (1925). Further details on Sir Stephen Vaughan can be found in Richardson (1953).

[93] Richards (1929), p. 31; Goodman (2009), pp. 11-3, who values specific operations of the goldsmiths as practicing "a version of 'fractional reserve banking'".

[94] Francis (1888), p. 23.

[95] Bisschop (1910), pp. 16-7, who comes to the conclusion, though, that these merchants cannot be considered as bankers, because they "were money-lenders, not intermediaries".

debtors of the goldsmiths in Europe? However, what if these “European debtors” were actually debtors of the Crown? The sources are slightly unclear in this respect. However, even in the second scenario, a four-party arrangement with goldsmiths as “agents” using bills of exchange that would be remitted to “sub-agents” in Flanders would be a rather senseless endeavour as a three-party arrangement, for example, with letters of credit, could have led to similar results – without the additional necessity to pay the “goldsmith-agents”. We prefer the term “goldsmith-correspondents” as a proper description of the role of Evance and Herne. Optionally, one could see them (at least) as “remittance-contractors”. Further aspects of the two goldsmiths’ relations to the Treasury can be found in the *Minute Books* and *Entry Books* of the Treasury between 1689 and 1692.[96] In this period, both goldsmith correspondents are mentioned numerous times as regards their business connections with the Treasury. Sir Evance appears 86 times in the Treasury’s books between 1689 and 1692 in the context of loans he provided.[97] Thirteen times he was part of bill of exchange arrangements with the crown.[98] Sir Joseph Herne plays a decisive role in 17 citations of bills of exchange for the Forces in Flanders[99], and he was involved in

[96] Compiled in *Calendar of Treasury Books, Volume 9, 1689-1692*, ed. William A Shaw (London, 1931).

[97] See *Calendar of Treasury Books, Volume 9, 1689-1692*, ed. William A Shaw (London, 1931), pp. 39-41, 44, 45, 61, 66, 73, 178-79, 183, 187, 202, 210, 292-93, 365, 369, 410-12, 414, 416, 418, 421-22, 461, 492, 583, 595, 644, 651, 656, 668, 747, 765, 773, 780, 788, 829, 843, 860, 882, 935, 965, 991, 1057, 1203, 1443, 1446, 1537, 1552, 1557, 1609, 1615, 1618, 1621, 1626, 1641, 1643, 1652-53, 1743-44, 1759, 1764, 1767, 1773, 1777, 1798, 1818, 1862, 1889, 1964, 1975, 1977-78, 1985, 1987-88, 1990, 1996, 1998-99, 2001, 2004.

[98] Bills of exchange for the “Forces in Flanders”, with the involvement of Sir Evance, can be found in *Calendar of Treasury Books, Volume 9, 1689-1692*, ed. William A Shaw (London, 1931), pp. 1183-4, 1426, 1692. Bills for other occasions we see ibid., pp. 51, 278, 359, 360, 425, 462, 476, 991, 1015, 1487.

[99] Ibid., pp. 1152, 1183-4, 1239, 1263, 1360, 1366, 1405, 1426, 1460, 1480, 1525, 1647, 1692, 1878, 1888, 1896; he was also part of bills of exchange – for arrangements for other occasions, see pp. 425, 431, 433, 435, 476, 477, 1015, 1465, 1535.

numerous payments for Danish, Hanoverian, and Wolfenbuettel forces.[100]

None of those primary sources hints at an agent-arrangement with the Treasury. Also the legal framework of the cooperation between the crown and the syndicate of Evance and Herne echoes a correspondent relationship as they assumed remittance responsibility on a series of six-month contracts.[101]

We will get back to different remittance options for troops overseas in more detail below.[102]

cc. English banking and correspondents pre-1694

On the institutional level, we have referred to the early concepts of a public, respectively national bank above. Also, the idea of using correspondents by a newly founded major bank in England was not an ad hoc-decision that evolved out of the necessities and historic complexities of the 1680s and 1690s. Already in Cromwellian times, Henry Robinson (c. 1604 - c. 1664) demanded the establishment of a bank in England, not only with "Agents" or "Publick Exchangers", but explicitly also with "Correspondents":

> "If the Common-wealth keep a Correspondent, or Banker in *Paris, Antwerp, Amsterdam, Roterdam*, and in such like principal places of Trade, and have a stock of money, or Credit with each of them, their publick Exchanger may eyther returne moneys upon them, or receive Charges from them according to the *Par*, or intrinsecal value, which will hinder transportation, and this can be no dammage or losse unto the Parliament, because their Agents deale onely according to the true worth of the Coynes in themselves at the Mint, what ever the denominations be, or

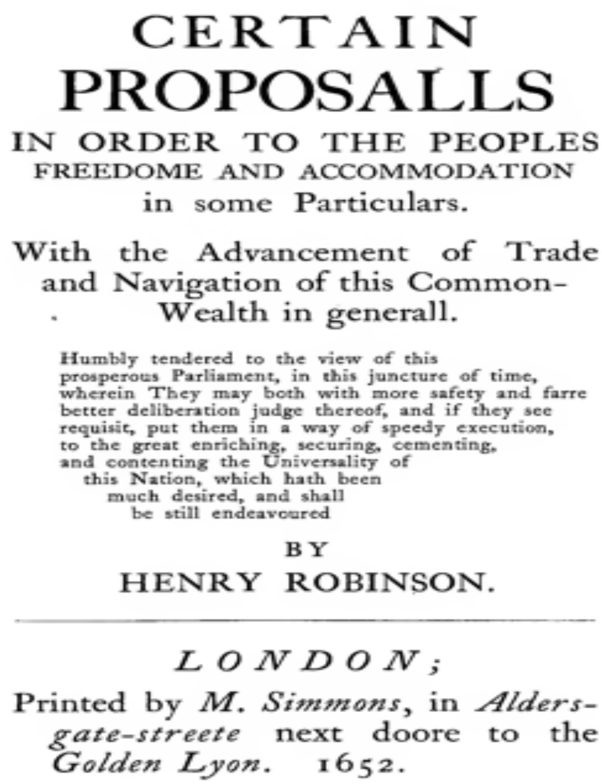
[100] Ibid., pp. 477, 541, 1603, 1754, 1769, 1791, 1802, 1814, 1843, 1854, 1860, 1896, 1902, 1908, 1917, 1929, 1943, 1949, 1955, 1212, 1238, 1282. Herne's support for the Emperor and the Duke of Bavaria is described at ibid., pp. 1212, 1224, 1242, 1247, 1249, 1253-54, 1263, 1268, 1280, 1290, 1299, 1303, 1309, 1319, 1325, 1522.

[101] See Childs (1991), p. 63.

[102] See Chapter 6.

however they be Lightened or Embased […]"[103]

Even earlier, in 1622, Gerard Malynes already described correspondent banking. Structurally, he hints at "[t]hese Bankers, as they have their Companies, Factors, or Corespondence in the chief places of Trade in *Europe* […]"[104] and in the context of clients in need of bills of exchange "they [the banks] will also serve his turn, in giving him Bills of Exchange for any place wheresoever, because they have their Companies or Corespondence in every place."[105]



CERTAIN
PROPOSALLS
IN ORDER TO THE PEOPLES
FREEDOME AND ACCOMMODATION
in some Particulars.

With the Advancement of Trade and Navigation of this Common-Wealth in generall.

Humbly tendered to the view of this prosperous Parliament, in this juncture of time, wherein They may both with more safety and farre better deliberation judge thereof, and if they see requisit, put them in a way of speedy execution, to the great enriching, securing, cementing, and contenting the Universality of this Nation, which hath been much desired, and shall be still endeavoured

BY
HENRY ROBINSON.

LONDON;
Printed by *M. Simmons*, in *Alders-gate-streete* next doore to the *Golden Lyon.* 1652.

Figure 7: Cover page of Henry Robinson's "Certain Proposalls"

103 Robinson (1652), pp. 78-79.

104 Malynes (1622), p. 95.

105 Ibid., p. 96.

In the four decades after 1660, a system of international finance was put in place around a London – Antwerp – Amsterdam centre that allowed international clearing of payments via bills of exchange and an expanding network of correspondents, branches, and agents. Authors who only refer to the axis Amsterdam – London[106] need to be reminded of the still existing ties to Antwerp and direct and indirect impulses that came from there.

c. Conclusion: not a revolution in finance

In conclusion, it needs to be underlined that the use of cashless transaction methods by English merchants was already highly developed in the 14th century. Although these businessmen had created an original model of letters of commitment for long-distance payments as early as the 13th century, the prevailing method that should serve as the role model for the remises to Flanders four centuries later was the bill of exchange that paved the way for trans-European trade on the basis of the Italian re-invention of an ancient idea. On another note, it is a myth that only Italian merchants supplied other merchants with money for trading as the court records of these times clearly show.[107] A remarkable example for this assumption is again hidden in the Calendar of Plea and Memoranda Rolls, where the protocols of a case between 1381 and 1383[108] not only prove (again) the existence of bills of exchange, but even include a list of “money changers”, respectively merchants who have been involved in the transaction procedures of the plaintiff and defendant of the case and where the nationalities of the parties can be determined. According to Thomas (1932), at least fifteen of the fifty-four persons mentioned in the list were “well-known English merchants, while of the remainder, Flemings and Germans, outnumbered the Italians.”

Furthermore, early business and trade correspondence like the Cely Letters demonstrate and confirm that remittance payments from England through intermediaries and by means of bills of exchange in order to fund soldiers overseas – and especially in Flanders -

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[106] See, for instance, Sperling (1962), p. 446.

[107] See also Thomas (1932).

[108] Calendar of Plea and Memoranda Rolls, Vol 3, Roll A 25, Membr. 18-30.

occurred in similar forms already in the 15th century. All these documents help to shed light on some rather abstract descriptions of England's use of bills of exchange before the 17th century, especially between London and the Low Countries.

Different types of representation found their way into English trading procedures already before bills of exchange were even fully established. In the 14th century, the so-called 'letters obligatory' could entail assigned parties with attributes of correspondents for the settlement of debts. Letters of attorney give hints that England's merchants were increasingly involved in correspondent structures and not only relying on agent-relationships.

Since the 15th century the main impulses for the refinement of trade instruments used between and both on the continent and England stemmed from Antwerp. London and Antwerp advanced a prosperous interaction of agents and correspondents on both sides of the channel, outmanoeuvring the importance of Amsterdam, even after the foundation of the Wijsselbank. Yet, merchants of London formed strong trade relationships based on the same set of instruments with other European trade hubs as well, showing again that the modus operandi for cashless transactions of the newly established Bank of England was not based on highly innovative ideas.

Moreover, in the 15th century, three groups of businessmen - Mercers, Staplers, and Merchant Adventurers - established geographical as well as de facto "trading triangles" and provided remittance services between England, Calais, and fairs in the Low Countries, mainly via bills of exchange. Their transactional focus and respective independence strongly lead to the suggestion of correspondent arrangements.

Finally, England's "specificum", the goldsmiths, were heavily involved in domestic and international transactions. They gradually cultivated networks, in which they used correspondents and acted themselves as such intermediaries in "inter-goldsmith correspondent networks"; from time to time, they appeared as "dual correspondents" when being involved in two different locales. Eventually, they even became relevant parties in international remittance payments to troops abroad, via bills of exchange, decades before the founding of the Bank of England, thus setting standards and giving examples of structuring these complex undertakings. The last intermediaries used by the Crown for remitting soldiers in Flanders, preceding the launch of the Bank of England, were two goldsmith correspondents, named Sir Stephen Evance and Sir Josiah Herne.

However, not only correspondent *relationships* were well-known structures familiar to England's finance community; even correspondent *banking* had already been discussed in the early 17th century, way before the Bank of England was to be put in place.

Still, England can certainly not be called an innovative stronghold in international banking until the late 17th century; the inception of the Bank of England was more an eclectic adaptation to a desperate situation than a "kairos" embraced by financial geniuses. A revolution in finance is something different.

Chapter 6 Correspondent Banking for the Troops - Remitting Funds to Flanders during the Nine Years War

Financing a bellicose England - Methodology and Actors

The original declared intent of the establishment of the Bank of England was the facilitation of the substantial remittances required overseas for warfare abroad. The Nine Years War resulted in the need for England to supply its troops in Flanders with sufficient pay. A system had to be put in place that allowed reliable foreign army remittances, i.e., the process of providing local currencies for the English troops abroad.

Kleer (2017) gives a good first overview of the English remittance options used to pay the troops fighting the Nine Years War on the continent in Flanders, a certain imprecision in terminology notwithstanding. He identifies three ways to remit the needed funds using the - at this time, already conventional, as laid out in Chapter 5 - method of bills of exchange, yet he offers only scarce sources for his (correct) findings.[1] We shall identify several further alternatives that were in use – or at least in discussion – to facilitate such “remises”.

Therefore, we first need to understand the role of the players and parties involved. In addition, we gain a clearer picture by separating the remittance efforts into two periods - before and after the founding of the Bank of England. We make this distinction for several reasons. Firstly, in order to draw out the degree to which the Bank of England used new and original methods of remittance; secondly, to identify to what extent it took over or copied existing models, albeit in refined form; thirdly, to help us better understand the significance of the establishment of this institution in the context of the existing practice of correspondent banking. The creation of the Bank was logically entwined with the Crown’s needs to keep its finances for the troops in order and the willingness of private sector actors to facilitate this – for a price.

[1] Kleer (2017), pp. 43-4.

1. Models before the inception of the Bank of England

As seen above, England relied for centuries on international payment methods that evolved from letters of commitment to mainly bills of exchange and letters of credit with different forms of representation.

During the first half of the Nine Years War, participants in the remittance operations were England's army paymaster Richard Jones, Earl of Ranelagh (1641-1712), but also agents and correspondents of Antwerp merchants, London-based correspondents of the Treasury (two of them: Sir Stephen Evance and Sir Josiah Herne, were so-called "goldsmith bankers")[2], and, after its founding in 1694, the Bank of England.

Many of Earl Ranelagh's methods of using bills of exchange can easily be reconstructed, not only by analysing the ledgers of the Bank of England and some of his "transaction partners". Several details were also revealed by the hearings preceding his expulsion from the Commons in 1703, especially in the "Narrative of the Commissioners for the taking the Public Accounts, in relation to the accounts of the Earl of Ranelagh" presented to the House of Commons on November 11th 1702 and the answer of the Earl of Ranelagh on November 30th of the same year.[3] This, of course, is a quite partisan text, but it offers a unique view on the techniques and procedures of the remittance payments and transactions of the crown in the late 17th century.

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[2] This term was used for goldsmiths, who became private bankers, see Kleer (2017, p. 44), but also much of the earlier literature, such as Quinn (1997). For an earlier survey of London banks, see Hilton-Price, F. G. (1890).

[3] The Parliamentary History of England, Vol VI (1810), pp. 97-126. Earl Ranelagh obviously fell victim to an intrigue that led to his expulsion from the House of Commons. A comment in the Parliamentary History (ibid., p. 126) underlines this observation: "He had an account of one and twenty millions lay upon him. […] it had often been said that great discoveries would be made, whensoever his [Ranelagh's] accounts were looked into […]. But now, when all was brought under strict examination, a few inconsiderable articles of some hundreds of pounds, was all that could be found to be objected to him; and even to these he gave clear answers. […] upon all this canvassing, he appeared much more innocent than even his friends had believed him."

On the continent, a key figure was Sir Richard Hill of Hawkstone (1655-1727),[4] based in Flanders. Richard Hill started as "the deputy of the Paymaster-General in England, the Earl of Ranelagh" in April 1692,[5] after replacing Roger Sizer who had to leave the position because of peculation. In the Accounts of the Bank of England, Richard Hill appears as the "Paymaster to the King's Army In Flanders" (*Figure 8)*.[6] Both Hill and Sizer, fit into the role of an agent. Their degree of dependence on the Crown was evident through their official position as deputies of Ranelagh.

Another important player in the Low Countries was William Schulenberg (or Schuylenberg, respectively Schuylenburg or Schyllemburg), the Paymaster of the Dutch army – and therefore Ranelagh's equivalent in the Dutch army - as the Treasury's representative in Flanders. His position as either an agent or a correspondent needs to be explored.

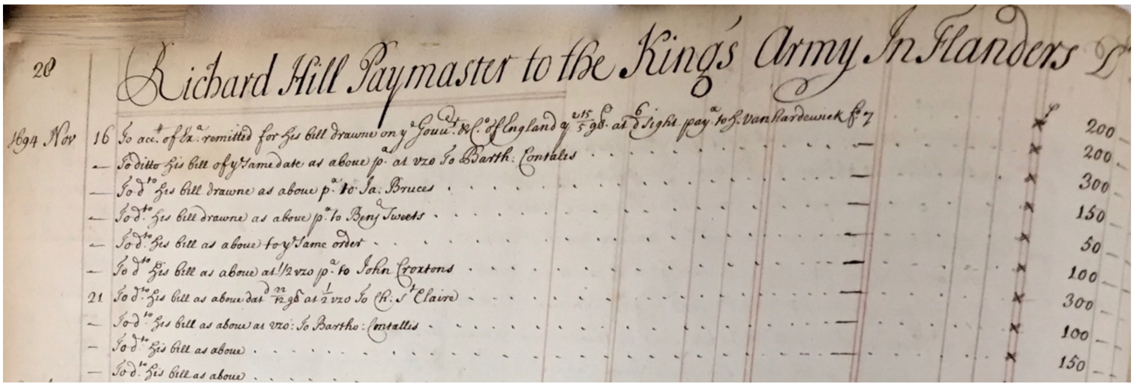

Figure 8: Remittance transactions of the Bank of England in November 1694, involving Richard Hill, Supplementary Ledger No. 1, Folio 28

In addition, we encounter merchants and bankers from Antwerp, whose representatives in London we have already mentioned, and agents and correspondents, respectively, in Flanders, of the goldsmith bankers in London. Obviously, a plethora of constellations to remit funds across the Channel was conceivable with such a variety of participants.

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[4] On Richard Hill, see Jancey (1954-56).

[5] Childs (1991), pp. 62-3.

[6] Supplementary Ledger No. 1 (ADM7/2), Folio 28

a. The agent-principal cycle of a bill

In the early years of the war, between 1689 and 1691 – and later only occasionally - the funds were remitted to Flanders through a bill of exchange construct (*Illustration 2)* that involved the Earl of Ranelagh from London (as the *principal* of the remittance arrangement) and a representative (from 1692 Richard Hill) on the Continent, who, in turn, would draw bills upon the Paymaster Ranelagh in London. The merchants in Flanders (mostly Antwerp) would buy the bills from the Crown's representative in Flanders in order to receive the equivalent in English pounds in London via their correspondents or agents from Ranelagh.[7]

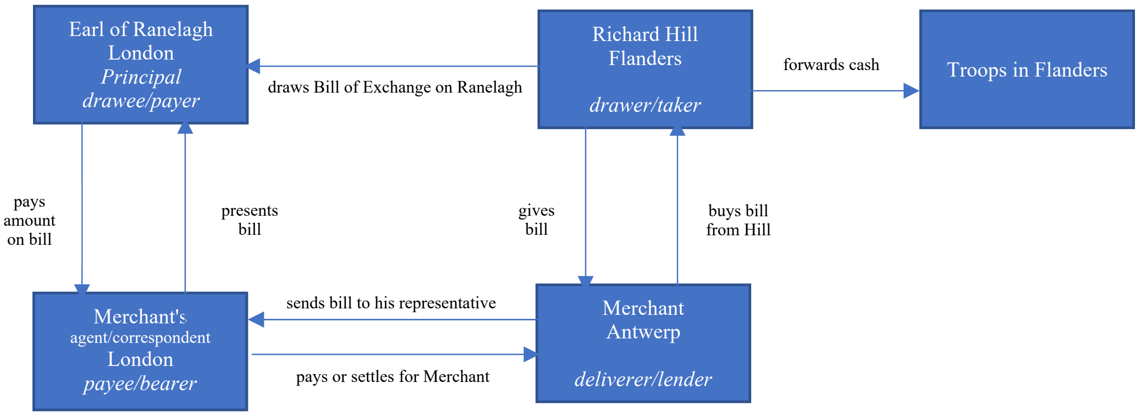

Illustration 2: Remittance Option A; agent-principal cycle of a bill with the sequence agent-merchant-correspondent-principal using a fully dependent representative of the English crown in Flanders.

Kleer (2003) calls this payment scheme, "a last resort, used only in times of crisis."[8] His assessment can be substantiated through numbers: of the total sum of £4,874,000 provided to Richard Hill in Flanders between March 1692 and 1696 only £472,000 was gained through bills drawn upon Ranelagh by Hill.[9]

[7] Kleer (2017), p. 43.

[8] Kleer (2003), p. 3.

[9] Ibid., pointing at the fact that these bills were only drawn in three short periods within the timeframe between 1692 and 1696.

This remittance structure reflects a cycle of the bill from the drawer of the bill (Hill) to the deliverer (Merchant in Antwerp who buys the bill from Hill and "delivers" the 'money' to the "taker" (Hill), often combined with a loan agreement) and from there, the bill would be sent to the bearer and payee, the merchant's correspondent (or agent) in London who would finally present it to the drawee and principal (Ranelagh).

For a more precise distinction of the different ways to 'remit' funds to the troops in Flanders, we describe these options via the protagonists of the initiating step of the "bill cycles" – the drawer and drawee. In this case, we would call this an *agent* (Hill)-*principal* (Ranelagh) *cycle* – in a bill-sequence from agent/drawer to merchant to correspondent to drawee.

b. The correspondent-principal cycle of a bill

The preferred approach in the first years of the war, though, was to use a representative on the continent who would draw bills of exchange on England's army paymaster Ranelagh, and then sell them to merchants in Antwerp whose agents or correspondents in London would receive the cash from Ranelagh. The representative in Flanders, in turn, would provide Richard Hill with the cash for the troops (*Illustration 3)*.

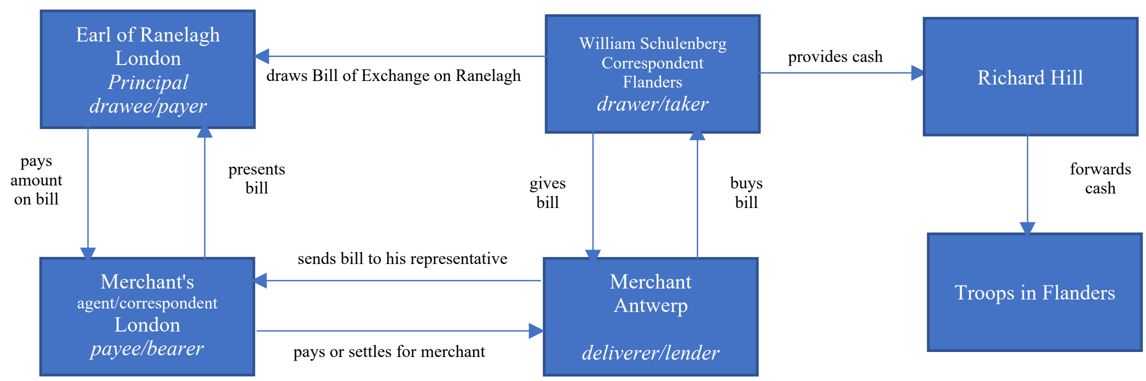

Illustration 3: Remittance Option B; correspondent-principal cycle of a bill with the sequence correspondent-merchant-correspondent-principal using a correspondent of the English crown in Flanders.

Kleer (2017, p. 43), categorizes this representative in Flanders, for years the Dutch Army Paymaster William Schulenberg, as an *agent*. In our view, this classification is incorrect.

In the "Parliamentary Proceedings Relating to the Case of Earl Ranelagh in 1703" we find some hints on the structure of the relationship between the Crown and

Schulenberg.

On the one hand, the narrative of the Commissioners for taking the Public Accounts declares Ranelagh's payments "to several persons, for several services, and on several occasions" [as done] "without specifying the services, or occasions". But they also cite sums with which Ranelagh "discharged himself in some instances thus: […] To Monsieur Schuylenburg for several sums advanced by him, for several services relating to the forces".[10]

This is partly vague as it does not sufficiently describe the type of relationship. Yet we also get an idea of the interaction between Ranelagh and Schulenberg. He obviously "advanced" money to the troops that was repaid to him at a later stage. For further clarification let us also look at the Calendar of Treasury Books. The following circumstances, involving Schulenburg and Ranelagh, were described in the Entry Book of March 1692:

> "Same to same to allow to said Ranelagh in his same account for the year commencing 1690-1, Jan. 1, the sum of 785*l*. 4*s*. 0*d*., being the remainder of the sum of 15,569*l*. 1*s*. 0*d*. which was detained by Schuylenburg on account of exchange and of which 14,783*l*. 17*s*. 0*d*. was directed to be allowed by the warrant of July 7 last, *supra*, p. 1220 : all by reason that the said William van Schuylenburg at the Hague has received from said Ranelagh the total sum of 305,638*l*. 2*s*. 0*d*., viz. 2,814*l*. in money paid him [Schuylenburg] in London, and the remaining 302,824*l*. 2*s*. 0*d*. upon divers bills of exchange drawn by him or by Mr. Geo. Clifford, his correspondent at Amsterdam, as appears by said Schuylenburg's general acquittance dated Nov. 21 last : and of the said sum of 305,638*l*. 2*s*. 0*d*. the sum of 15,569*l*. 1*s*. 0*d*. was detained by him upon account of exchange and in consideration of paying 11 gilders for every 1*l*. sterling of the remainder of said 305,638*l*. 2*s*. 0*d*., being 290,069*l*. 1*s*. 0*d*. (which was paid by him to Roger Sizer for the use of our Forces in Flanders), and also to answer interest and loss on [such of] his said bills not being

[10] The Parliamentary History of England, Vol VI (1810), p. 103.

> duly [in proper time] paid and also for his commission and charges in conveying the moneys to the quarters where the Forces were."[11]

Noteworthy is the fact that Schulenburg was able to detain money and to ask for commission and charges. It is highly unlikely that an agent would have had the "freedom" to detain money. In addition, why would an agent act in a bill of exchange-construct as the drawer (or even his "correspondent" who logically would rather be a "sub-agent")? Another indication of Schulenberg's different and more independent position than "just" being an agent is the information that the Treasury had to pay "Monsieur Schuylenburg towards satisfying his bills" (Disposition Book X, p. 73 a.a.o.). Finally, from a teleological perspective, we can interpret the following wording in the King's Warrant Book (XVI, p.167) as a relationship that was based on a looser affiliation:

> "[…] viz. upon several bills of exchange drawn upon Ranelagh by said Schuylenburg at the Hague, "to whose care the payment of the said Troops was committed by us" : the said present payments being by bills respectively for 4,700*l*., 7,200*l*., 3,600*l*., 3,600*l*. and 8,106*l*. 2*s*. 0*d*. and 2,819*l*. 14*s*. 0*d*. in money by [the hands of] Roger Sizer, making in all 30,025*l*. 16*s*. 0*d*. as by the several acquittances of the said Schuylenburg, dated 1691, Nov. 23."

"Committing" someone to take care of payments creates a different level of reliance on a principal than "constituting" a position – a term regularly used in those times to describe the installation of an agent who then would be "obliged" to certain actions.[12] In a nutshell, calling Schulenberg an agent would be misleading. He rather combined all elements of a correspondent in his position.

The structure of the second remittance option (*Illustration 3)* reflects a cycle of the bill very similar to the first example (*Illustration 2)* – with the exception that Hill, as Ranelagh's deputy and the Crown's agent, stands outside the cycle and the drawer is the Crown's correspondent Schulenberg. We, therefore, encounter a *correspondent-*

[11] Entry Book: March 1692, 1-5, in *Calendar of Treasury Books, Volume 9, 1689-1692*, ed. William A Shaw (London, 1931), pp. 1517-1530; *King's Warrant Book* XVI, p. 166.

[12] See, for instance, Robinson (1652), p. 77: "and if this faile, it may infallibly be effected, by constituting […] an Agent of the Commonwealths, who may be obliged to Furnish […] with the ful value of their moneys […]".

principal cycle of the bill in a bill-sequence from correspondent/drawer to merchant to correspondent to drawee.

c. The correspondent-merchant cycle of a bill

From 1692 on, a third possibility emerged to transfer funds to the armed forces in Flanders: we had already hinted at it when we referred to the two goldsmith bankers, Evance and Herne. As we have shown in Chapter 5, they were not agents (as Kleer sees them),[13] but correspondents of the Treasury, respectively of Ranelagh, and acting from London by drawing bills of exchange upon debtors from the continent who would eventually pay agents or correspondents (but not "sub-agents")[14] to whom the bills would have been remitted. However, four aspects are not entirely clear according to the descriptions that the literature on the topic has to offer: First, what type of representatives were used in Flanders – correspondents or agents? Second is the question of whether the bills were remitted directly by the correspondents in London to the representatives in Flanders (in exchange for being paid the amount on the bill by Ranelagh) or whether the traditional way was used, meaning the correspondents sold the bill to Ranelagh, handed them over to him, and Ranelagh forwarded them to the representatives in Flanders. It is, third, not fully obvious whether the aforementioned debtors from the Continent owed only the correspondents or the Crown. Finally, were those representatives in Flanders only representing the correspondents, or could they potentially also have been representatives of the Crown?

It needs to be stated that all arrangements would have led to the goal of remitting funds via bills of exchange to Flanders. All options follow a *correspondent/drawer* (Evance & Herne) – *merchant/drawee cycle of the bill*. Still, the bill sequence would differ significantly according to the nature of the four uncertainties. Therefore, let us have a closer look at the different options and the preconditions that need to be fulfilled.

aa. Dual-cycle remittance option

Kleer (2003, pp. 3-4) offers a solution that tries to settle some of the described

[13] Kleer (2017), pp. 43-4 and 89-90.

[14] This is the terminology of Kleer (ibid., pp. 43-4), which would only make sense if the goldsmiths were indeed agents.

quandaries – which apparently he chose not to repeat in his monograph of 2017 (probably a reflection of evidence that this arrangement was more an exception than the insinuated routine). This remittance concept – with two (or more) bill cycles (*Illustration 4*) - would have worked as follows: The Treasury contracted Evance and Herne, they "furnished Ranelagh […] with bills of exchange […] payable on the continent to himself or order."[15]

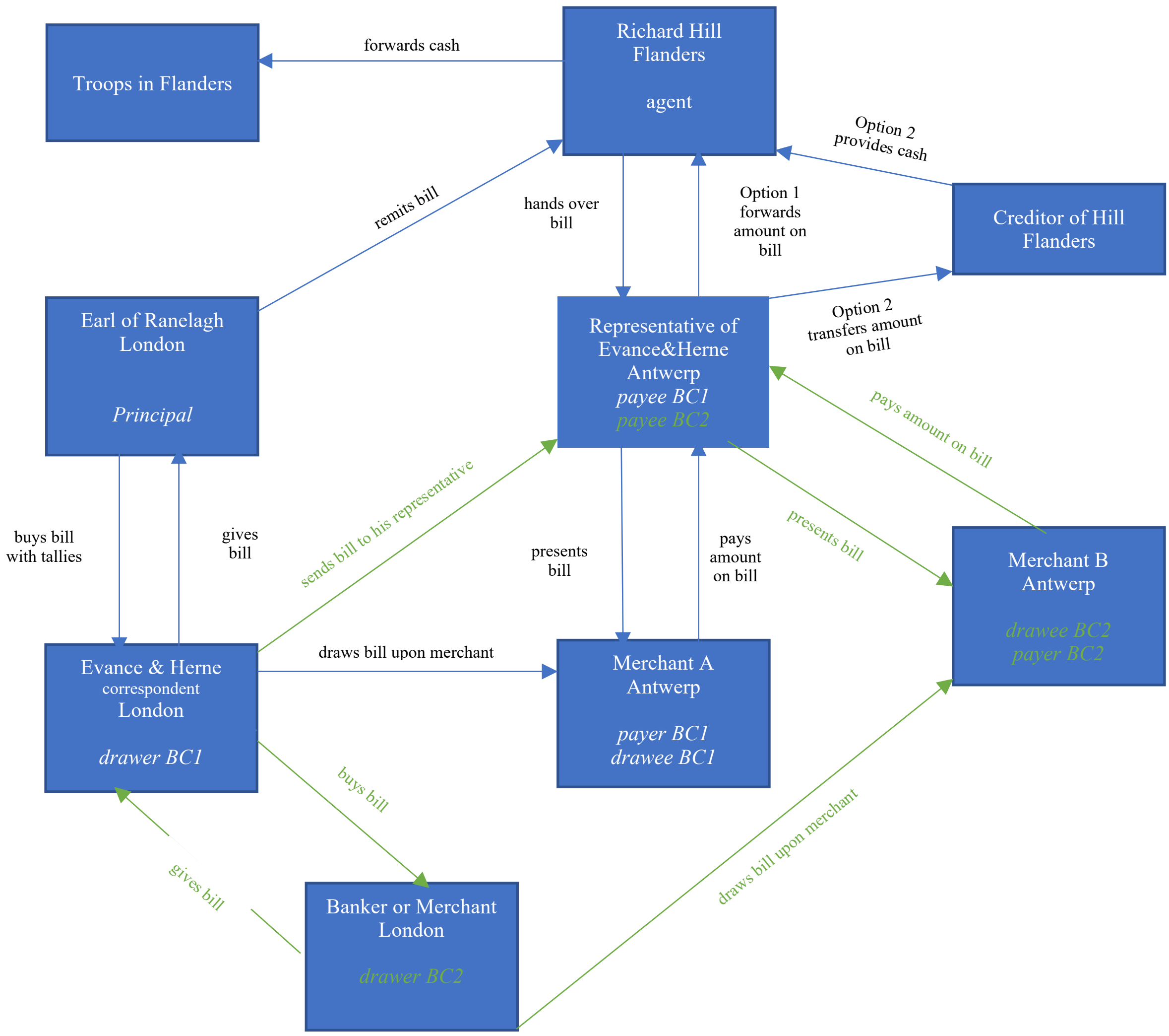

Illustration 4: Remittance Option C(1): correspondent-merchant cycle of a bill with two sequences (BC1 and BC2).

BC1 in order to facilitate remittance payments to the troops using correspondents in London, their representatives as well as the Army paymaster's deputy, both in Flanders: correspondent-merchant-principal-agent-representative-merchant-representative-agent (offering two possible options for the last step).

BC2 in order to provide the correspondent's representative in Flanders with sufficient financial means: correspondent-merchant-representative-merchant.

[15] Kleer (2003), p. 3.

As a next step, Ranelagh would have issued a “matching quantity of tallies to the contractors”[16] and sent their bills to his deputy paymaster Hill in Flanders.[17] The deputy paymaster in Flanders showed the bills to the representatives of Evance and Herne, who then would either pay Hill directly (Option 1) or transfer the requested amount to the accounts of Hill’s local creditors (Option 2).

However, in this overall arrangement, the contractors in London needed to provide their representatives with enough financial means to fulfil Hill’s demand. This would have been accomplished by purchasing bills of exchange in London drawn upon merchants in Flanders. After receiving the bills from Evance and Herne, the representatives in the Low Countries would have been able to cash in the respective amounts from the bankers and merchants mentioned on the bills.

This setup is not entirely unfeasible. However, due to its complexity and impracticability, it is unlikely that it became the “normal pattern […] for “remittances” to be contracted out by the Treasury to London-based financiers.”[18]

Quite interesting in this constellation are the intertwined bill cycles – an often undervalued reality in international trade procedures.

And although there were obviously more direct ways to reach the goal of remittances via the correspondent-merchant bill cycle (see below), some of the initial questions would find answers in this case: (1) the representatives in Flanders represented the correspondents in London and not directly the Crown (respectively Ranelagh), (2) the merchants on whom the bills were drawn were originally not debtors of the Crown, and (3) the bills that effected the remittance payments (bill cycle 1) were sold to Ranelagh who forwarded them to Flanders. However, they would not have been sent directly to the representatives of Evance and

[16] Ibid.

[17] The tallies acted as receipt for services provided to the Crown, which was equivalent of having paid future taxes (as Werner (2016) shows, the fiscal receipts in the form of split tally sticks enabled the government to fund purchases with relative ease, at least in the early phase of the system that started, at the latest, in the 12th century).

[18] This is Kleer‘s (2003, p. 3) opinion – though, without further evidence.

Herne, but to Ranelagh's deputy Hill first. The last steps, of course, were time-consuming and unnecessarily complicated as it involved the instalment of a second bill cycle.

It may surprise that the Bank of England – after its establishment succeeding Evance and Herne - would adopt, especially in its early years, a similar, but not so convoluted model: Another *dual cycle remittance option* with a combination of a letter of credit and bill(s) of exchange cycles (we will get to this method later in more detail when we view the remittance alternatives involving the Bank of England, see also *Illustration 12*).[19]

(1) Representatives in Flanders – only agents or (sub-)correspondents of the Crown?

To make things even more complicated, the Crown's correspondents in London (and even Ranelagh himself) often bought bills drawn on merchants outside Antwerp. This eventually led to the situation that expressly the representative in Flanders, as bearer and payee of the bill, had to rely on a widespread network of agents and correspondents in order to finally benefit from the bill.

This finding becomes relevant with respect to the remaining unresolved question in connection with the described *dual cycle remittance option*; namely, whether the representatives in Flanders were correspondents or agents. But, it is also a necessary clarification for the other options of the correspondent-merchant or the correspondent-correspondent cycle of a bill.[20]

So, let us explore the nature of representation in Flanders. Aside from the already mentioned Deputy Paymaster, Richard Hill, key figures in the Low Countries before the launch of the Bank of England were Jacob de Coninck (or de Koning, Conninck, Deconick) who mainly worked from Antwerp, and Benjamin Poulle from Amsterdam.

In this context, the receipts for money paid by the Bank of England to Richard Hill are highly instructive. They were meant to provide funds for payment of the troops in Flanders.

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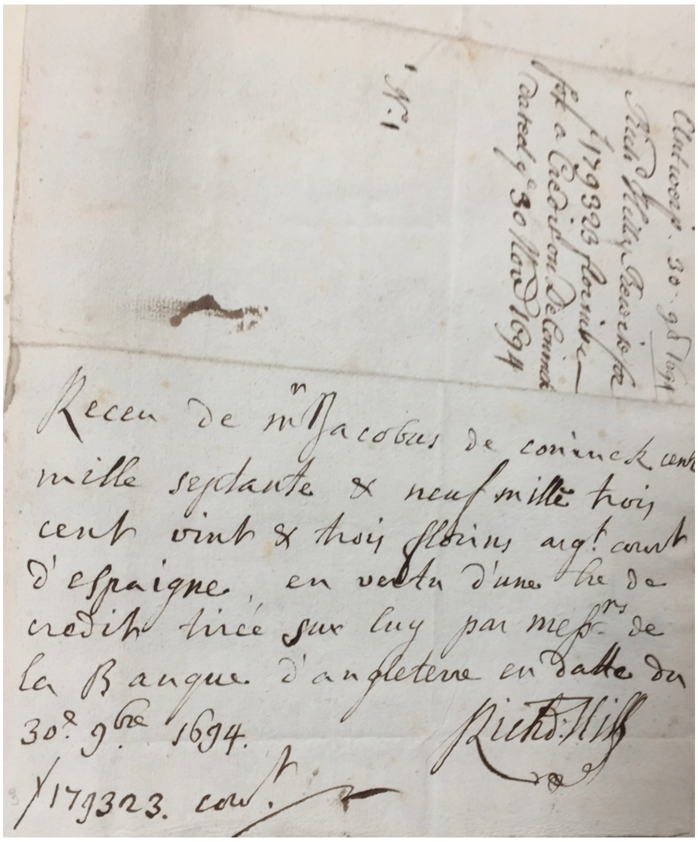
[19] See below, 2.c.

[20] See below in this chapter.

Twenty-two receipts are for money paid to Hill by Jacob de Koning from Antwerp (*Figure 9*).[21]

A detailed look at all receipts that included the Antwerpian merchant discloses that de Coninck was mainly involved in constructs entailing letters of credit, however, secured with additional bill of exchange-cycles. Some transaction types were based on directly remitted bills of exchange, only a few on shipment of specie.

For the academic literature and the commentators in the archives the situation seems clear: almost all of them use the term *agent* for the representatives of the Crown or its remittance contractors (the "syndicate" Evance and Herne who, as we have shown, have also incorrectly been labelled as "agents" before the Bank of England took over their role).



Receu de mr Jacobus de coninck cent mille septante & neuf mille trois cent vint & trois florins argt court d'espaigne, en vertu d'une lre de credit tirée sur luy par messrs de la Banque d'angletere en datte du 30e 9bre 1694.

Richd Hill

f179323. court

Figure 9: The first receipt from November 30 1694 involving the Bank of England, signed by Sir Richard Hill, Deputy Paymaster-General in Antwerp, for receiving 179,323 florins from "Jacobus De coninck" acting on a basis of a "credit" for the "Banque D'angleterre".

[21] Archive of the Bank of England, Receipts for Money Paid Abroad on Account of the Bank of England, Numbers 1 to 21 and 24.

Sometimes we read that de Coninck was "employed"[22] by Evance and Herne (and the Bank of England)[23], while on the other hand he is labelled as "a banker in his own right"[24] whose services were based on a "string of contracts."[25] This is a surprising and somehow paradoxical description of someone labeled as an "agent".[26]

As de Coninck was a crucial component of letter of credit - and bills of exchange - arrangements between England and Flanders, we need to correct this confusing classification to a more precise portrayal of this businessman from Antwerp. This is especially so as he was also a decisive player in the remittance operations of the Bank of England. His term of service for the Bank was short,[27] but intense and is sufficiently mirrored through the ledgers and receipts of the Bank and Richard Hill's account books. There are fewer pieces of evidence regarding his relationship with Evance and Herne.

We find proof for de Coninck's and Poulle's involvement in the remittance operations for example in the Entry Books of the Treasury.[28]

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[22] Kleer (2003), p. 4.

[23] Richards (1929), p. 202.

[24] Kleer (2017), p. 92.

[25] Kleer (2003), p. 4.

[26] Kleer (2003), ibid., and (2017), ibid.

[27] In the Supplementary Ledger of the Bank of England (ADM7/2), de Coninck only appears between October 9, 1694 and October 10, 1696. Yet his contract with the Bank wasn't prolonged after summer 1695.

[28] Entry Book: March 8, 1694 (Calendar of the Treasury Books, Volume 10, 1693-1696), disposition Book XII, p. 42: "Henry Guy to the Auditor of the Receipt to issue as follows out of the Exchequer: *Out of* 12,920*l. reserved for levy money* [*out of*] *contributions for annuities*. to [the Earl of Ranelagh] to answer bills drawn on him for the subsistence of the Forces in Flanders payable to Clifford, Poulle, De Coninck and Topham."

Although we will dive deeper into the Bank of England's remittance efforts below, we need to consider its relation to de Coninck at this point as well in order to gain a clear picture of his true role vis-a-vis England. In none of the primary sources we accessed were any indications or clues that the position of de Coninck changed after the Bank of England stepped in for Evance and Herne (to be precise: the latter were actually ousted by the Treasury in a bidding process that did not leave them much chance to keep their position). Therefore it makes sense to take the sizeable sources of the Bank of England and descriptions of de Coninck's interaction with the bank into account as well.

Delving into the Bank of England's archives, we find that in the early ledgers and receipts of the newly established institution in London, de Coninck was one of the most mentioned characters. In the Supplementary Ledger to the Bank's first accounts, he appears more often than any other person between 1694 and 1701[29], although his services were only needed in the first year from October 1694 until summer 1695.

For Acres (1931) "de Koning acted as the Bank's agent in Antwerp" in order to pay Richard Hill, who "acted as the banker of the British Government in that place by receiving and paying money for the maintenance of the Army."[30] According to Acres, the Bank of England also placed other "agents" at numerous European cities. Their task was to receive and remit money using their payment interconnections in and with nations that were aligned against the French King.[31] Ironically, the Bank itself called these representatives "correspondents" in its Court of Directors Minutes (March 9, 1695).[32]

Two years earlier, Richards (1929) stated that "the Bank had, as early as October 1694, employed [sic!] in this city [Antwerp] a special exchange agent, Jacobus de Koning."[33]

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[29] Namely in the Supplementary Ledger's (ADM7/2) Folios 30-49, 88-99, and 171-172.

[30] Acres (1931), p. 52.

[31] Such representatives were appointed at Amsterdam, Cadiz, Hamburg, Leghorn, Lisbon, Madrid, Oporto, and Venice, see Acres, ibid.

[32] Archives of the Bank of England, Court of Directors Minutes, Lib. A, pp. 177-8 (March 9th 1694[5]), listed in the Minutes as 9th March 1694 (!).

[33] Richards (1929), p. 202.

Certainly, de Coninck's portfolio was considerably broader than just dealing with "exchange" matters. With respect to the detail that Richards also saw him "employed" by the Bank of England he could refer to wording used by the Court of Directors Minute Books:[34] In the minutes of October 8, 1694, we read about a credit given to Earl Ranelagh along with a bill and that "Jacobus DeKoning of Antwerpe be the person employ'd therein" (*Figure 10*).

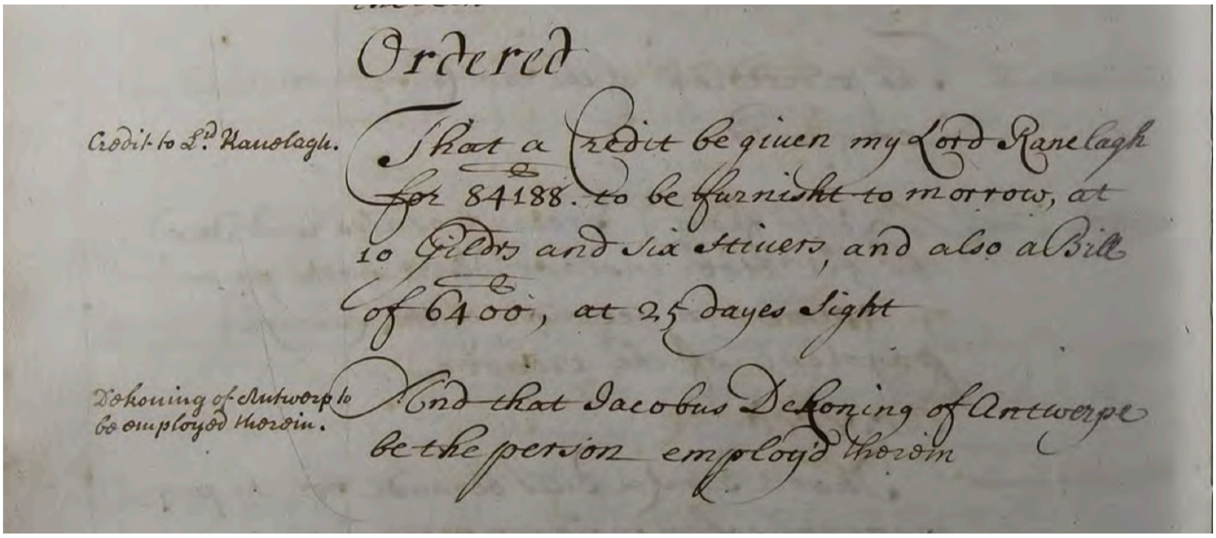
Ordered
Credit to Ld. Ranelagh. That a Credit be given my Lord Ranelagh for 84188. to be furnisht to morrow, at 10 Gilders and six stivers, and also a Bill of 6400, at 25 dayes sight
DeKoning of Antwerp to be employed therein. And that Jacobus DeKoning of Antwerpe be the person employ'd therein

Figure 10: Facsimile of the Court of Directors Minute Books, Lib A, October 8, 1694 stating the "employment" of Jacobus de Coninck.

Yet, we need to be careful not to understand "employment" in its strictest sense of a full dependence of de Coninck on the Bank - or earlier of the syndicate of Evance and Herne. Today's meaning of "to employ" is mainly to give work to someone and pay them for it as well as to keep occupied. In the 16th and 17th centuries, though, the word had the additional senses of "enfold", "entangle", and "imply" based on its etymological Latin origin "implicare", but more importantly, the term also entails the simpler, more general meaning of "to make use of someone", which according to Merriam-Webster, correctly reflects the sense it had in Middle English ("emploien").[35] We can, therefore, conclude that the word "employ" allows different options of tighter and more flexible forms of representation and

[34] The Books, known as Court of Directors Minute Bookes Lib's. A-D, are structured as follows: Lib. A July 27 1694 - March 20, 1695; Lib. B, March 27, 1695 - July 14, 1697; Lib. C, July 26, 1697 - April 10, 1700; Lib. D, April 12, 1700 - March 28, 1705.

[35] See Merrian-Webster's website: https://www.merriam-webster.com/dictionary/employ and Oxford Dictionaries' website https://en.oxforddictionaries.com/definition/employ.

that it does not necessarily stand for an agent-principal relationship. The soundest argument comes from the Bank of England itself. According to its Court of Directors Minutes, it not only repeatedly mentions correspondents (to be installed overseas)[36], but it even empowered the Committee of Remittances

> "to employ such correspondents att Genoa, Turin & Milan […]"[37]

However, even historians of the Bank of England itself refer to de Coninck as its "agent" in an introduction to its collection of Receipts for Money Paid abroad on Account of the Bank of England, 1694-1698, namely that "[t]he receipts numbered 1 to 21 and 24 are for money paid to Hill by Jacobus de Coninck who acted as the Bank's agent in Antwerp." This is a view that needs to be corrected.

Some scholars try some kind of a hybrid description. Take John Clapham (1944) in his profound history of the Bank of England: he portrays de Coninck superficially as more sophisticated when he states that "[o]n the other side of the water, much the most important correspondents of the Bank were de Coninck of Antwerp, who had begun to act as its agent in October 1694, when the work was new, and the great Dutch firm with an English name of George Clifford at Amsterdam."[38] It is unclear whether Clapham uses the terms "correspondent" and "agent" synonymously (as so many other authors incorrectly would) or as a depiction of a move de Coninck made from an agent-relationship to an independent correspondent arrangement with the Bank of England. Although it cannot entirely be excluded that de Coninck was originally installed as an agent, we see a good number of reasons that de Coninck worked as the Bank's correspondent, a position he already held in his business affairs with Evance and Herne.

Undoubtedly, individuals like Poulle and de Coninck were the Flemish "hinge" in a multi-cycle of bill of exchange- or combined letter of credit–bill operations.

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[36] Archives of the Bank of England, Court of Directors Minutes, Lib. A, pp. 177-81 (March 9th and 18th 1694[5]).

[37] Court of Directors Minutes, Lib. B, p. 3 (March 27th 1695).

[38] Clapham (1944), Vol I, p. 27.

Aside from the often misleading terms describing a certain position let us have a look at the contractual framework of the representatives' job. A relationship with an agent is usually aimed to last longer than just a short period of time. Short-term contracts would be the exception and usually indicate looser interactions and ties between the respective sides.

However, the (sub-)contracts between the Crown's remittance contractors and its representatives lasted only comparatively short periods – at least not much longer than the contactors' own agreements with the Treasury. Because of the limited length of the contracts between Evance and Herne (as well as between the Bank of England) and the Treasury, a more flexible relationship between the remittance contractors in England and their representatives in Flanders made perfect sense. The two goldsmiths had contracts with the Crown that lasted for a maximum of only six months.[39] The shorter the timeframe, the easier it was for the Treasury to adapt to volatile exchange rates and unforeseen developments. This is why we find almost only three- to six-month contracts initiated by the Treasury for remittance efforts. Naturally, it would not make any sense for the remittance contractors to be tied to their representatives significantly longer as they would have had to carry all the risks alone in case the contract with the Treasury had been terminated.

Could the fact that de Coninck and Poulle (and others) took a commission (regularly 0.5-1.7 percent)[40] be considered a distinguishing element regarding their nature of representation? In other words, would an agent take a commission? According to the ledgers of the Bank of England, de Coninck received commissions and brokerage fees for his services, which were usually settled at the end of the fiscal year (- there are no indications of single settlements in connection with individual bills). This last point could suggest closer ties between de Coninck and the Bank. However, settlements on fixed dates were not and are not excluding arguments for correspondent relationships or exclusive arguments for a position as an agent.

In a more or less timeless understanding of an agent-principal relationship, agents can conduct, and respectively, finance certain transactions with the capacity to accept bills of

[39] See Treasury Minutes on Flanders, British Library, Lansdowne MS 1215, and Kleer (2017), pp. 88-9 Footnote 3).

[40] See Kleer (2003), p. 4.

exchange as well as honour and issue letters of credit.[41] These activities allow them to be facilitators of "foreign trade between home and foreign countries."[42] Most importantly, an agent is an operational, and also a legal extension of its parent foreign institution, and not a separately capitalized cooperation in the host country.[43]

The relationship between the Bank of England and de Coninck does not even come close to such an understanding. For instance, the fact that according to a note from Hill to the Treasury from March 25, 1695, de Coninck refused to honour letters of credit from the Bank of England is a clear indication of highly autonomous behaviour.[44] After this episode, the Bank did not abandon the contract with de Coninck (as one probably would have with an agent), but it only ceased to issue more letters of credit on de Coninck for a few weeks.[45] At the same time, the Bank wanted to resolve the existing overdraft with de Coninck as soon as possible – another piece of evidence that they did not deal with an agent. Jacobus de Coninck, in turn, did not have the patience (and any internal restriction through his

[41] Goldberg and Saunders (1981), p. 367.

[42] Curry et al. (2003), p. 40.

[43] Other services imply corporate and commercial loans, and – to a limited extent - deposit taking (often with the exception of taking them from residents of the host country), see Chapter 3.

[44] Treasury Minutes, 1695A, 88r (Minutes Taken at the Treasury Relating to the Returns of Money for Payment of the Forces in Flanders before 1 May 1695 – delivered by John Taylor, August 14, 1695, British Library, Lansdowne MS 1215, 79-91).

[45] This step is reflected in the Court Minute Books of the Bank and in Richard Hill's Account Book: two bills were directly given to Richard Hill – without having de Coninck involved as intermediary – for a combined sum of 364,310 guilders, due for payment at the Royal Ordnance in Amsterdam, see Court Minute Books, Lib. B (1695-97), Folio 26 and Richard Hill's General Account Book (1692-1700), Shropshire Archive, 112/1A/1. On additional measures like bills drawn by the Bank's directors on merchants in Amsterdam that were remitted to Hill who sold them to dealers in Antwerp, see Kleer (2003), p. 8, who also sketches another case, namely that Hill got the allowance to draw bills upon William Schulenberg after the Bank had borrowed significant amounts from the latter.

relationship with the Bank) to wait accordingly. Therefore, in early April 1695 - and to King William's furor - he repudiated again the demand to forward specie to Richard Hill.[46]

We already mentioned that the representative in Flanders often only received bills drawn on merchants outside the Low Countries. In order to finally receive the profit of the bill, de Coninck and others had to count on their own network of representatives across Europe. This is one of the strongest arguments against the assumption that the representatives of the crown in Flanders were "only" agents. It obviously occurred regularly that they had to provide Richard Hill with money before they had a chance to cash in the bill on places far away from Flanders (or to settle them with other outstanding debts abroad). Such a constellation would not have worked with de Coninck being only a legal and operational extension of the remittance contractors in London. Required were strong international business and banking structures, independent of the contract with the Crown or its representatives in London (or later with the Bank of England).

The archives of the Bank of England reveal the bandwidth and scope of de Coninck's network and therefore his status as an internationally fully established and commercially independent Antwerpian merchant.

Let us have a look at the Bank of England's early ledger where it listed the Bills of Exchange it purchased and forwarded to de Coninck.[47] Already in their early days of cooperation we find bills that de Coninck needed to cash in far from Antwerp (and not "only" in Amsterdam or Antwerp). In October 1694, the Bank of England listed in its ledger bills bought in London and remitted to de Coninck that were drawn upon merchants in different European cities.[48]

[46] In the Treasury Minutes (1695A, 90v), we read about a report from Ranelagh from April 17, 1695, about letters from Richard Hill (from April 3 and 8, 1695) in which he complained about de Coninck's repeated unwillingness to pay.

[47] Supplementary Ledger No.1 (ADM7/2) Folios 30-49, 88-99, and 171-172.

[48] Ibid., Folios 30-37.

	Oct. 9 1694	Oct. 12 1694	Oct. 16 1694	Oct. 19 1694	Oct. 23 1694	Oct. 26 1694	Oct. 30 1694
Amsterdam	141	41	16	10	33	12	12
Antwerp		8	7	4	2	4	8
Hamburg	3	2	2	10	6	5	
Ghent		5					
Brussels		1	1			1	
Bruges		5	6	2	3		6
Rotterdam		2	6	3	6		
Bremen				2	5		
Ostende			1		1		
Leyden		1					
Paris						15	
Cadiz						4	
Madrid						2	
not clear	3	2	4	4	2	7	1
Total of remitted bills	147	67	43	35	58	50	27

Table 1: Bills remitted to Jacobus de Coninck of Antwerp, in October 1694, the first month of the operation of the Bank of England.

The majority of them were running their business operations in Amsterdam (265 bills forwarded to de Coninck were drawn upon merchants based in Amsterdam, only 33 were from Antwerp); however, as shown in *Table 1,* de Coninck had to rely on representatives in a good number of other European trading hubs: 28 bills "went to" Hamburg, 22 to Bruges (appears as "Bridges" in the ledgers), 17 to Rotterdam, 15 to Paris, seven to Bremen, five to Ghent, three to Brussels, two to Ostende and one to Leyden, but also six as far as to Spain (four to Cadiz and two to Madrid). One might argue that the cities of the Low Countries might have still been in the reach of de Coninck and his people at Antwerp. Yet, already, Hamburg and Bremen would have required trips of several days, not to speak of Paris, Cadiz, and Madrid.

In November 1694, de Coninck received bills that were drawn upon merchants in Bilbao and Sevilla, and again, numerous ones on individuals in Madrid and Cadiz, alongside Amsterdam, Antwerp, Hamburg, Ghent, and Bruges, among others (*Figure 11*).[49]

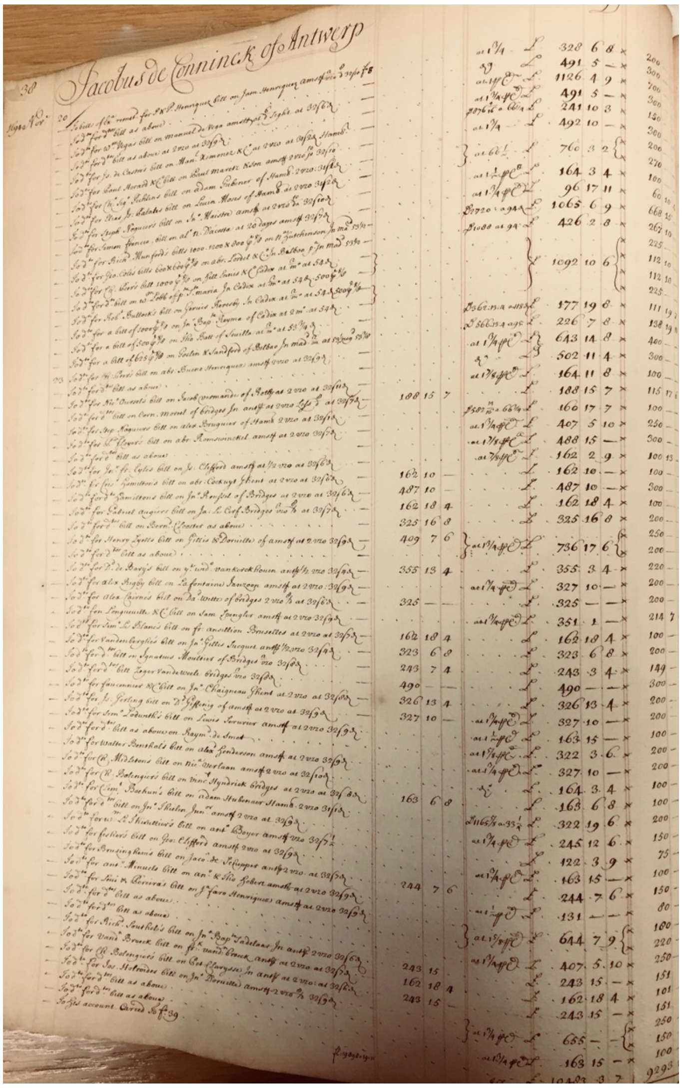

Figure 11: Bills of Exchange remitted to Jacobus de Coninck of Antwerp, Nov. 20 and 23, 1694, Supplementary Ledger No. 1 of the Bank of England, Folio 38.

The bills the Bank of England bought and remitted to de Coninck reflect a *European panopticum of merchants*. In order to gain the benefits of the bills remitted to him by the Bank of England, de Coninck needed to use a network of representatives (agents and

[49] Ibid., Folios 36-40.

correspondents) in the cities mentioned in the ledgers. This was an undertaking that would have been illusory for simply an agent of the Bank.

Furthermore, the Bank of England knew exactly the differences of a representation via individuals like de Coninck or Poulle and agents fitting the description above. Otherwise, they would not have installed the branch (mistakenly called "Agency"[50]) in Antwerp in 1695 - also, as a reaction to difficulties they had with the remittance operations by using only characters in Flanders who acted with a high degree of autonomy.

Over time, the new operation at Antwerp took over de Coninck's role, with employees/directors of the BoE relying not on their own, but on the Bank's network; far from being independent actors as de Coninck et al. were.

It is important to state that the representation at Antwerp did not immediately sideline de Coninck. The plan to install an operation there was discussed at a Treasury meeting on April 19, 1695[51], agreed upon a few days later. In mid-May the Bank of England decided to send three directors to Antwerp to run the new institution.[52] They resumed their positions shortly after. Yet, the receipts mentioned above show that de Coninck was involved in payments to Hill at least until August 1695 where receipt No. 24 proves his involvement in a transaction of 303.000 Florins[53] (*Figure 12*).

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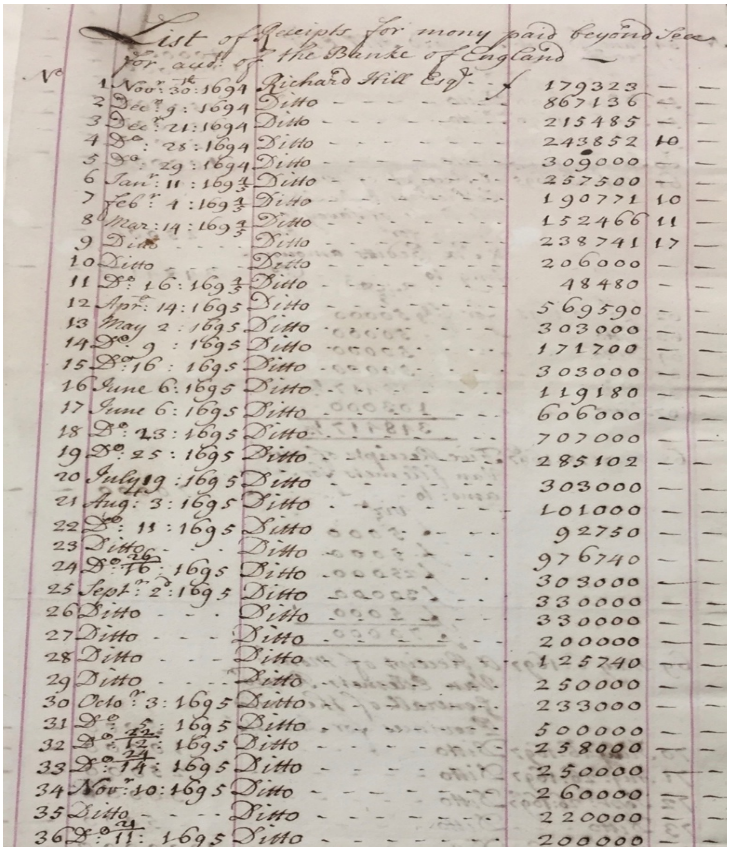
[50] See below, 2.i.

[51] Court Minutes Book, Lib. B.,19 April, 1695.

[52] See the letter of Ralph Montagu to William Blathwayt, May 17, 1695 (University of Nottingham, MS Pw A 935).

[53] Archive of the Bank of England, Receipts for Money Paid Abroad on Account of the Bank of England, M5/11, Receipt No. 24.



List of Receipts for mony paid beyond Sees
for acct: of the Banke of England —

No					
1	Novr: 30th: 1694	Richard Hill Esqr	179323	—	—
2	Decr: 9: 1694	Ditto	867136	—	—
3	Decr: 21: 1694	Ditto	215485	—	—
4	Do: 28: 1694	Ditto	243852	10	—
5	Do: 29: 1694	Ditto	309000	—	—
6	Janr: 11: 1694/5	Ditto	257500	—	—
7	Febr: 4: 1694/5	Ditto	190771	10	—
8	Mar: 14: 1694/5	Ditto	152466	11	—
9	Ditto	Ditto	238741	17	—
10	Ditto	Ditto	206000	—	—
11	Do: 16: 1694/5	Ditto	48480	—	—
12	Apre: 14: 1695	Ditto	569590	—	—
13	May 2: 1695	Ditto	303000	—	—
14	Do: 9: 1695	Ditto	171700	—	—
15	Do: 16: 1695	Ditto	303000	—	—
16	June 6: 1695	Ditto	119180	—	—
17	June 6: 1695	Ditto	606000	—	—
18	Do: 13: 1695	Ditto	707000	—	—
19	Do: 25: 1695	Ditto	285102	—	—
20	July 19: 1695	Ditto	303000	—	—
21	Aug: 3: 1695	Ditto	101000	—	—
22	Do: 11: 1695	Ditto	92750	—	—
23	Ditto	Ditto	976740	—	—
24	Do: 26/16: 1695	Ditto	303000	—	—
25	Septr: 2: 1695	Ditto	330000	—	—
26	Ditto	Ditto	330000	—	—
27	Ditto	Ditto	200000	—	—
28	Ditto	Ditto	125740	—	—
29	Ditto	Ditto	250000	—	—
30	Octor: 3: 1695	Ditto	233000	—	—
31	Do: 5: 1695	Ditto	500000	—	—
32	Do: 12: 1695	Ditto	258000	—	—
33	Do: 24/14: 1695	Ditto	250000	—	—
34	Novr: 10: 1695	Ditto	260000	—	—
35	Ditto	Ditto	220000	—	—
36	Do: 11: 1695	Ditto	200000	—	—

Figure 12: Archive of the Bank of England, List of Receipts for Money Paid Abroad on Account of the Bank of England between November 1694 and November 1695. Jacobus de Coninck appears on Receipts No. 1-21 and 24.

(2) Deciphering de Coninck

So, in conclusion, who was de Coninck? A rich banker from Antwerp? Correspondent or agent of the Crown? All details listed above bring to light a highly independent merchant from Antwerp with a European network of representatives that could handle complex bill of exchange arrangements. Although he might be called an “operational extension” of a “foreign institution” in the sense of the above definition of an agent, he was neither a “legal extension” of Evance and Herne or the Bank of England (none of his contracts with them fulfill the requirements) nor could any of the remittance contractors be called a “parent institution” as he was a separately capitalized “cooperation” in the host country. Even the fact that his contractual partners in London would equip him with “money” in the form of bills of exchange does not justify a different judgment. If he would have been furnished beforehand with specie, we could come to a different result. But, a representative who would continuously run the risk of delaying or lacking payments of the contractor in the parent country (as it repeatedly happened to de Coninck) cannot and should not fit into the categorization of an agent. On the contrary, representatives with such a risk exposure were forced to have enough means in stock to pay the final recipient of a remittance cycle without fully relying on punctual payments of interests and remittances of bills by their contractual partners. They also needed the freedom to withhold or deny certain payments in case the partners defaulted regarding their duties.

In Chapters 3 and 4, we developed criteria and parameters for identifying correspondent relationships. Regardless of whether we look at correspondent arrangements in the 12th or the 21st century, (1) the access and influence factor, (2) the savings factor, (3) the local and global networks factor, (4) the efficiency factor, (5) the interconnectivity factor, (6) the business accelerator factor and (7) the predictable revenue factor are all equally applicable. All of those are pertinent in de Coninck's relation to, both, Evance and Herne and the Bank of England.

Moreover, most of our "timeless" criteria of correspondent relationships are well reflected between Antwerp and London in 1694 and 1695:[54] (1) De Coninck was used to "overcome the respondent's lack of a physical presence in a certain region", here Flanders. (2) He offered his "services for cross-border customer demands". (3) The cooperation with de Coninck fulfils the criteria of "competitiveness" (meaning in the context of war remittances the expansion to foreign markets); this goes hand in hand with (4) "foreign market entry and access to overseas local markets" and (5) "cost reduction" (instead of remitting specie to Flanders or running a branch or subsidiary or – in the case of the correspondent – getting the opportunity to widen the global network via the bills of exchange that covered most of Europe). Although the aspect of profitability was questionable for the Bank of England, the contract with de Coninck improved its efficiency. In terms of reliability the (6) "financial strength" of de Coninck was clearly given, his (7) "market reputation" went far beyond Antwerp, (8) and his "range of services" and (9)" efficiency" in respect of service delivery was that of a correspondent and not only a fully dependent representative with limited scope.

At this stage of its business development, the Bank of England apparently needed to rely on a correspondent, even if this may in the short-term be costlier than an agent on a transaction basis (since agents do not take individual risk and thus do not need to be rewarded for such), but the entry cost to establish a dependent agent abroad is higher. This analysis is confirmed by the Bank of England's subsequent move to establish a branch in Antwerp,

[54] The following criteria are extensively listed in Chapter 4 1. Those applicable are "quoted".

staffed with its own directors. It was a costly move likely justified by the expansion of the remittance business and the recognition that, in the long-run, costs could be reduced by direct action overseas and reducing reliance on correspondents, despite the significant initial setup costs that do not exist when using a correspondent.

Therefore, and with respect to conceptual clarity and for the sake of a stringent (timeless) definition, representatives like Jacobus de Coninck could only be seen as correspondents and not as agents in bill cycles as described above.

We come to a similar conclusion regarding Benjamin Poulle (1646-1711) who was one of the richest individuals in Amsterdam at that time and acted as the correspondent of the remittance contractors from there. Compared to de Coninck he is only sparsely mentioned in the ledgers of the Bank of England with which he also engaged,[55] but the arguments given for de Coninck's role in Antwerp are equally as relevant for Poulle (at least as long as Evance and Herne were involved). The Bank of England abandoned the work with Poulle when it took over the goldsmith bankers' business and relied almost exclusively on de Coninck for the first months of its remittance operations.

Theoretically, one could be tempted to qualify de Coninck, Poulle and other correspondents not only as correspondents of Evance and Herne (and later the Bank of England), but as "sub-correspondents" of the Crown or Ranelagh. Yet, such an approach is misleading (as is Kleer's incorrect classification of this group as "sub-agents")[56] because the Crown could not have been interested in accumulating dependencies on the continent apart from the already shown correspondent-principal cycle of a bill (with Ranelagh's correspondent Schuylenburg); instead, it outsourced the risks of default.

[55] Supplementary Ledger No.1 (ADM7/2), Folio 129.

[56] Kleer (2017), p. 44. We have already shown ample evidence why we are not dealing with "agents" but correspondents in this constellation.

bb. Other remittance options

Our thorough look into the correspondent-merchant cycle of a bill gave us the opportunity to answer one of the open questions; namely, the nature of representation in Flanders (especially de Coninck's). However, when we initially examined this most complex remittance scenario before the inception of the Bank of England (*Illustration 4*), we hinted at remittance alternatives within the correspondent-merchant cycle of bills with simpler structures.

In order to gain a clear picture of those alternatives, we still need to know whether the bills were remitted directly by the correspondents Evance and Herne in London to their correspondents in Flanders (in exchange for being paid the amount on the bill by Ranelagh) or whether the conventional way was used, meaning the correspondents sold the bills to Ranelagh, gave them to him and he forwarded them to his representative in Flanders. Then, we shall clarify whether the debtors from the continent owed only the correspondents or the Crown. Finally, were those correspondents in Flanders only representing the Crown's correspondents, or could they potentially have been direct representatives of the Crown as well?

The last question can be quickly answered by referring to the already described agent-principal and correspondent-principal cycles of a bill.[57] In a correspondent-merchant cycle, a dual representative structure on both sides of the Channel would not have made much sense. First and foremost, why would Ranelagh employ representatives in Flanders and in London whilst the latter were the ones drawing bills on merchants in the Low Countries? The much easier option would have been to have the representatives in Flanders draw bills on him. Furthermore, Ranelagh would have been burdened with an additional risk factor of bearing the full responsibility for both the correspondents in London and in Flanders as opposed to outsourcing the potential default risks in Flanders to his correspondents in London.

Illustration 5 shows the constellation where Ranelagh would only buy the bill from his correspondents in London who, in turn, would forward the bill directly to their own correspondents (in case de Coninck, Poulle, or comparable figures were the recipients) or agents in Flanders, while giving Ranelagh de facto ownership of the bill – at least until the

[57] See above, 1.a. and 1.b.

bill was cashed in. The representative would receive the money against presenting the bill from the merchants in Antwerp who were indebted to Ranelagh's correspondents in London.

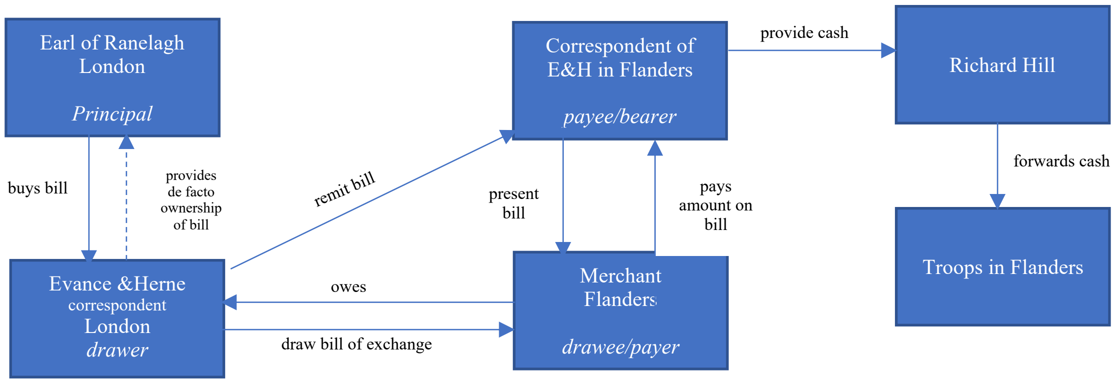


Illustration 5: Option C (2); correspondent-merchant cycle of a bill with the sequence correspondent-merchant-principal-correspondent-merchant using correspondents in Flanders who receive the bills directly from the principal's correspondent in London whom they represent.

In the Treasury's Books, we repeatedly find evidence for this option, for example in the Disposition Book XI (p. 22), where we read about the demand "to issue as follows out of the Exchequer: viz.: to the Earl of Ranelagh for Sir Joseph Herne towards answering the bills he gave, payable in Amsterdam" or "for Sir Joseph Herne upon the bills he gave, payable in Amsterdam, for the Hanover Troops" (ibid., p. 29).[58] In this case, Ranelagh's correspondent in London obviously remitted the bill directly to the Low Countries.

A look into the account books of Richard Hill offers evidence for another uncomplicated way of "closing" this bill cycle, namely, through the active involvement of Ranelagh who would get the bill from his correspondents in London and forward it directly to his agent,

[58] These sources can also be found in 'Entry Book: November 1692, 1-15', in: *Calendar of Treasury Books, Volume 9, 1689-1692*, ed. William A Shaw (London, 1931), pp. 1886-1901.

Richard Hill, in Flanders (*Illustration 6*).[59] The King himself even occasionally sent bills directly to Flanders, as revealed by letters in the Shropshire Archives.[60]

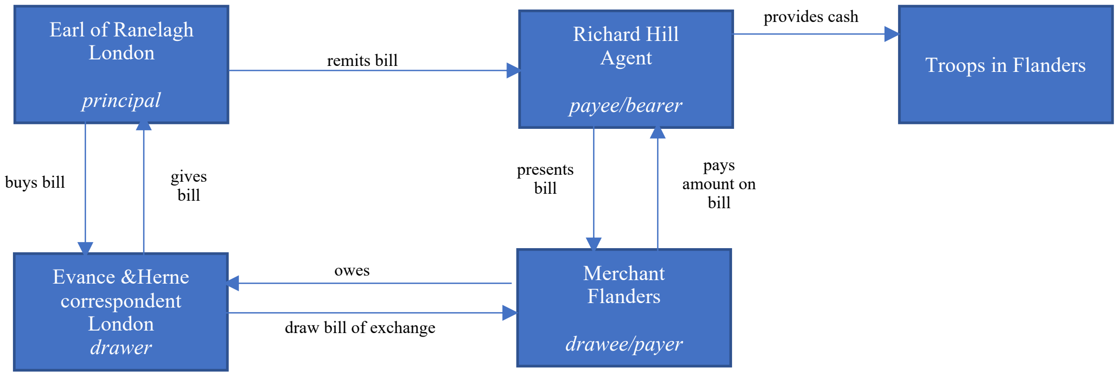


Illustration 6: Option C (3); correspondent-merchant cycle of a bill with the sequence correspondent-merchant-principal-agent-merchant using Richard Hill as Ranelagh's agent in Flanders who receives the bills directly from the principal in London.

[59] See numerous references in the Shropshire Archives, Records relating to Hon Richard Hill's activities as Deputy Paymaster General to the FC, X112/1/2/1/1 (General account book 1692-1700, Includes monthly payments to regiments, details of bills of exchange received to finance campaigns, and contingency payments for forage, hospital, and petty cash. Also abstract of total payments for the campaign, 1692-1698, prepared to be sent to the Earl of Ranelagh at Whitehall (folio 391)), X112/1/2/1/2 (Ledger 1694-1696), X112/1/2/1/3 (Ledger 1694-1697) and X112/1/2/1/7 (current accounts 1692-1694), X112/1/2/1/8 (draft current accounts 1692-1694).

[60] See the letter from Mathew Ingram to Richard Hill from 28 March 1693 (Shropshire Archives, Records relating to Hon Richard Hill's activities as Deputy Paymaster General to the FC, X112/1/2/7/1652): "The King went on Friday in order to embark for Holland, but the wind proving contrary, is now come back to London. He sends instructions for the management of accounts and explains how he will send bills to meet Hill's demands. Directed to Hill as Paymaster to the English Forces in Flanders, at Antwerp Docketed twice, once in Hill's hand "bill for f56700 on Mr Poulle sent back". March 28, 1693 at 7 of ye clock." Ingram had just received 5 letters from Hill, one returning a bill of exchange of 56,700 guilders, but he has not read one, being too busy that he cannot answer them. "'My Lord' being not well, but striving to accomodate all things with Sir Jos Hearne".

Ingram's letter[61], in which Evance and Herne obviously remitted bills directly to Richard Hill, is also a most interesting example for a third remittance option (*Illustration 7*). Ranelagh would only be involved in order to purchase the bill from Evance and Herne. This is also only consequential in the light of Option C (2) (*Illustration 5*), where we have already seen remittances from Evance and Herne to Flanders in more sophisticated constellations. However, two observations make this model particularly noteworthy: On the one hand, Richard Hill acts (for a shared goal) as a "double agent" (officially for Ranelagh, and de facto for Evance and Herne in this specific transaction as well); secondly, in Ingram's letter, we hear about a bill drawn on Poulle, the merchant from Amsterdam, who also served as a correspondent of Evance and Herne in other bill cycle constellations (see above).

This model, where Poulle apparently owed Evance and Herne in his role as a merchant from Flanders must not be confused with the correspondent-correspondent cycle of a bill (see below) where Poulle and de Coninck were drawees and correspondents in one person but compensated for their efforts through another bill cycle.[62]

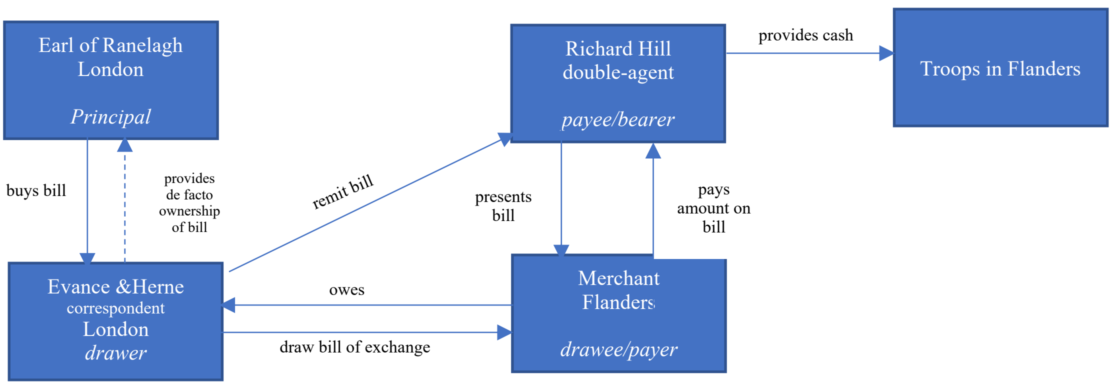


Illustration 7: Option C (4); correspondent-merchant cycle of a bill with the sequence correspondent-merchant-principal-correspondent-agent using Richard Hill as agent in Flanders who receive the bills directly from the principal's correspondent in London whom they represent.

[61] Ibid.

[62] See below, 1.d.

As easy and simple the last three alternatives on the correspondent-merchant cycle may seem, they were clear exceptions as the number of merchants in Flanders who owed Evance and Herne was naturally limited. In this context we shall also find an answer to the question "who owed whom" in this bill cycle. Bills of exchange certainly made sense if the creditors were the Crown's correspondents as they had good reasons to draw upon their debtors abroad and then sell the bill to the principal (Ranelagh). However, would a correspondent-merchant bill cycle also have worked if the creditor was the Crown, respectively Ranelagh, and the debtors (again) merchants across the Channel? Theoretically, it would have been possible, though in practice there was no necessity to involve a third party (remittance contractors) if bills could be drawn directly on the debtors by Ranelagh and remitted to Flanders and especially fees for the contractor in London would be spared.

d. The correspondent-correspondent cycle of a bill

Earlier, we already touched on the possibility of intertwined cycles of a bill when we described the knotty Option C(1) of a correspondent-merchant cycle (*Illustration 4*). It allowed the financial backing of the correspondents of Evance and Herne in Flanders. The literature on English remittance systems has not recognized another possibility for facilitating payments to the troops that builds on this *dual bill cycle* approach. Suppose Evance or Herne as Ranelagh's correspondents would have drawn a bill upon their own correspondents, de Coninck or Poulle in Flanders. After buying the bill from Evance or Herne, Ranelagh would have remitted the bill to his deputy, Hill, who in turn would receive cash from de Coninck or Poulle. They, of course, needed sufficient financial means to fulfil the demand. This again was accomplished through another bill sequence where de Coninck or Poulle would also be paid by merchants in Flanders on whom Evance and Herne would have drawn bills upon (*Illustration 8*).

It is difficult to gain clear evidence from accessible ledgers and account books for this correspondent-correspondent cycle of a bill. However, in the Shropshire Archives, we find correspondence of Richard Hill and a letter from May 8, 1694, where Joseph Herne wrote to Hill who had made complaints on the bills drawn on Benjamin Poulle. Herne, ordered to accelerate the payments to Richard Hill, promised

> "for the future I will draw the bills payable in Mr. De Connick howse that you may have all the conveniences possible so I intrete you for what past to make no complainte."[63]

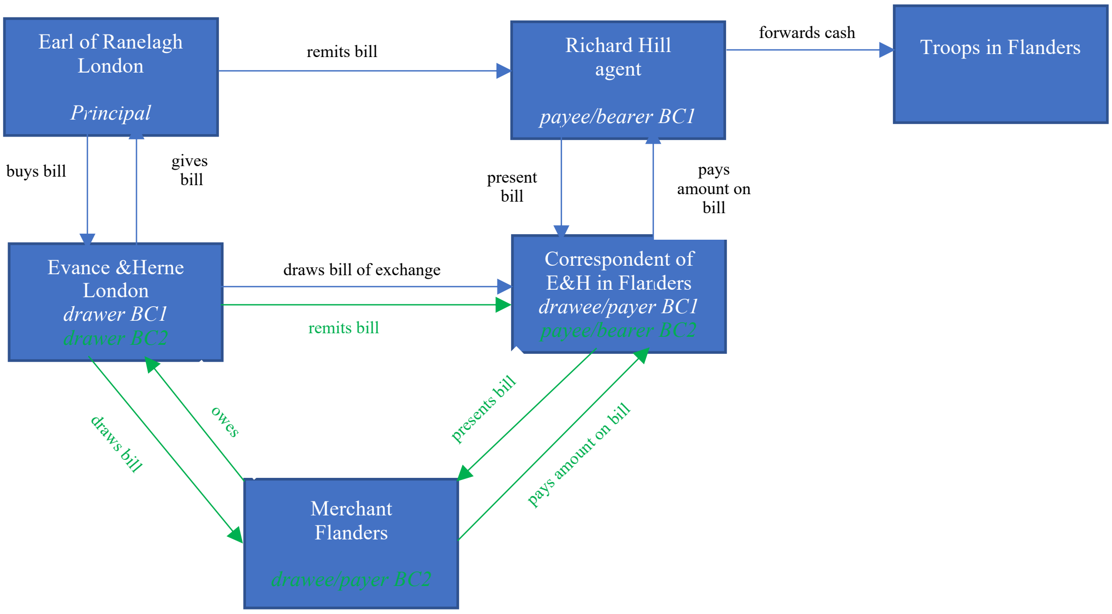


Illustration 8: Option D(1); correspondent-correspondent cycle of a bill with two sequences (BC1 and BC2).

BC1 in order to facilitate remittance payments to the troops using correspondents in London, their representatives (correspondents) as well as the Army paymaster's deputy, both in Flanders: correspondent-correspondent-principal-agent-correspondent-agent.

BC2 in order to provide the correspondent's representative in Flanders with sufficient financial means: correspondent-merchant-correspondent-merchant.

This proves an additional correspondent-correspondent bill cycle in order to remit funds to the troops. An earlier letter from Matthew Ingram to Richard Hill (March 31, 1693) also refers to bills drawn upon de Coninck and Poulle.[64]

Of course, option D(1) (*Illustration 8*) only worked if Evance and Herne could involve a merchant in Flanders who owed them at that very moment. Consequentially, this

[63] Shropshire Archives, Records relating to Hon Richard Hill's activities as Deputy Paymaster General to the FC, X112/1/2/7/426, 8 May 1694.

[64] Ibid., X112/1/2/7/1653, 31 Mar 1693: "Matth Ingram writed to Hill He sends a bill for 5400 on Deconinck instead of on Poulle"

model can only be seen as a fall-back position under special circumstances. More reasonable appears a dual cycle approach, where the second bill cycle would have entailed London merchants from whom the remittance contractors would have bought bills drawn on merchants across Europe (ideally in Flanders). In the next step, Evance and Herne would have remitted those bills to their correspondents (for example de Coninck) to compensate their payment in the first bill cycle (option D(2), *Illustration 9*).

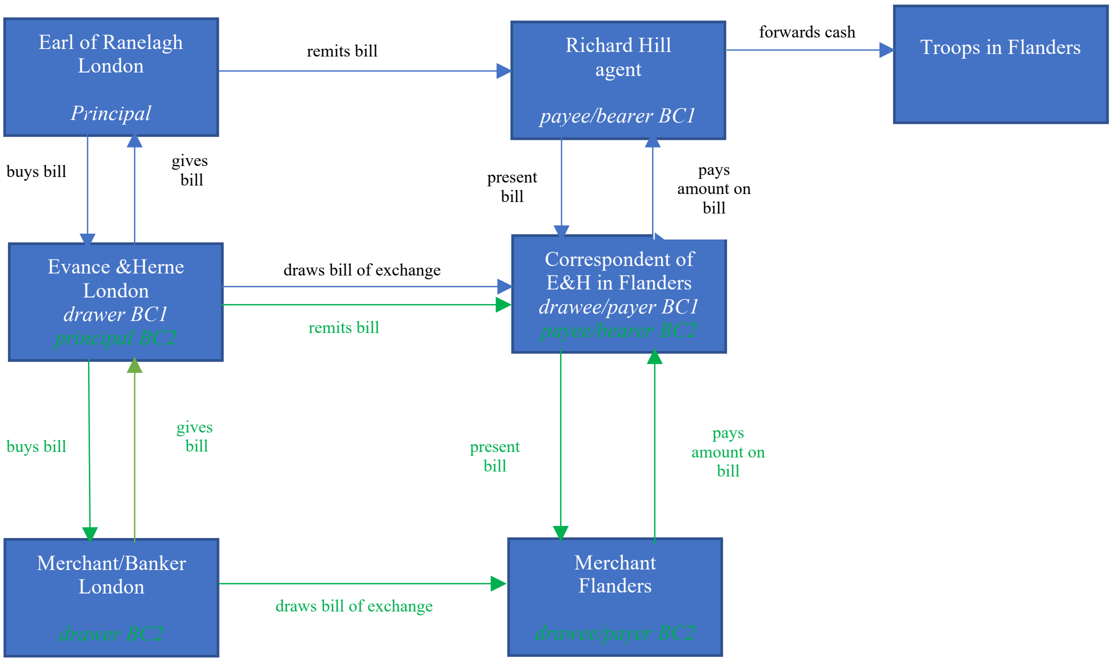


Illustration 9: Option D(2); correspondent-correspondent cycle of a bill with two sequences (BC1 and BC2).

BC1 in order to facilitate remittance payments to the troops using correspondents in London, their representatives (correspondents) as well as the Army paymaster's deputy, both in Flanders: correspondent-correspondent-principal-agent-correspondent-agent.

BC2 in order to provide the correspondent's representative in Flanders with sufficient financial means: merchant-merchant-principal-correspondent-merchant.

Again, variations of this dual cycle model cannot be excluded as the sources are sometimes vague. Similarly, for example, as for the (correspondent-merchant) bill cycle described before, it is feasible that Evance and Herne forwarded the bills (in the first cycle) to Hill directly.

e. Operations with letters of credit

So far, we have concentrated on several forms of bill of exchange operations before the founding of the Bank of England. However, it needs to be mentioned that also letters of credit were regularly in use to facilitate payments to the troops as even the remittance contractors preceding the Bank of England furnished Ranelagh with letters of credit "payable on the continent to himself or order"[65].

Especially, the last option, namely the correspondent-correspondent cycle of a bill, offered an alteration from a bill cycle to a letter of credit cycle. Analogous to a system which the newly founded Bank of England would install a little later, and instead of a correspondent-correspondent or correspondent-merchant bill of exchange cycle, Ranelagh would have paid the Evance and Herne syndicate for a letter of credit that he would then remit to Richard Hill in Flanders. The letter authorized Hill to ask the representatives of Evance and Herne in Flanders to pay him the respective sum in Flemish currency, yet still, the representative needed proper compensation for his payment to Hill. Therefore, Evance and Herne would have bought bills from other merchants or bankers in London drawn on merchants abroad (*Illustration 10*).

Often, however, the remittance contractors would buy bills drawn on merchants abroad and further away than Flanders as they could rely on the wide network of their correspondents, especially if they were as powerful international merchants as de Coninck and Poulle. They, in turn, would use their own representatives in the respective cities to benefit accordingly from the bills.[66]

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[65] Kleer (2003), p. 3, who also points to the fact that the "contractors' agents [respectively correspondents] supplied cash in ad hoc installments over a span of one to two months (sometimes longer)", (ibid., Footnote 2).

[66] For a similar visualisation of this model, see already *Illustration 4.*

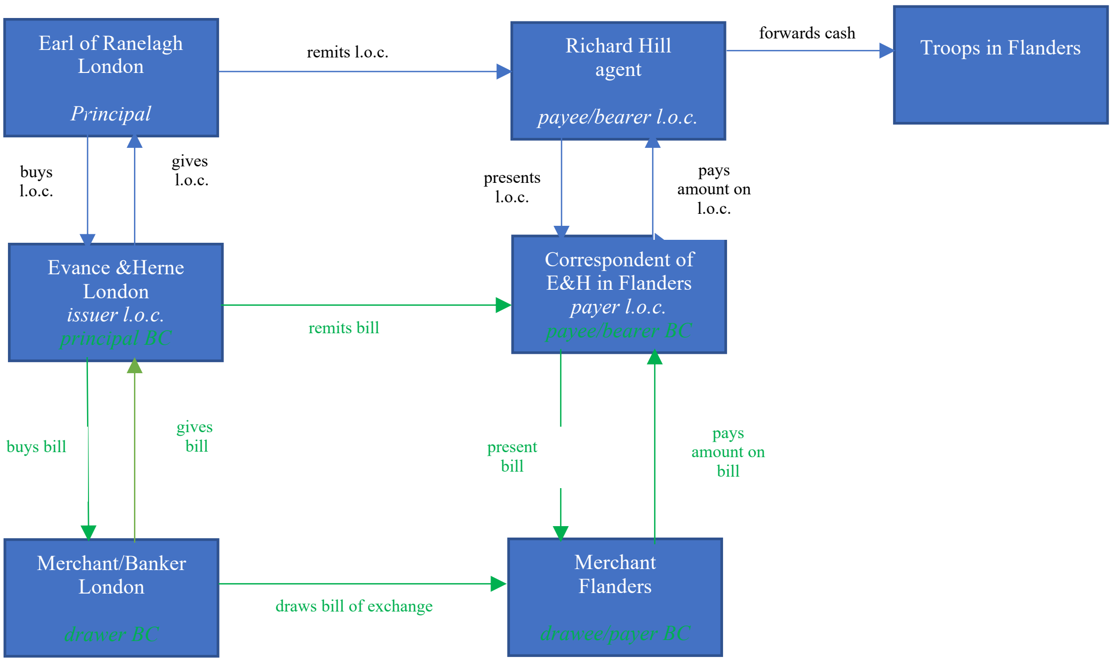

Illustration 10: Option E: letter of credit (l.o.c.) cycle with a bill cycle (BC) to compensate payer of the letter. correspondent-correspondent cycle of a bill with two sequences (l.o.c. and BC).

L.o.c. cycle in order to facilitate remittance payments to the troops using correspondents in London, their representatives (correspondents) as well as the Army paymaster's deputy, both in Flanders: correspondent-principal-agent-correspondent-agent.

BC in order to provide the correspondent's representative in Flanders with sufficient financial means: merchant-merchant-principal-correspondent-merchant.

2. Remittance options involving the Bank of England

We have already touched upon the fact that in October 1694 the Bank of England stepped into the role of Evance and Herne as remittance contractor of the Crown. The syndicate of the goldsmith correspondents was more or less elegantly sidelined, although they desperately tried to continue their operations.[67]

Getting a firm grip on the Bank of England's remittance efforts to Flanders and its use of agents and correspondents is a demanding task. Let us have a look at the early

[67] The goldsmiths, apparently, correctly foresaw that the appearance of the Bank of England would mean competition for them, since they were not found among the subscribers of the original shares of the Bank of England.

ledgers we find in the archives of the Bank. The newly founded institution had different accounts to reflect its liabilities (namely the funds meant for the troops in the Low Countries) and assets (bills of exchange bought to balance the respective amounts of cash outside England). Interestingly enough, the two accounts did not match in a way that the balance on the account reflecting the "Exchanges" kept a balance of (or near) zero.[68] This resulted in a scenario that, for most of the time, the Bank had a deficit on this "mixed account". Money borrowed from the Dutch army paymaster did not appear in the aforementioned accounts, but in a separate ledger (hereafter Supplementary Ledger[69]).

a. The Bank of England - correspondent or agent or *institutio sui generis* to the Crown?

As the Bank of England took over the main functions of the Crown's remittance contractors, whom we have eventually identified as correspondents, one might be tempted to give the Bank the same or a similar attribute. In Chapter 3, we came to the conclusion that central banks can very well act as correspondent banks. Yet, this finding relates to a multi-bank network for payment transactions, especially involving foreign currencies. Today, the Bank of England frequently operates as a correspondent, for example, within the Clearing House Automated Payment System (CHAPS).[70]

However, analogies should be used carefully, and this modern example does not relate to the relationship between the government and the Bank of England. Additionally, specific aspects of current central banking were not developed in the late 17th century.

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[68] See also Kleer (2017), p. 88, Footnote 1, who correctly notes that this discrepancy was mainly caused by a drop of the London-Antwerp exchange rate in 1695, leading to more expensive foreign bills of exchange and delayed purchases of bills by the Bank of England – the Bank frequently relied on loans from foreign bankers.

[69] Archive of the Bank of England, ADM7/2.

[70] According to the Bank of England's website, "[d]irect participants in CHAPS include the traditional high-street banks and a number of international and custody banks. Many more financial institutions access the system indirectly and make their payments via direct participants. This is known as agency or correspondent banking." The Bank of England lists itself as a CHAPS "Direct Participant", see https://www.bankofengland.co.uk/payment-and-settlement/chaps.

Thus, we will look more thoroughly at some traditional elements of correspondent relationships. Unlike today, the Bank of England was not owned by the government after its founding and during the Nine Years War. Over 1200 people purchased "bank stock" to create a loan of £1,200,000 to the government at 8 percent and hence built the fundamentals for the "Governor and Company of the Bank of England" established by Royal Charter and under the authority of sixteen sections of the Tonnage Act of 1694.[71] The Bank of England acted (for over 250 years) as a private bank and it, therefore, seems logical to categorize the early interaction between the Treasury and the Bank as a correspondent relationship. However, a decisive factor is always the degree of independence of a representative. In the 21st century and since its nationalization in 1946, the Bank has been wholly owned by the government, with the entire capital held by the Treasury Solicitor, apparently on behalf of the Treasury. Such an institutional framework - despite undeniable aspects of independence[72] - barely allows a parallel to correspondent arrangements in similar constellations. The interaction would rather resemble the aspects of an agency.

Although Richards (1929) reports about a "particularly close personal relationship between the Lords of the Treasury and the directors of the Bank of England" in the first six years after its founding referring to numerous excerpts in the Treasury Minute Books[73], there is no indication that the nature of the contacts between the Treasury and the Bank mirrored further dependence. Within the "financial community" – not unlike today – everyone knew each other, and it does not come as a surprise that a vivid exchange of views took place in such volatile times. According to Howells (2013), the Bank of England was seen in its first decades as a commercial banking operation and concerns about the Bank's independence were not a decisive factor in its early history and "only came to the fore after it had acquired, step by step, the responsibilities of a

[71] Better known as "Ways and Means Act of June 1694, 5 and 6 Wm. & M., c. 20 (1694), ss. 18-33". See, also, the Journal of the House of Lords (L.J.), XV, under 23rd, 24th, and 25th April 1694 and the detailed descriptions of Richards (1929), pp. 155-175.

[72] For instance, the Bank's sole responsibility for setting the short-term policy interest rate (since May1997), see, on this aspect, McCafferty (2017).

[73] Richards (1929), p. 199; the Treasury Minutes that he mentions are to be found at P.R.O., Recs. T.,T.29/8-11 (1695-1700) and T.29/627 (1694-1700).

central bank”.[74]

Some might claim that in its first months and years, the Bank resembled some elements of an agent as they were tied to the Crown by strict contracts that could not be terminated by the Bank as the Bank Minutes of May and June 1695 plainly reveal.[75] However, analogous to the preceding role of Evance and Herne, some parameters to distinguish the Bank’s role from an agent-principal relationship apply also here. In the first year of its operation, the relationship between the Bank of England and the Treasury regarding the remittance efforts was only based on short-term contracts.[76] The Bank also acted independently in respect of its handling of the bill cycles that it had installed to pay de Coninck. Richards (1929) sees that “some of the bank's first directors were among the earliest “trustees for managing the moneys advanced or to be advanced for exchanging and circulating” these “indented bills of credit.””[77] However, a trustee must not be confused with an agent.

Purists might state that a correspondent could only be installed, used, or created through another bank. Clearly, this is a characteristic that the other side, as the respondent (Ranelagh, in this case), would not fulfil. But, strictly speaking, with such a definition, even the syndicate of Evance and Herne would not have qualified as correspondents. This view is too narrow (and we have already widened the scope in Chapters 3 and 4). The Earl of Ranelagh undoubtedly represented not only the crown but, more precisely, the Treasury, which could be seen as a “financial institution” that had all the necessary options for choosing different forms of representation, including agents and correspondents.

Although the Bank of England grew into an *institution sui generis* over the next few centuries, often reflecting a hybrid form of different banking models, it could logically

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[74] Howells (2013), pp. 2 and 8.

[75] Archives of the Bank of England, Court of Directors Minutes, Lib. B.

[76] See the agreement of March 8, 1695, between the Treasury and the Bank of England that was signed for only three months, Treasury Minutes 1695A, 88r.

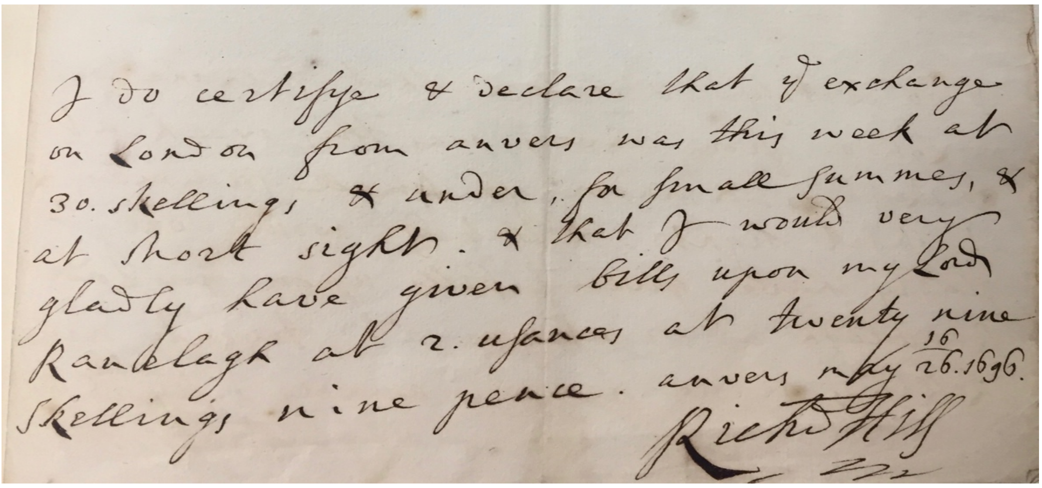
[77] Richards (1929), p. 166, referring to the Treasury Minutes, at P.R.O., Recs.Ex.R., E. 406/207.

only be seen as the Treasury's correspondent during the Nine Years' War. It not only took over the role of Evance and Herne, as the Crown's main remittance contractor, but it also built on the experiences of the goldsmith syndicate regarding different useful bill-cycles or combined letter of credit- and bill cycles.

b. The agent-principal cycle of a bill

The equivalent of the agent-principal cycle of a bill is illustrated by a good number of sources. We find evidence of this cycle, for example, in Hill's account books already in November and December 1694.[78] However, the Bank of England wasn't involved directly at this time; the method was used to balance disappointing first remittance steps of the Bank, and it simply resembled the procedures that were in place already before the Bank's inception (see above Remittance Option A, *Illustration 2*).

Yet it shouldn't take too long until the Bank of England also became a relevant player in such cycles. In the aforementioned collection of "Receipts for Money Paid Abroad on Account of the Bank of England" Richard Hill added a few sentences to receipt No. 53 (16/26 May 1696) where he "would very gladly have given bills upon my Lord Ranelagh at 2 usances […]" (*Figure 13*).



I do certifye & declare that ye exchange on London from anvers was this week at 30. skellings, & under, for small summes, & at short sight. & that I would very gladly have given bills upon my Lord Ranelagh at 2. usances at twenty nine skellings nine pence. anvers May 16/26.1696.
Richd Hill

Figure 13: Addendum of Richard Hill to Receipt no. 53 of the "Receipts for Money Paid Abroad on Account of the Bank of England" (May 1696)

More indications for participation of the Bank are to be found in the first four Court

[78] Shropshire Archives, X112/1A/1 (Attingham Collection).

Minute Books covering the years 1694-1705[79]. On August 11, 1697, for instance, the Bank accepted Exchequer bills "for the payment of a bill of Exchange of £8,315,35.*2d.* drawn by Mr Hill on the Lord Ranelagh payable to Mr Abraham Houblon for the use of the Bank."[80] Abraham Houblon, first director of the bank, was the brother of John Houblon, the first governor of the Bank of England. It is not entirely clear if and how much time Abraham Houblon spent in Antwerp.[81] However, directors of the Bank of England were repeatedly on the other side of the Channel – either representing the newly founded branch of the Bank of England at Antwerp or part-time for specific business operations.

In the Low Countries, different constellations of dealing with this agent-principle cycle were possible. Let's take the example just mentioned above: Suppose Abraham Houblon was in Antwerp at that time, where he would act as the Bank of England's agent, receiving the bill of exchange drawn by Hill on Ranelagh against payment. He then would have remitted the bill to London, where "his" bank would have gotten the Exchequer bills after showing the bill. In case, Abraham Houblon had stayed in London, other options seem possible: On the one hand, he could have relied on the Antwerp representation of the Bank of England (see below) that was installed in 1695 to overcome the difficulties - among others - with existing correspondent arrangements. The Antwerp branch would take care of the payment to Hill and forward the bill to London where Houblon, as a director of the Bank, would find the appropriate way to have the bill presented to representatives of the government.

Finally, and again with Houblon in London, the Bank of England could have relied on a correspondent in Antwerp (similar to the construct we have seen with de Coninck, who at this time did not work any longer under a remittance contract with the Bank of England).

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[79] Court Minute Books, Lib's. A-D.

[80] Court Minute Books, Lib. C, fol. 8.

[81] Even Archer Houblon's (1907) thorough study of the Houblon family offers no evidence.

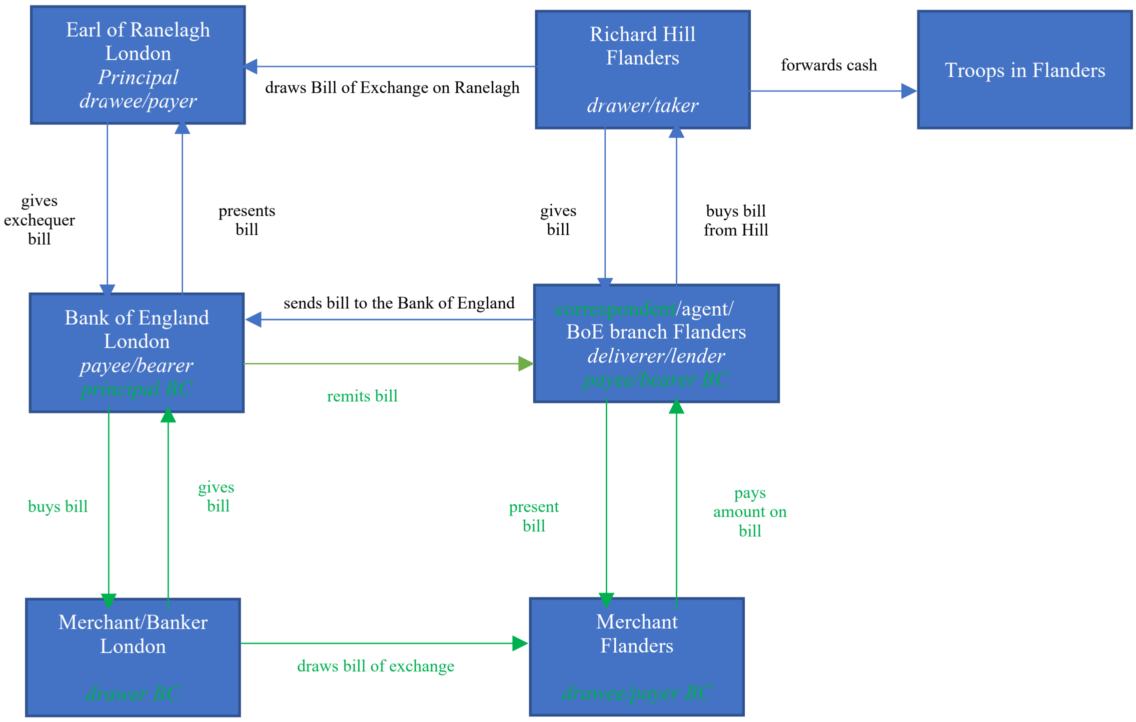

Illustration 11: Remittance Option A; agent-principal cycle of a bill with the sequence agent-principal-correspondent/agent/Antwerp branch-Bank of England-principal. The bill cycle (BC) is only relevant if the Bank of England used an independent correspondent in Flanders. [82]

In order to facilitate sufficient resources for the correspondent, the proven method of buying and remitting bills to the correspondent would have been the best choice. Unfortunately, we don't find clear evidence in the primary sources what exact method was used in our example from August 1697, but all of these (rather straightforward) alternatives were practised over the years in agent-principal cycles of a bill involving the Bank of England *(Illustration 11)*.

[82] To avoid further complexities in this context, we only show the constellation with a correspondent that was equipped with the necessary financial means. In our paragraph on the Antwerp "Agency" (see below, 2.i.), we will also touch upon the difficult ways to furnish this institution with sufficient money that could eventually be forwarded to the troops.

c. Dual cycle remittance option – a letter-bill cycle

We have touched upon the complicated *dual cycle remittance* option above involving two or more sequences of bills of exchange.[83] After the inception of the Bank of England, an analogous remittance instrument came into play. Instead of a correspondent-merchant bill of exchange cycle, Ranelagh paid the Bank for letters of credit (or he charged a matching sum to his account at the Bank of England), which he[84] then remitted to Richard Hill in Flanders. The letter authorized Hill to ask the Bank's representative in Flanders (in the first year, mainly its correspondent de Coninck) to pay him the respective sum in Flemish currency.[85] However, the representative needed to be compensated for his payment to Hill. Here, we face an analogy to the dual bill cycle we described in the "pre-bank"-context previously. The Bank of England would remit bills to its representative that were bought in London and drawn on debtors across Europe. It was the representative's responsibility to cash in the bills via his own network (*Illustration 12)*.

Again, the "Receipts for Money Paid Abroad on Account of the Bank of England" substantiate the details of this model. Receipt No 3 (*Figure 14*), signed by Richard Hill, serves as a good example: The Deputy Paymaster acknowledges there the receipt of *fl*215,485 in Antwerp "for a Credit on De Coninck" on 21. December 1694.[86]

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[83] See above, 1.c.aa.

[84] If not Ranelagh himself, it was his secretary Mordecai Abbott, who undertook these responsibilities for the Paymaster, see in the Shropshire Archives (Attingham Collection) the so-called "Abbott Letters" (X112/1/2/1).

[85] See Kleer (2017), p. 92.

[86] Most of the early receipts are written in French with a side-note in English; the French part of the receipt is more precise, stating that Richard Hill received the specified sum on 21st Dec., 1694, based on a letter of credit "par le governeur & compagnie de la Banque d'angleterre".

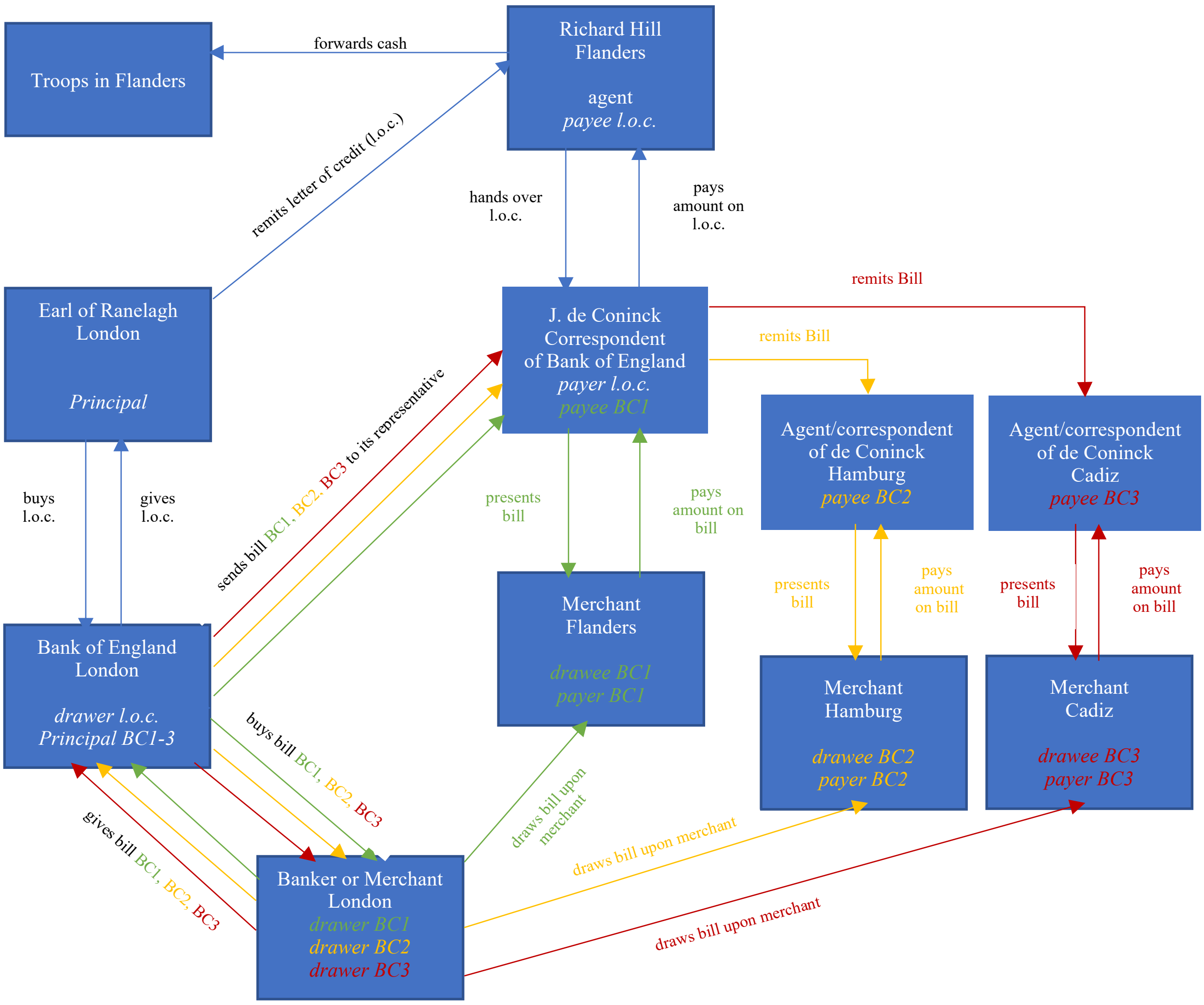
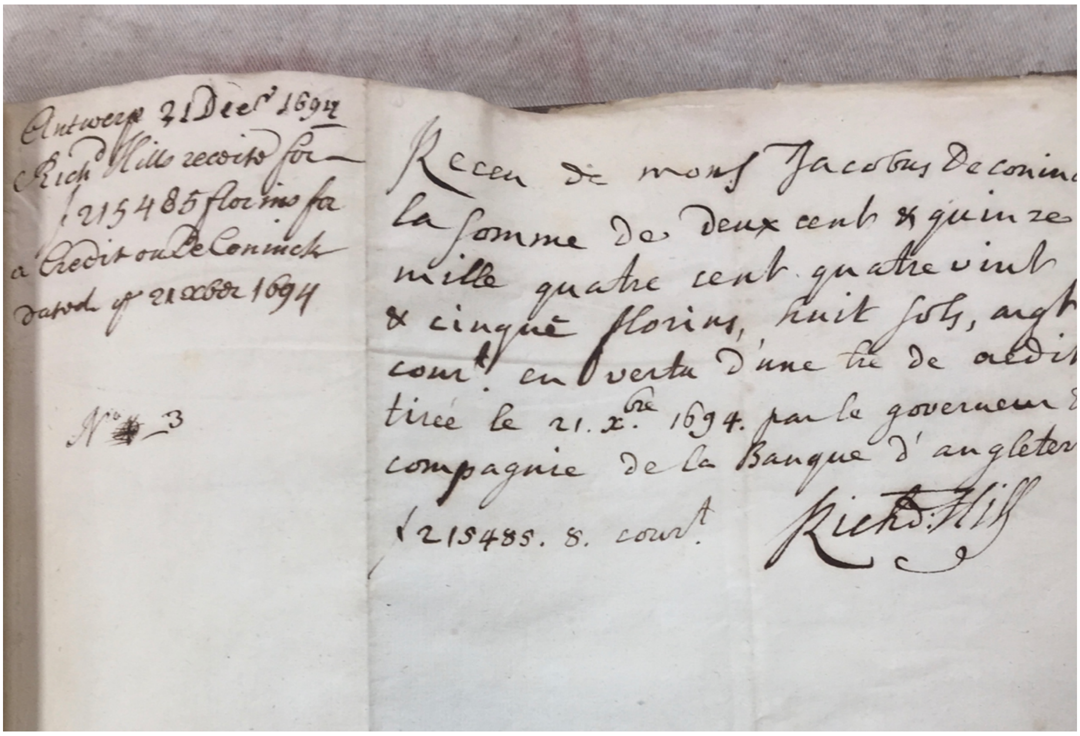


Illustration 12: Remittance Option B: letter of credit (l.o.c.) cycle with potentially multiple bill cycles *(BC1, BC2, BC3) to compensate the payer of the letter.*

L.o.c. cycle in order to facilitate remittance payments to the troops using correspondents in London, their representatives (correspondents) as well as the Army paymaster's deputy, both in Flanders: correspondent-principal-agent-correspondent-agent.

BC1-3 in order to provide the correspondent's representative in Flanders with sufficient financial means: merchant-merchant-principal-correspondent-merchant.


Antwerp 21 Decr 1694
Richd Hills receits for
ƒ215485 florins for
a Credit on De Coninck
dated ye 21 xber 1694

No 3

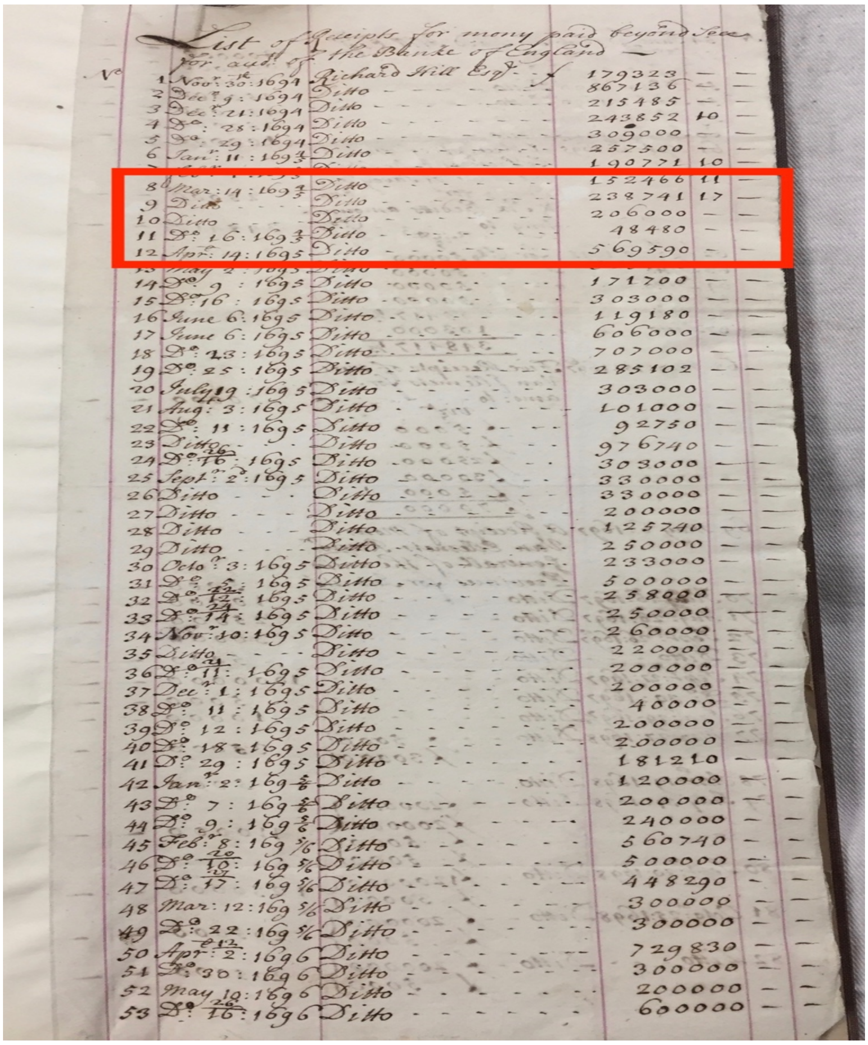
Receu de mons Jacobus De coninck
la somme de deux cent & quinze
mille quatre cent quatre vint
& cinque florins, huit sols, argt
court en vertu d'une lre de credit
tirée le 21. xbre 1694. par le governeur &
compagnie de la Banque d'angleterre
ƒ215485. 8. court Richd Hill

Figure 14: Receipt for a payment to Richard Hill via Jacobus de Coninck, correspondent of the Bank of England in Antwerp ("Receipts for Money Paid Abroad on Account of the Bank of England", No 3).

This letter-bill cycle did not work smoothly at all times, though. Take the following example: Hit by a sudden drop of exchange rates in March 1695, the impact on the market rate for bills of exchange led to negative repercussions for the Bank of England. So it stopped the purchase of bills of exchange for de Coninck (who in turn refused to honor some of the Bank's letters of credit).

We find evidence for this observation again in the ledgers of the Bank of England, and highly visibly, again, amongst the "Receipts for Money Paid Abroad on Account of the Bank of England"[87]. On March 14, 1695 three receipts contained payments of the Bank to de Coninck of altogether *fl*598,207.28, then, on March 16, we have a sharp drop and a payment of only *fl*48,480, before the payments add up again to the sum of *fl*569590 in April (see *Figure 15*).

[87] Receipts for Money Paid Abroad on Account of the Bank of England, Archives of the Bank of England, M5/11.



List of Receipts for mony paid beyond Seas for acc.t of the Banke of England

No	Date		£	s	d
1	Nov.r 30 : 1694	Richard Hill Esq.r	179323	—	—
2	Dec.r 9 : 1694	Ditto	867136	—	—
3	Dec.r 21 : 1694	Ditto	215485	—	—
4	D.o : 28 : 1694	Ditto	243852	10	—
5	D.o : 29 : 1694	Ditto	309000	—	—
6	Jan.r 11 : 169 4/5	Ditto	257500	—	—
7	[illegible]	Ditto	190771	10	—
8	Mar: 14 : 169 4/5	Ditto	152466	11	—
9	Ditto	Ditto	238741	17	—
10	Ditto	Ditto	206000	—	—
11	D.o : 16 : 169 4/5	Ditto	48480	—	—
12	Apr.e 14 : 1695	Ditto	569590	—	—
13	May 2 : 1695	Ditto	[illegible]	—	—
14	D.o : 9 : 1695	Ditto	171700	—	—
15	D.o : 16 : 1695	Ditto	303000	—	—
16	June 6 : 1695	Ditto	119180	—	—
17	June 6 : 1695	Ditto	606000	—	—
18	D.o : 13 : 1695	Ditto	707000	—	—
19	D.o : 25 : 1695	Ditto	285102	—	—
20	July 19 : 1695	Ditto	303000	—	—
21	Aug: 3 : 1695	Ditto	101000	—	—
22	D.o : 11 : 1695	Ditto	92750	—	—
23	Ditto	Ditto	976740	—	—
24	D.o : ~~16~~ 26 : 1695	Ditto	303000	—	—
25	Sept.r 2 : 1695	Ditto	330000	—	—
26	Ditto	Ditto	330000	—	—
27	Ditto	Ditto	200000	—	—
28	Ditto	Ditto	125740	—	—
29	Ditto	Ditto	250000	—	—
30	Octo.r 3 : 1695	Ditto	233000	—	—
31	D.o : 5 : 1695	Ditto	500000	—	—
32	D.o : ~~12~~ 22 : 1695	Ditto	258000	—	—
33	D.o : ~~14~~ 24 : 1695	Ditto	250000	—	—
34	Nov.r 10 : 1695	Ditto	260000	—	—
35	Ditto	Ditto	220000	—	—
36	D.o : ~~11~~ 21 : 1695	Ditto	200000	—	—
37	Dec.r 1 : 1695	Ditto	200000	—	—
38	D.o : 11 : 1695	Ditto	40000	—	—
39	D.o : 12 : 1695	Ditto	200000	—	—
40	D.o : 18 : 1695	Ditto	200000	—	—
41	D.o : 29 : 1695	Ditto	181210	—	—
42	Jan.r 2 : 169 5/6	Ditto	120000	—	—
43	D.o : 7 : 169 5/6	Ditto	200000	—	—
44	D.o : 9 : 169 5/6	Ditto	240000	—	—
45	Feb.r 8 : 169 5/6	Ditto	560740	—	—
46	D.o : ~~10~~ 20 : 169 5/6	Ditto	500000	—	—
47	D.o : ~~17~~ 27 : 169 5/6	Ditto	448290	—	—
48	Mar: 12 : 169 5/6	Ditto	300000	—	—
49	D.o : 22 : 169 5/6	Ditto	300000	—	—
50	Apr.e ~~2~~ 12 : 1696	Ditto	729830	—	—
51	D.o : 30 : 1696	Ditto	300000	—	—
52	May 10 : 1696	Ditto	200000	—	—
53	D.o : ~~16~~ 26 : 1696	Ditto	600000	—	—

Figure 15: "Receipts for Money Paid Abroad on Account of the Bank of England", p. 1. Marked in red payments of the Bank of England to its correspondent on Antwerp, Jacobus de Coninck in March and April 1695.

Obviously, the Bank of England had to come up with creative alternatives to avoid similar situations in the future.

d. The correspondent-merchant cycle of a bill

The Bank of England was off to a bumpy start, and the sheer necessity of staying in the remittance business made the Bank try some models that implied high risks of failure. In order to forward money as quickly as possible to Richard Hill and without overstretching the already strained relationship with de Coninck, the Bank's governors decided to borrow short-term from lenders in the Low Countries by drawing bills upon these bankers and merchants across the channel.[88] The next step was to remit these bills

[88] Kleer (2017), p. 96.

of exchange to Hill (who discounted the bills in Antwerp), whilst trusting that up to four usances would give them enough time for repayment (*Illustration 13*).[89] The compensation of the lender in Flanders was facilitated through a second bill cycle (or more), where the bank of England would buy bills in London that were drawn on merchants in Flanders.

As another option within this model, Hill could also discount the bills locally in Flanders, and the buyers of the bills would then show these bills to the lenders of the Bank of England in Flanders against payment. In the long run, the Bank of England had to come up with other ways of providing funding to the troops, as the different forms of this correspondent-merchant cycle left the Bank with multiple risks, for example, late or insufficient compensation by the Treasury, unattractive market conditions for buying bills in London, or Hill showing himself as incapable of discounting the bills properly in the Low Countries.

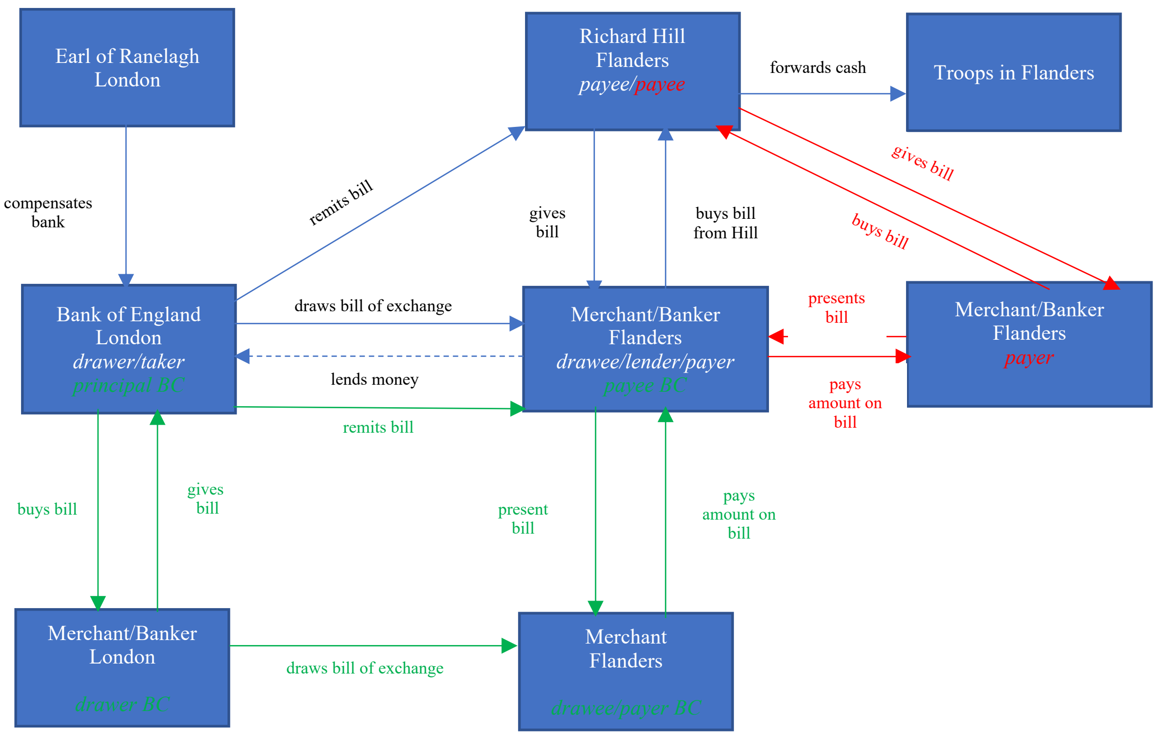


Illustration 13: Remittance Option C: correspondent-merchant cycle of a bill with the sequence correspondent-merchant-agent-merchant-agent. Alternatively, the bill would be discounted to other merchants leading to a sequence correspondent-merchant-agent-merchant-merchant. The bill cycle (BC)in order to compensate the lender is based on a sequence merchant-merchant-principal-merchant.

[89] Ibid.

e. The merchant-merchant cycle of a bill

The modification of a simple bill cycle, based on buying bills in London drawn upon merchants on the continent (merchant-merchant cycle), bore the potential of lowering some of the risk factors for the Bank of England. Let us first look at the simple version that obviously still assembled some of the risks: the Bank would forward bills payable for the most part in Flanders to de Coninck who, in turn, would sell bills from agents of continental importers (in London) to local exchange dealers or cash bills from English exporters (in London) when they came due.[90] In case a bills was upon a creditor of Richard Hill, de Coninck would only forward the bill directly to the Crown's deputy paymaster in Flanders.[91]

We have seen this cycle already before, for instance, as part of the dual cycles where the merchant-merchant part would be used to equip the correspondent in Flanders with sufficient money to facilitate payments to Richard Hill. However, in order to circumvent low exchange rates between London and Antwerp, the directors of the Bank tried another solution via Amsterdam, where they had appointed a second correspondent, Henry Meulenaer, an internationally well-connected banker. Kleer (2017) perceived Meulenaer as the Bank's "agent"[92]. We disagree with this classification as most of the arguments laid out above for Jacobus de Coninck also applied to Meulenaer. In fact, the Bank's ledgers show that the relationship to Meulenaer was as intensely developed as the connection between the Bank and de Coninck.[93] Most importantly, the Bank of England itself saw Meulenaer as its "correspondent": he appears in the Court of Directors' Minutes[94] as well as in the Index of the Court of Directors Minutes (1694-1697) in a list of "Correspond^{ts} beyond Sea" [95]

[90] Kleer (2003), p. 4.

[91] Ibid.

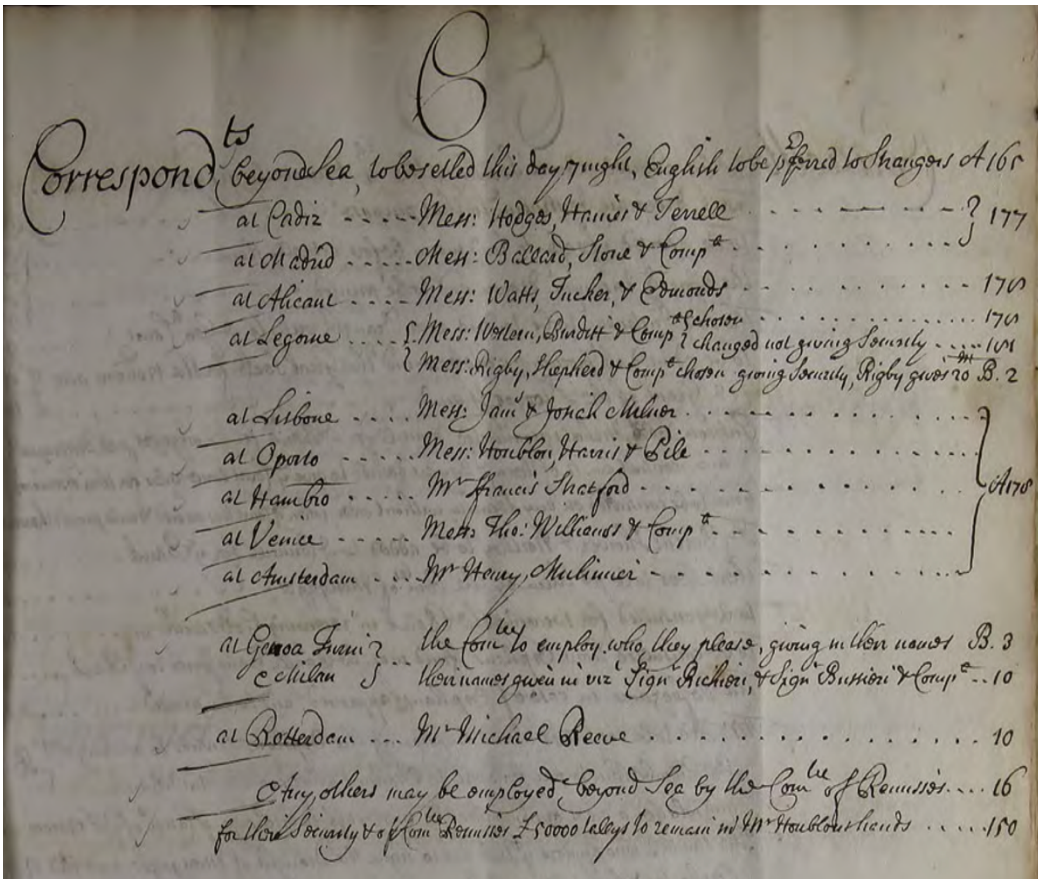
[92] Kleer (2017), p. 96.

[93] See only the Supplementary Ledger's (ADM7/2) Folios 50-59, 134-139, 196-197.

[94] Archives of the Bank of England, Court of Directors Minutes, Lib. A, p. 178.

[95] Archives of the Bank of England, Index to the Minute-Bookes A. & B. (1694-1697) under letter C.

(*Figure 16*).



C

Correspondts beyond Sea, to be settled this day 7night, English to be preferred to Strangers A 165
al Cadiz ....Mess: Hodges, Harris & Terrell ....} 177
al Madrid ....Mess: Ballard, Stone & Compa ....}
al Alicant ....Mess: Watts, Tucker, & Edmonds 170
al Legorne ....{ Mess: Watson, Burdett & Compa chosen 170
{ changed not giving Security 181
{ Mess: Rigby, Shepherd & Compa chosen giving Security, Rigby gives 20 m B. 2
al Lisbone ....Mess: Jam & Jonah Milner ....}
al Oporto ....Mess: Houblon, Harris & Pile ....}
al Hambro ....Mr Francis Shatford ....} A178
al Venice ....Mess: Tho: Williams & Compa ....}
al Amsterdam ....Mr Henry Meulenaer ....}
al Genoa Turin } the Comtee to employ who they please, giving in their names B. 3
& Milan } their names given in viz Sign Richieri, & Sign Bussiori & Compe .. 10
al Rotterdam ....Mr Michael Reeve 10
Any others may be employed beyond Sea by the Comtee of Remisses 16
for their Security & of from Comtee Remisses £50000 tallys to remain in Mr Houblons hands 150

Figure 16: Facsimile of an (incomplete) list of the Bank of England's correspondents abroad in the Index to the Court of Directors Minute Books between 1694-1697.

Within this merchant-merchant remittance model, the Bank saved money - at least for a while – by buying bills drawn on merchants and bankers in other European trading hubs, and by forwarding them to Meulenaer who would discount them in Amsterdam and forward the gains into de Coninck's hands in Antwerp (*Illustration 14*).

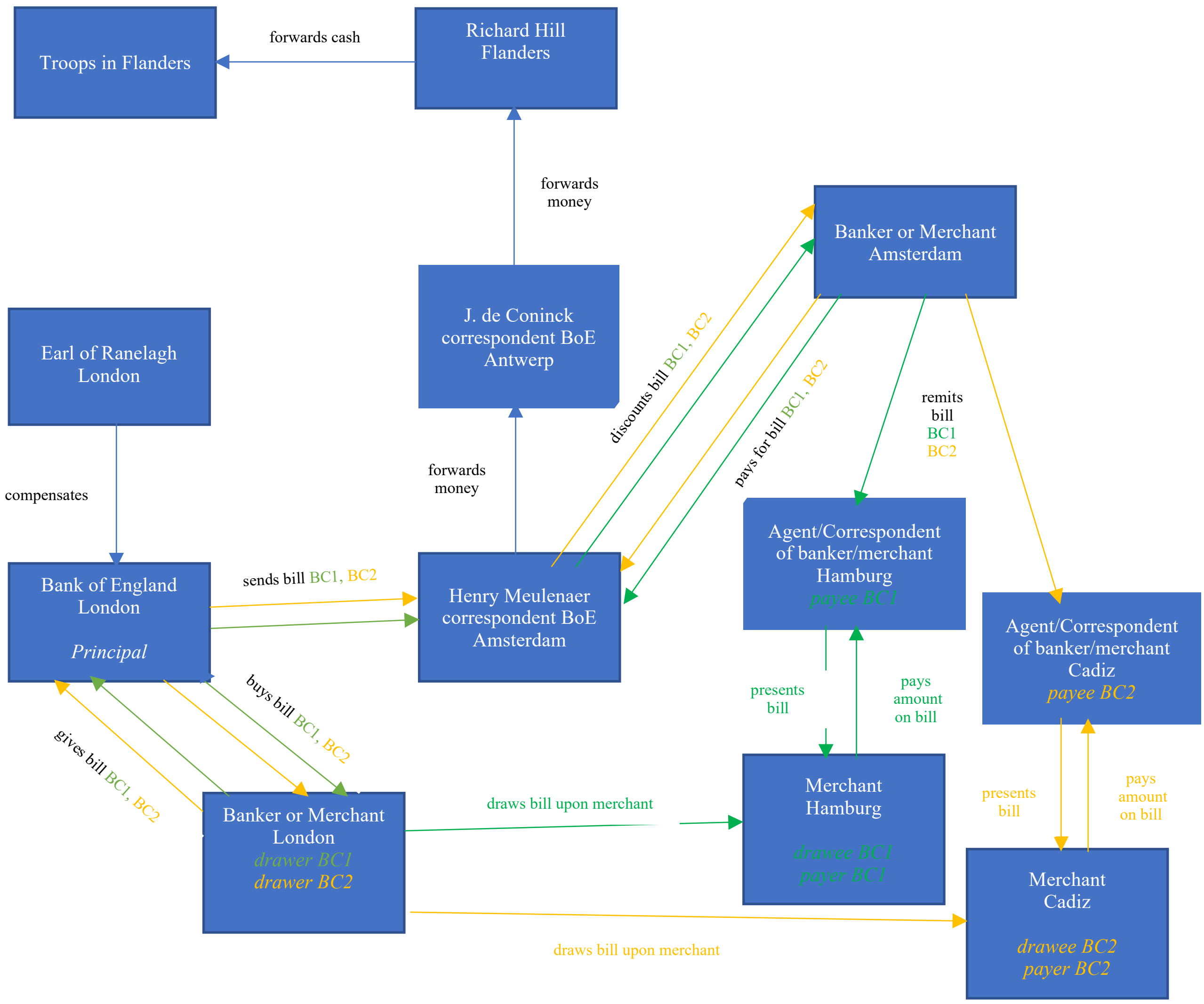


Illustration 14: Remittance Option D: merchant-merchant cycle of a bill in order to remit money to Jacobus de Coninck in Antwerp via a correspondent (Meulenaer) in Amsterdam with the sequences BC1 and BC2 (or more): merchant-merchant-principal-correspondent-merchant-correspondent-merchant

Alternatively, Meulenaer forwarded bills directly to de Coninck or in combination with specie. According to his account with the Bank of England, between January 1695 and September 1695, de Coninck received a total of £210,467 from Henry Meulenaer (*Table 2*). However, Meulenaer was not only involved in bill cycles but - as shown in the Bank's records – he sometimes only received bullion (£20,000 in silver bullion in April 1695[96]) which he then forwarded to de Coninck as well.

[96] Supplementary Ledger (ADM7/2).

month	Payments Meulenaer – de Coninck
Jan. 1695	11,616
Feb. 1695	2,407
Mar.1695	12,324
Apr. 1695	26,659
May 1695	76,684
Jun. 1695	45,452
Jul. 1695	35.229
Aug. 1695	0
Sep. 1695	96
Total	**210,467**

Table 2: Receipts for payments from the Bank of England's correspondent in Amsterdam, Henry Meulenaer to its correspondent in Antwerp Jacobus de Coninck. Source: de Coninck's accounts in the (supplementary) ledgers of the Bank of England (ADM7/1 and ADM7/2).[97]

De facto, the Bank of England had two correspondents (Meulenaer – directly, and de Coninck – indirectly) in this arrangement.

f. The principle-merchant cycle of a bill

Eventually, and obviously only as an exception, another remittance model was tested by the Bank's directors. Again, the Supplementary Ledger of the Bank of England offers valuable insight. In the account dedicated to Richard Hill, for the period of November 1694 to September 1695, we find models that not only reflect merchant-merchant cycles of a bill, where, for example, the Bank of England bought bills from the London Huguenot merchant (and later East India Company director), Denis Dutry (1663-1729), but there was another constellation that seems more unusual: Here, the directors of the Bank of England themselves drew bills of exchange upon merchants and bankers in Amsterdam (more explicitly, the directors Sir William Scawen (c.1644-1722) and Theodore Jannsen (1658-1748)), which they forwarded directly to Hill. In a next step, Hill would have sold the bills

[97] Kleer (2003, p. 8) identified and assembled a good number of receipts in de Coninck's account in the ledgers of the Bank of England.

to merchants in Antwerp who, in turn, would have asked their agents and correspondents in Amsterdam to cash in the bills (*Illustration 15*).[98]

This means that we are also confronted with a principal-merchant cycle of a bill in the Bank's remittance business. The difference from the correspondent-merchant model, described above, is the relative independence of the Bank's directors who acted less as correspondents of the Treasury than in their own capacity (although the Bank also sought compensation through the Crown for this format).

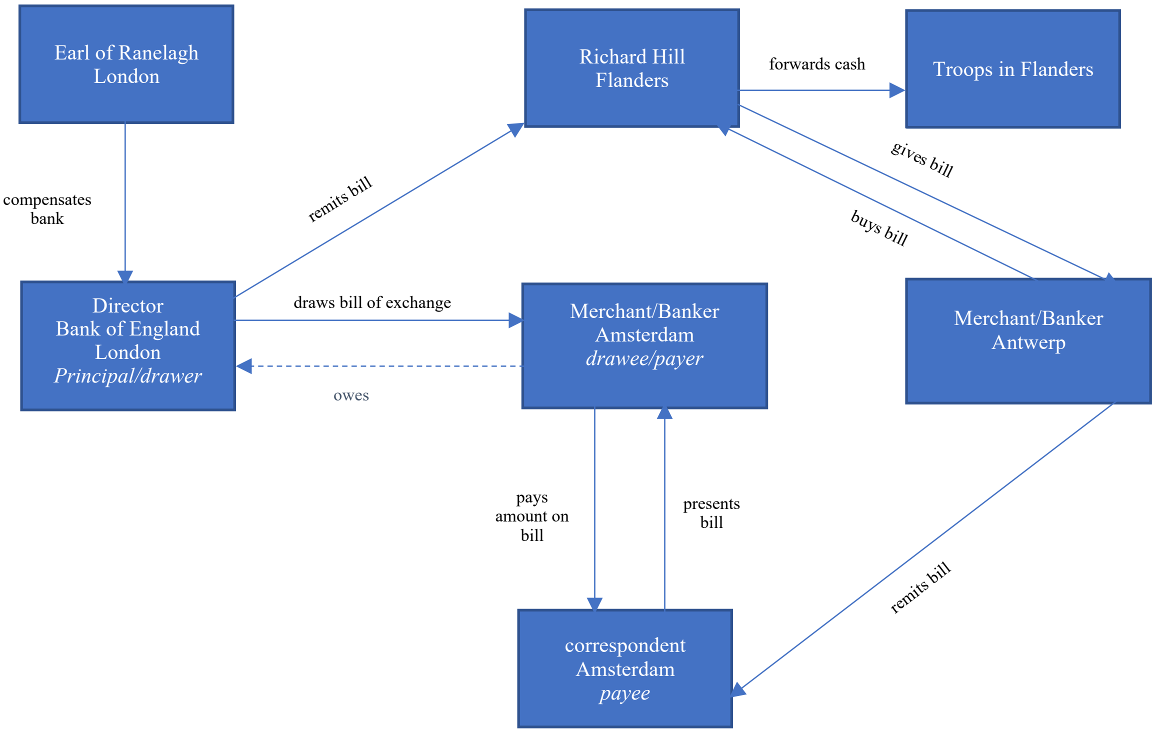


Illustration 15: Remittance Option E: principal-merchant cycle of a bill with the sequence principal-merchant-agent-merchant-correspondent-merchant. In case the merchant in Amsterdam did not owe the principal a dual cycle of bill would have been an alternative option.

[98] Supplementary Ledger (ADM7/2), Folio 28. These bills were payable in up to four months (as opposed to the routine of one or two months).

g. The agent-correspondent cycle of a bill

As we have seen, payment models could be somewhat complicated. Another model borders on the bizarre: Here, the Dutch Army Paymaster William Schulenberg appeared as a lender to the Bank of England and Hill would be allowed to draw upon Schulenberg. Evidence for this construct – an agent-correspondent cycle of a bill (*Illustration 16*) – can be found in Hill's ledger (1694-1696).[99] It is not entirely clear how the cycle continued, but it would be feasible if Hill then sold the bill to merchants or bankers in Flanders who would eventually present the bill to Schulenberg. The latter could be compensated through a second bill cycle via bills drawn in London and remitted to him.

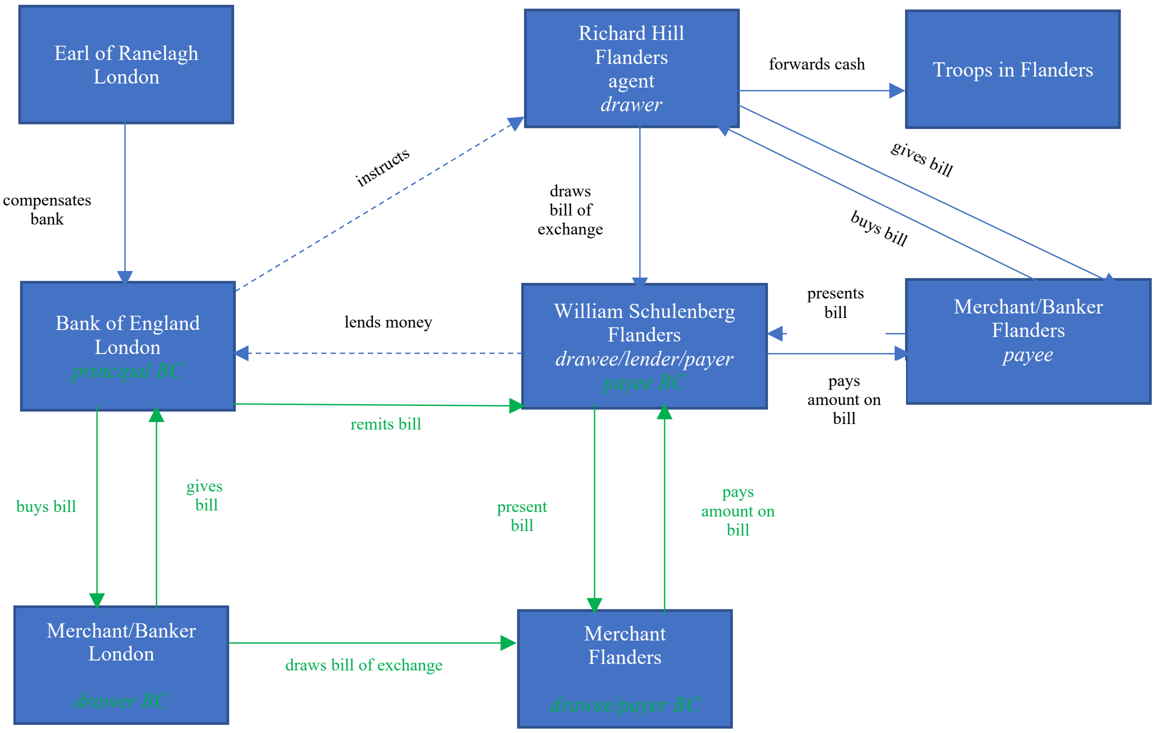


Illustration 16: Remittance Option F: agent-correspondent cycle of a bill with the sequence agent-correspondent-merchant-correspondent-merchant. The bill cycle (BC)in order to compensate the lender is based on a sequence merchant-merchant-principal-merchant.

h. The reverse correspondent-correspondent cycle of a bill

The directors of the newly founded Bank of England did not lack creativity. The ledgers of the Bank reveal that even correspondents in Amsterdam (Henry Meulenaer and Les Frères

[99] Shropshire Archive, 112/1A/2. 670,000 guilders at an interest rate of 5% were borrowed from Schulenberg, see also Kleer (2003), p. 8.

Huguetan) were asked to draw bills upon the Bank's directors in London. After selling the bills in Flanders, they forwarded their proceeds to de Coninck - sometimes together with bills which the Bank purchased in London drawn on merchants on the Continent. De Coninck advanced the cash (also resulting from selling the remitted bills in Antwerp) to Richard Hill and kept some of it to balance the overdraft of the Bank of England.[100]

Due to the fact that the Bank's correspondents in Flanders drew bills upon the Treasury's correspondent (Bank of England) and because of the opposite direction of the bill cycle – compared with the correspondent-correspondent cycle we have covered above – we call this model a *reverse* correspondent-correspondent cycle of a bill (*Illustration 17*).

On April 22nd 1695 we find in the Court of Directors Minutes

> "Order 'd That a particular Booke bee kept for such who draw on the Bank or keepe their Accounts in Books and papers."[101]

This is not only another substantiation of the correspondent-correspondent model but also an interesting description of the installation of nostro-vostro accounts in order to facilitate smoothly functioning correspondent relationships.[102]

The constant change of remittance models, however, did not result only in satisfaction. Some of the strategic shifts were caused by varying exchange rates. In order to avoid losing money, the newly established Bank of England had to come up with innovative solutions. However, the King was repeatedly furious as middlemen, like de Coninck, suddenly refused to advance money to the Deputy Paymaster Hill in Flanders - triggered by the already mentioned heavy overdraft.

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[100] Kleer (2003, p. 12) describes a scenario of May 1695, where Meulenaer was approached by the Bank of England to transmit £77,000 to de Coninck (bullion and bills). In addition, a credit agreement was made with Les Frères Huguetan for £25,000. They drew bills upon the directors in London, payable in three months, and transferred the money to de Coninck via bills of exchange. As Kleer does not offer further sources, see also Supplementary Ledger (ADM7/2), Folio 121.

[101] Court of Directors Minutes, Lib. B, p. 13 (April 22nd 1695).

[102] See Chapter 3 for more details on nostro-vostro accounts.

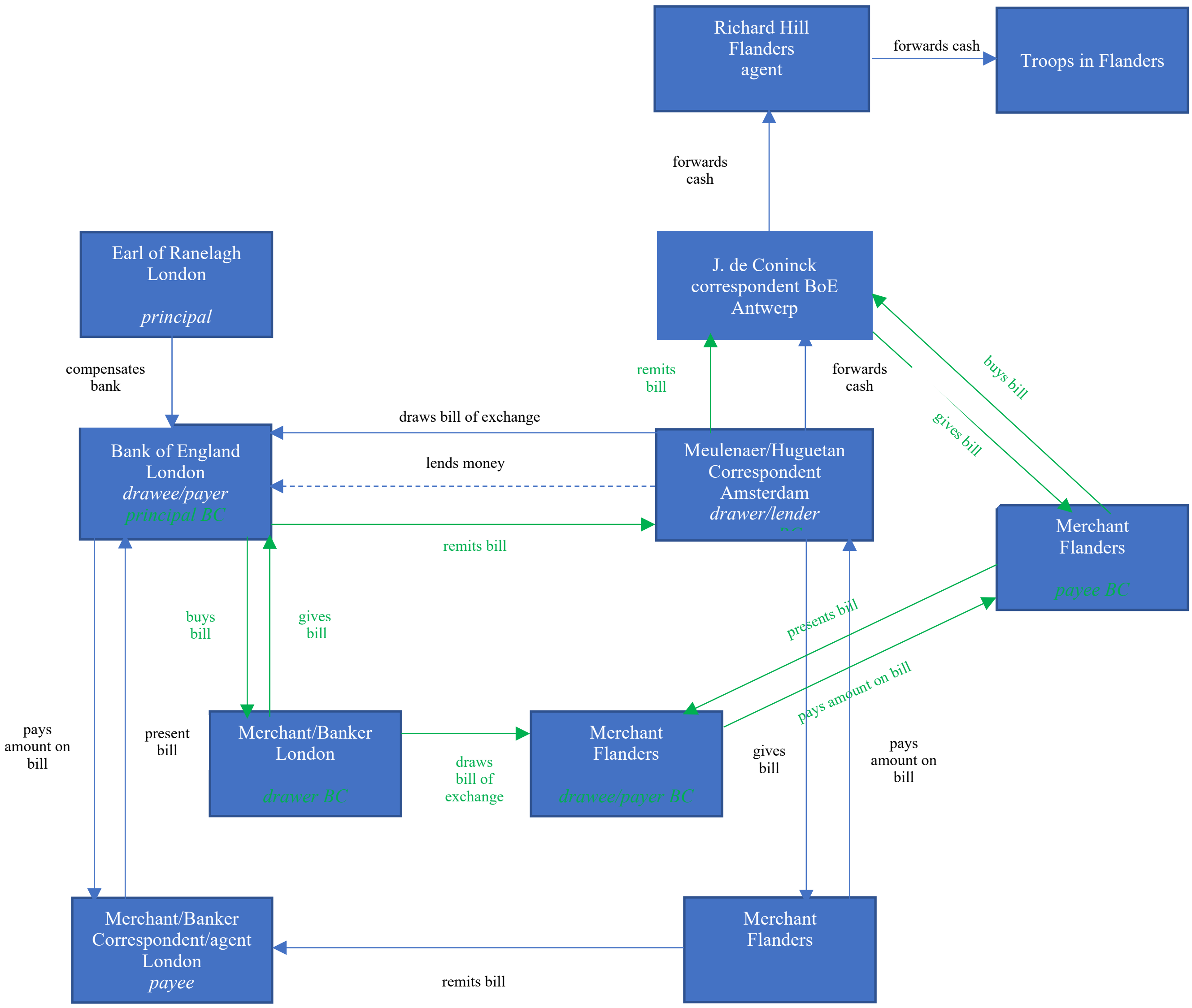

*Illustration 17: Remittance Option G: reverse correspondent-correspondent cycle of a bill with the sequence correspondent (Amsterdam)-correspondent (London)-merchant-*correspondent/agent*-correspondent. The parallel bill cycle (BC) was installed to allow an additional way to get money in the hands of de Coninck. It is based on a sequence merchant-merchant-principal-correspondent-correspondent-merchant-merchant.*

Some of the constellations the Bank's directors came up with were nothing else than the same ideas we have already seen in the pre-Bank phase when the Evance-Herne syndicate still had filled the role of the remittance contractor. However, it became obvious that hectic ad-hoc decisions to change the bill cycles were not necessarily the best way to sustainably cover the enormous demands of the troops in Flanders.

i. A branch-like "Agency" in Antwerp

The Treasury Minutes and the Minutes of the Court of Directors of April and May 1695 draw an almost surreal picture of the increasingly desperate attempts by all players involved to finally develop a sustainable method for remitting funds to Flanders. A plethora of ideas was discussed, tried, dismissed, and tried again. Most of them were based on models involving bills of exchange and letters of credit. Moreover, reactionary methods - like shipping specie across the channel - had their renaissance.

On May 17th 1695, Narcissus Luttrell (1657-1732) noted in his infamous and gossipy diary:

> "This day the bank held a general court, and elected Mr. Peter Godfrey a director; after which they resolved to establish a bank at Antwerp, where they will coin money to pay our army in Flanders, (his majestie and the elector of Bavaria having agreed theretoo;) in order to which have appointed sir James Houblon, sir William Scawen, and Mr. Michael Godfrey, deputy governors, to goe thither to methodize the same."[103]

And only a day later, on Saturday, May 18th 1695, Luttrell reports that

> "[…] the bank of England have agreed with the lords of the treasury to pay our army in Flanders, and in order to it will coin money at Antwerp, which will prevent the exportation of money in specie from hence."[104]

What had happened? After credits from the government and the exchange rate had further deteriorated in 1694 and early 1695, the First Lord of the Treasury, Sidney Godolphin, discussed with the Bank of England the possibility of having a permanent representation in Antwerp in order to facilitate payments of the armed forces in

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[103] Lutrell (1857), Vol III, p. 473. The original diary, written in Greek letters, can be found in the library of All Souls' College, Oxford.

[104] Ibid., p. 474.

Flanders at a fixed and agreed rate of exchange.[105]

aa. The representation's *spiritus rector*

According to the Treasury minutes the bank directors discussed the option to "use their own credit in supplying the army".[106] It is unclear who eventually brought up the idea of a representation in Antwerp. Debates about a more permanent operation in Flanders started as early as March 1695. Some see it as an initiative from the directors, others as a reaction to a proposal by the king. Clapham (1944) only hints at the possibility of a royal flash of inspiration by stating that "[t]o Dutch William one of the chief uses of his new bank was to facilitate the remittance of money to Flanders […] through a formal organisation, a "settlement at Antwerp of some persons on behalf of the Bank", a thing which "His Majesty favours and desires."[107] Kleer (2017), in contrast, sees the proposal of an "Agency […] broached by the Bank directors themselves"[108] while also referring to a demand of the king at a Treasury meeting in April from which it is

> "[r]eported to the Court that for the Ease of Furnishing money for the Remittance for the Subsistence of the Armey – it was thought necessary by his Ma.[tie] that some of the Directors of the Bank should bee sent by this Court into Flanders to settle a Creditt and borrow money there on the Creditt of the Bank".[109]

This quote led Acres (1931, p. 53) to the conclusion that the directors ultimately followed a proposal of William. However, Saw (1944) mentions the bank's governor, "Michael Godfrey and a few others [who] went out to establish an agency at

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[105] Another option to overcome the exchange rate challenges was introduced by King William, namely, to coin Flemish "permission money" at the Mint in London. This idea was obviously dismissed, see Kleer (2017), pp. 98-9.

[106] British Library, Lansdowne MS 1215, Treasury Minutes re Flanders, 26 March 1695, Folio 85.

[107] Clapham (1944) Vol. 1, p. 26, citing the General Court Book (G.C.B.) I, May 17[th] 1695.

[108] Kleer (2017), p. 98.

[109] Archives of the Bank of England, Court of Directors Minutes, Lib. B, p. 12 (April 19[th] 1695).

Antwerp"[110]. A similar impression leaves Richards (1929), although imprecise, generally seeing the Court of Directors in a strong and decisive role.[111] Andréadès (1909), somewhat surprisingly, does not even bother to mention the enterprise at Antwerp.

So, let us have a look at the Court of Directors Minutes to gain a clearer picture. Here, in the protocol of the meeting held on March 9, 1695, we already read that the directors "proceeded to consider of sending correspond^ts (sic!) beyond sea in the business of Remittances […]"[112]. It cannot be excluded that the directors had already discussed, at least, in the context of installing Henry Meulenaer as a correspondent in Amsterdam[113], that there were similar options for Antwerp, especially because, later in the year, Amsterdam was weighed up as being an additional location for an agency to Antwerp. Until March 27, 1695, we find no further indications in the Court Minutes. However, on that day. the protocol (*Figure 17*) reflects the Treasury Minutes of March 26, mentioned above, when we read about the order

> "that the said Committee [of Remises] & such other Members as shall Joine with them bee empowered for the future to make use of the creditt of the Bank & and their owne creditt for furnishing the money for supplying the publick services & remittances into forreigne parts by such ways and meanes as they Judge best, to any summe not Exceeding 200,000."[114]

Unambiguously, this declaration hinted at the possibility of launching representation(s) of the Bank of England abroad, for the sake of optimizing remittance payments. The next paragraph in the Court Minutes underlines this observation as it already resembles certain structures of the future operation:

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[110] Saw (1944), p. 22.

[111] Richards (1929), pp. 202-4.

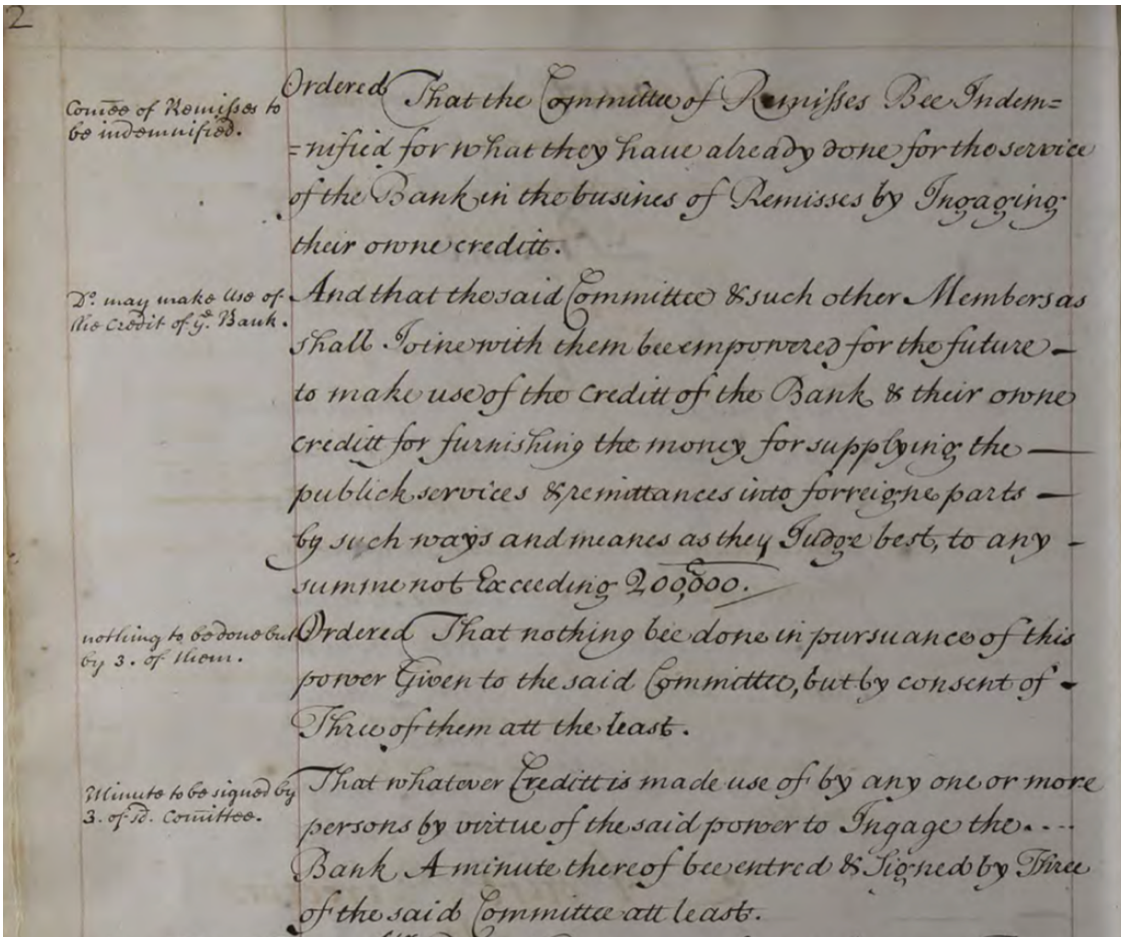
[112] Court of Directors Minutes, Lib. A, p. 177 (March 9th 1694[5]).

[113] Ibid., p. 178.

[114] Court of Directors Minutes, Lib. B, p. 2 (March 27th 1695).

> "Ordered That nothing bee done in pursuance of this power Given to the said Committee, but by consent of Three of the att the least.
>
> That whatever Creditt is made use of by any one or more persons by virtue of the said power to Ingage the Bank A minute there of bee entred & Signed by Three of the said Committee att least."[115]

This statement obviously reflects a more precise framework than the Treasury's call to use the directors' "own credit". In the following four Court meetings of April 3, 9, 15, and 17, 1695, the directors did not discuss this new idea again.



2

Ordered That the Committee of Remisses Bee Indem=
=nified for what they have already done for the service
of the Bank in the busines of Remisses by Ingaging
their owne creditt.
And that the said Committee & such other Members as
shall Joine with them bee empowered for the future
to make use of the Creditt of the Bank & their owne
creditt for furnishing the money for supplying the
publick services & remittances into forreigne parts
by such ways and meanes as they Judge best, to any
summe not Exceeding 200000.
Ordered That nothing bee done in pursuance of this
power Given to the said Committee, but by consent of
Three of them att the least.
That whatever Creditt is made use of by any one or more
persons by virtue of the said power to Ingage the
Bank A minute thereof bee entred & Signed by Three
of the said Committee att least.

Figure 17: Facsimile of the Court of Directors Minutes (Lib. B, p. 2) of March 27th 1695 where we find first indications to install an agency of the Bank of England abroad.

It is quite possible that the idea of a representation of the Bank of England in Antwerp evolved from discussions between the Treasury and the Bank's directors. During the Bank's first few decades, its relationship to the Treasury was generally "amicable", as

[115] Ibid.

reflected through continuous "close personal contact with the officials of the Treasury by means of their Committee of the Treasury and by special committees and deputations."[116]

After the announcement of March 26th and 27th the Treasury and the Bank of England refined within a few weeks the design of an "agency" in Flanders. It took all leading protagonists until April 19th 1695 to come up with a detailed setup that had the blessing of the King. Then, it was

> "[r]eported to the Court that for the Ease of Furnishing money for the Remittances for the Subsistence of the Armey It was thought necessary by his Ma.tie that some of the Directors of the Bank should bee sent by this Court into Flanders to settle a Creditt and borrow money there on the Creditt of the Bank."[117]

Further specifics were confirmed three days later ranging from the duration of the remittance agreement with the Treasury (six months) to the number of directors sent to Flanders (at least three in shifts), their payments, commissions and brokerage fees (analogous to what de Coninck received).[118]

In summary, the King apparently gave the crucial stimulus to install the new institution in Flanders. However, we tend to see the inception of a "House" at Antwerp as mainly encouraged by discussions between the directors of the Bank and the Treasury. This finding is also not contradicted by the Minutes that speak of "the proposall of his Maj.tie for sending over some of the Directors into Flanders […]"[119]. The minute-taker's reference to the King's alleged initiative must be seen in the context of the general

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[116] Richards (1964), p. 230.

[117] Court of Directors Minutes, Lib. B, p. 12 (April 19th 1695).

[118] Court of Directors Minutes, Lib. B, pp. 13-4 (April 22nd 1695). It is notable that the minute-taker spelled the name of de Coninck twice, but differently on one page ("De Koning" and "De Coning"). More details were presented in the meetings of the Court on May 10th and May 15th 1695 (ibid., pp. 23-4, 25-7).

[119] Court of Directors Minutes, Lib. B, p. 13 (April 22nd 1695).

wording in the protocols of the Court and Treasury; the references to William often reflect respect rather than realities.

bb. Antwerp's true nature

We already alluded to the fact that the directors in Antwerp even circulated the idea to set up an additional representation - "a bank for currant money"[120] - in Amsterdam - a suggestion, though, that was immediately dismissed as being impractical and not feasible with a limited number of directors acting in Flanders.[121]

However, was "ye House at Antwerp" actually an agency? Neither literature nor the Bank of England itself has ever raised the question of whether the Bank's first institution[122] abroad actually was an agency – or maybe another form of representation.

The term "agency" does not appear in the Court minutes of the Treasury for as long as the institution in Antwerp existed. And, not even in the Court of Directors Minutes do we stumble once over the words "agent" or "agency". It took until April 20, 1696, that the institution in Flanders got an attribute, namely, "the House at Antwerp"[123], respectively, "y^e House at Antwerp"[124]. After the chapter at Antwerp was already

[120] Court of Directors Minutes, Lib. B, p. 47 (June 26th 1695).

[121] Court of Directors Minutes, Lib. B, p. 47 (June 26th 1695). The idea was discussed again on September 16, 1695, see Lib. B, p. 69.

[122] The Antwerp "Agency" wasn't the first international representation of the Bank of England, though. The bank had already installed correspondents across Europe (see, for example, Court of Directors Minutes, Lib. A, p. 178).

[123] Court of Directors Minutes, Lib. B, p. 125 (April 20th 1696), and, a few months later, see ibid., p. 146 (July 8th 1696), p. 151 (July 29th 1696), p. 153 (August 7th 1696), p. 191 (December 18th 1696, where the debate about a breakup of the House at Antwerp appeared first), pp. 237, and 240-1 (June 11th 1697).

[124] Ibid., p. 145 (July 1st 1696), where a few directors and the Committee for remises were "appointed a Com^tee to consider and report to the Court the State of y^e House at Antwerp".

closed, the Court used the description “the Establishm^{t} at Antwerp” once.[125]

As stated above, the directors (unsuccessfully) considered to set up another “bank” in Amsterdam analogous to the Antwerp representation. The questions the directors discussed regarding its outreach to Amsterdam also show that they had an equivalent to the institution in Antwerp in mind.[126] Using the term “bank” in this context is another hint that the directors thought about comparatively independent structures and a broader spectrum of services than a classical agent would have. It is not entirely clear if the Court of Directors declared the House at Antwerp also at one point as a “bank” when we read on December 18th 1696 in its minutes about the “Com^{tee} of Remisses desire Mr Bateman to stay at Antwerp a month after the last day of January for the Service of the Bank.”[127] This could be a reference to the representation in Antwerp or to the Bank of England itself. Some of the constellations the Bank’s directors came up with were nothing more than the same ideas we had already seen in the pre-Bank phase when the Evance-Herne syndicate still had filled the role of the remittance contractor. Yet, it became obvious that hectic ad-hoc decisions to change the bill cycles were not necessarily the best way to sustainably cover the enormous demands of the troops in Flanders.

Since later generations named the endeavour at Antwerp an agency, one could be tempted to think that the word and concept of that form of representation was not in frequent use in finance circles. However, this would be a misperception. The term “agent” and its meaning were well known in the 17th century (and before) as, for

[125] Court of Directors Minutes, Lib. B, p. 236 (June 11th 1697).

[126] Court of Directors Minutes, Lib. B, p. 47 (June 26th 1695), pointing at some difficulties, e.g., whether “the said Directors there (being but foure persons) can carry on soe weighty a concerne in two distant places att one time.” They also asked what “advantage such Settlement [would have] to the Generall Interest of the Bank” or “With what safety they can employ any persons there to deliver out notes in the name of the Bank of England”.

[127] Court of Directors Minutes, Lib. B, p. 191 (December 18th 1696).

example, the works of Malynes (1622) and Robinson (1652) show.[128] Yet, a belated description could still be correct. However, we have repeatedly seen how thoughtless terms for different models of representation have been applied. So, again, questions arise regarding the type of representation chosen - an agency, branch, or even correspondent bank - and wheter the people involved were aware of the distinction?

As laid out in Chapter 3, the most restricted organization in multinational banking is the establishment of *representative offices.* They are perceived as commercial premises of multinational banks, and they conduct business in a limited form, mainly assisting and supporting the business of the multinational bank, but they may generally not conduct a commercial banking business. A representative office is expressly not allowed to make any business decision on behalf of the foreign parent bank or to commit the parent bank to any banking transactions.[129] The cited text in the Court Minutes states the opposite, namely that the representatives in Antwerp were expected to act “on behalfe” of the Bank of England.

The newly incepted format in Antwerp was also not a *subsidiary*[130] to the Bank of England. As such, it would have been incorporated in one country, but either wholly or partially owned by a parent bank in another country as a separate legal entity with its own capital basis that is separate from its foreign parent bank. The subsidiary bank follows only the laws of the host nation. However, the Bank of England did not seek a convenient way to circumvent stricter regulations at home, which is often a reason for setting up a subsidiary. Subsidiaries have to abide by the same regulations and requirements as other banks from the host country. Consequently, they may perform the same banking activities as domestic banks in the host country. Usually, the subsidiary’s board of directors consists (at least in the majority) of citizens and/or residents of the host country and the local management has a high degree of decisional autonomy within the parent bank’s group. This was clearly not given in our case as the Bank of England explicitly sent its own English directors to

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[128] See, for example, Robinson (1652), pp. 77-8, and Malynes (1622), p. 79. Malynes puts a lot of emphasis on the description of the representation through “factors” (ibid. pp. 81-6); the distinction to the services of an agent is not always clear, though.

[129] Thus, neither the purchase and sale of funds, notes or bills of exchange nor loan transactions or the acceptance of deposits are permitted. See Curry et al. (2003), p. 39.

[130] See, in more detail, Chapter 3.

Flanders to run the representation.

In addition, another typical feature of subsidiaries would have served the Bank of England badly: As a separate organization, a subsidiary does not have the credit-"backchannel" to the parent bank and is, therefore, limited in its freedom to grant loans. In contrast to representative offices, agencies and branches, whose services and activities are closely tied to the foreign parent bank, a subsidiary acts more independently and is "thus seen as being a financial investment rather than a supporting arm of the parent bank"[131].

We can also exclude that the "House at Antwerp" was a correspondent of the Bank of England. The decisive precondition of independence is not fulfilled when we have a parent institution (Bank of England) sending its own directors to run the representation abroad. They were "[a]ppointed to bee a sub:committee in any of the Territories of the Allies of the King of Great Brittaine."[132] The directors were obviously quite aware of the differences between both forms of representation as they, for example, only a few weeks earlier required the newly installed correspondent in Livorno (Leghorn) to "give security" (which the chosen person declined to do – leading to a suspension of filling the position).[133] Such a step was not required from the directors being sent to Antwerp. On the same day, the directors discussed the preconditions of an agency the first time in more detail (March 27th 1695). They also stated that

> "For Correspondents att Leghorne Alexander Rigby William Sheppard & Comp^d are chosen by the Ballot Giving security to the satisfaction of the Court."[134]

This leaves us with two more options to describe the format in Antwerp correctly: Was it a

[131] Curry et al. (2003), p. 43.

[132] Court of Directors Minutes, Lib. B, p. 27 (May 15th 1695).

[133] Court of Directors Minutes, Lib. A, p. 181 (March 18th 1694[5]).

[134] Court of Directors Minutes, Lib. B, p. 2 (March 27th 1695).

branch[135] or an agency? Both agencies and branches have a remarkable resemblance.

In today's understanding and as presented in Chapter 3, foreign branches and agencies operate in countries other than the parent bank to which they are legally tied. However, they are operational and also legal extensions of their parent foreign bank; they are not a separately capitalized corperation in the host country.[136] In contrast to representative offices, agencies and branches can conduct and finance certain transactions. They have the capacity to accept bills of exchange as well as honour and issue letters of credit.[137] All this allows them to be facilitators of "foreign trade between home and foreign countries"[138]. Typically, agencies maintain credit balances.[139] Because of their involvement in foreign capital and money markets, which comprises foreign exchange markets, agencies can also be an important factor in asset-management for the foreign head office.[140] Agencies may also be chosen by the head office to facilitate growth in exporter servicing or lending.[141] A foreign branch can also operate in many fields of banking, including investment and trading activities. It is also possible for a branch to give credit, to appear as a fiduciary, to receive foreign deposits and to engage in wholesale commercial activities; a limitation is that, for

[135] This term is used, for example, by Childs (1987), p. 153 (though without further explanation).

[136] PricewaterhouseCoopers (2005-2006), p. 27.

[137] Goldberg and Saunders (1981), p. 367.

[138] Curry et al. (2003), p. 40. It bears clear advantages for a head bank to choose branches or agencies instead of correspondent banks, especially, if it concentrates on trade finance: whenever a head office decides to expand its multinational business, the probability of an amplified frequency and volume of cross-border movement of money is very high. If the head office then only relies on correspondent banks, the increase of these transactions can lead to considerably large cash balances in the accounts of the correspondent banks (Merrett (1995), p. 83; Curry et al (2003), p. 43) - cash balances that could be used efficiently by the head bank itself through agencies or branches.

[139] In this context, "credit balance" means a deposit-like obligation that is generated by the exercise of other lawful banking powers (PricewaterhouseCoopers (2005-2006), p. 27.

[140] Heinkel and Levi (1992), p. 253.

[141] Ibid., p. 259.

some practitioners, foreign branches are not allowed to conduct retail deposit-taking activities.[142] The decision to establish a branch or an agency (instead of, for example, a subsidiary,) is often driven by the aim of keeping costs as low as possible. The advantage of having legal and operational ties to a foreign parent bank is that the typical costs of a separate organization, e.g., for accounting and legal advice or initial capital investments, can be saved. A major benefit of such organizational forms is the wider margin of making loans, as credit limits are based on the capital of the foreign parent bank[143]. The motivation behind establishing branches could also be to gain access to the savings of the respective populations in the form of individual deposit accounts[144], although this may contradict today's definition of branch activities and their limitations.

The only (modern) major difference between an agency and a branch in transnational banking is that branches are not as restricted in accepting deposits as agencies are. The U.S. Office of the Comptroller of the Currency (OCC) describes a [federal] branch as "an office […] operated by a foreign bank […] that may engage in the business of banking, including accepting deposits, and that is not a [federal] agency"; in contrast, it defines an agency as "an office licensed […] to conduct certain banking activities. [It] primarily makes commercial loans and finances international transactions. Although [it] may not accept domestic deposits, the agency can maintain credit balances."[145]

In the light of contemporary approaches to distinguishing an agency from a branch, it seems difficult to categorize "ye House at Antwerp" accurately. Up until today, the Bank of England has not used the term "agency" for its institution in Antwerp during the Nine Years' War. Recently, Cunliffe (2017), called it an "operation in Antwerp".[146] The terminological imprecision (of not only the 17th century) echoes the lack of clear definitions of different types of representations. However, in order to decide whether the new institution in Flanders resembled more characteristics to a branch or an agency,

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[142] PricewaterhouseCoopers, ibid.

[143] Ibid.

[144] Verdier (2002), p. 44.

[145] Office of the Comptroller of the Currency (2017), p. 10.

[146] Cunliffe (2017), p. 2.

let us have a look again at a primary source of the time when the institution was put in place:

On May 15, 1695 the Court of Directors' protocol describes a framework of methods the Agency could arrange to reach its ambitious goals:

> "In the name and for and on behalfe and upon the account of the said Govern. & Company to Act doe performe and execute in those parts the affaires and busienes of the said Governour & Company - And to Transact and negotiate Bills of Exchange and to -receive and pay moneys and to give notes for the same […] to constitute & appoint correspondents & Factors Officers and servants, and generally to doe fulfill and performe all and every other matters and things in the name and for and on behalfe of the said Governour and Company […]"[147]

This description not only lays out the spectrum of services at Antwerp, but also a more precise idea which format of representation for the Bank of England was chosen. There is only one little detail in this quote that hints more towards a branch structure than to an agency – again, mainly according to today's standards: allowing the directors in Antwerp to "receive" money and therefore to accept (foreign and domestic) deposits. In addition, the seconding of directors of the Bank of England to Antwerp - as opposed to using bankers or merchants unconnected to the bank - is also a strong indicator that an analogy to "agents" may not have been intended.[148] And finally, we found one source

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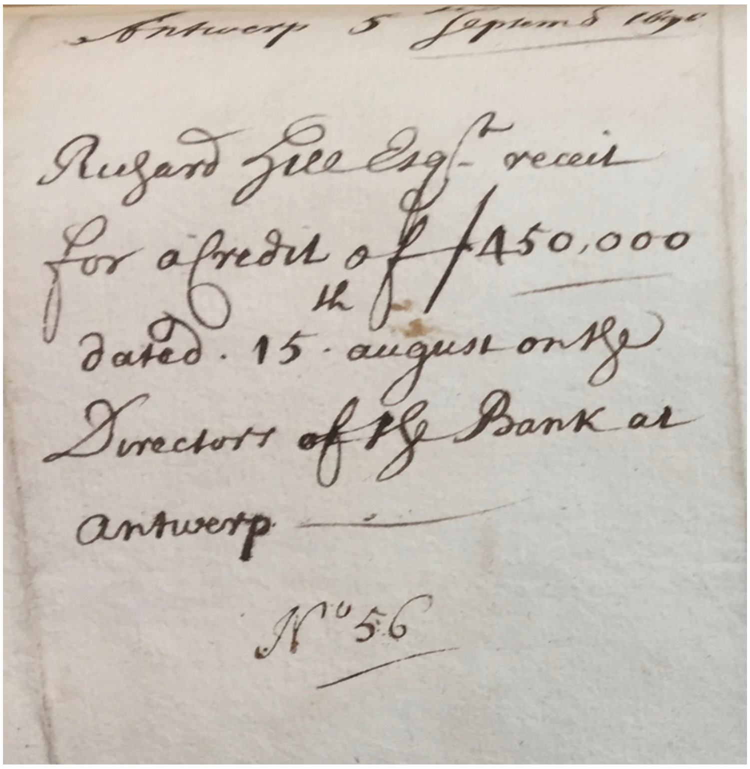
[147] Court of Directors Minutes, Lib. B, p. 27 (May 15th 1695).

[148] However, one could argue that otherwise the term "branch" would have been used. The idea of branch-banking was well known at that time. Clapham (1944, pp. 104-6), and the Bank of England (1963, p. 279), point at models that had been described already in the anonymous "Proposals for National Banks" (issued 1696). In addition, the Court of Directors must have noticed the methods floated in Scotland, where the small Bank of Scotland (established 1695/96) had set up branches across Scotland, see Clapham (1944), ibid. Without offering sources, Francis (1847, p. 82) refers to a quote from 1697 in which a proposal was made "that the Bank of England be branched into every city and market town in England, and that the several branches be accountable to the general Bank in London for the profits of their respective branches." Still, in all citations the word "branch" was only used in the national context. Interestingly enough, and adding to the terminological confusion,

where the Bank of England uses the term “Bank” for the operation at Antwerp: in a confirmation note of the Bank of England from September 5, 1696, to a receipt of Richard Hill from September 5, 1696 (Receipt No. 56)[149] it states that Richard Hill received “[…] for a Credit of £450,000 dated. 15. august on the Directors of the Bank at Antwerp.” (*Figure 18*). The internal use of the word “bank” suggests a comparatively strong parallel structure, including deposit taking options that were seen as typical of a “bank”.


Antwerp 5 Septemb 1696

Richard Hill Esqr receit
for a Credit of £450,000
dated. 15th august on the
Directors of the Bank at
antwerp

No 56

Figure 18: confirmation note of the Bank of England to Receipt No. 56 for a payment to Richard Hill via the directors of the branch of the Bank of England at Antwerp (“Receipts for Money Paid Abroad on Account of the Bank of England”, No 56).

It might be coincidental or even based on the lack of other words, but we should have a look again at the pamphleteer Luttrell and his quote from the beginning of this

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the Bank of England itself would name the staff at its branches (starting in 1826) “branch agents”, see Bank of England (1963), pp. 280-3.

[149] Archive of the Bank of England, Receipts for Money Paid Abroad on Account of the Bank of England, M5/11.

paragraph: even he called the new enterprise at Antwerp a “bank”.[150]

In summary, we tend to see more elements of a *branch* accomplished and performed by the directors at Antwerp - an institution that before its inception and during its two years of operation was called a “settlement”, “house”, or even “a bank at Antwerp”[151], but nobody at that time referred to it as an “agency”.

cc. The cycles of Antwerp

Regardless of its classification, the representation in Antwerp was in operation from May 1695 until the end of the Nine Years War despite an overall loss of £130,000.[152]

The procedures in Antwerp were obviously not flawless, and the Agency had difficulties in fulfilling its objectives. An entry in Luttrell’s diary of September 28, 1695, reveals that

> “[t]he bank of England not having that successe in their Mint at Antwerp for coyning of money to pay our army as they expected, have borrowed 200,000*l.* of the bank of Amsterdam at 4*l.* per cent., the king giving his word at the same time to see them reimburst, which money they have paid to his majesties army in Flanders without remitting hence.”[153]

One of the original intensions for installing the operation at Antwerp was the simplification of the remittance processes. This noble resolve shouldn’t work out. Somehow analogous to the methodical eclecticism of the Bank of England, the branch also tried numerous models to facilitate the task of forwarding sufficient forms of purchasing power to the troops.

The first experiment, namely to “receive and pay moneys and to give notes for the same” failed rather quickly. The directors obviously tried to gamble by borrowing

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[150] Lutrell (1857), Vol III, p. 473.

[151] Luttrell (1857), Vol III, p. 473.

[152] Child (1987), p. 153.

[153] Luttrell (1857), Vol III, pp. 530-31.

funds in Flanders through specie deposits against interest-bearing notes.[154] The bet was to keep enough specie reserves, as well as notes out in circulation, therefore replacing current money with the promise of repayment. Hill would be satisfied with direct payments out of the deposits against notes, which he would cash immediately or offer to his creditors. However, this trick only worked with rising exchange rates, because it presented the opportunity to always honor "the normal run of demand for notes to be repaid".[155] The plan should not prevail, though. The directors of the Bank of England, who went to take over the business in Antwerp, did not succeed in accumulating enough specie reserves. Furthermore, the market in Antwerp proved to be insufficient to circulate the notes successfully.[156]

For a short time, in July and August 1695, the branch at Antwerp was also involved in clearing the overdraft of the Bank of England with its long-standing correspondent, Jacobus de Coninck. The method was quite simple: the directors at Antwerp handed over bills of exchange to de Coninck which they had either brought with them from London or received from there (using the model of a merchant-merchant cycle of a bill[157]). The latter cycle was also used for remittance purposes, but it proved to be inefficient, as the exchange rates were not advantageous for that solution.[158]

Alternatively, the representatives at Antwerp considered simple and conventional loans from lenders across Flanders. This proved to be a comparatively expensive method. The Receipts for Money Paid Abroad show this method in more detail: between March 15, 1695, and October 25, 1698, we find receipts (Nos. 68 to 82) given by Monsieur

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[154] Kleer (2017), p. 99.

[155] Ibid.

[156] Court of Directors Minutes, Lib. B, p. 47 (June 26th 1695). We touched upon this question already above, in the context of the possibility of a second representation in Amsterdam, which was a consequence of the limited circulation efforts in Antwerp.

[157] See above 2.e. Evidence to be found in Supplementary Ledger (ADM7/2).

[158] Due to the enormous expenses, the directors in London contemplated the option of shutting down the operation at Antwerp as early as in September 1695, see Court of Directors Minutes, Lib. B, p. 69 (September 18th 1695).

Van Ellemet, Treasurer of the United Provinces, to George Clifford, the Bank of England's correspondent in Amsterdam, for interest on and repayment of moneys borrowed in 1695 by the directors in Antwerp from the States General of Holland.[159]

The house at Antwerp became a classic example of an ambitious endeavor that shifted to an ad hoc-operation that repeatedly changed its remittance practices. Again, the collection of receipts for money paid by the Bank of England to Richard Hill gives ample evidence of the adjustment of strategies at Antwerp.[160] Two examples that are not covered by other authors shall illustrate the fact that the inception of "ye House at Antwerp" did not lead to clearer remittance procedures.

In receipt No. 27 (September 2, 1695), we encounter a *letter of credit cycle*, where Hill received a letter given to Lord Ranelagh by the Bank of England. The deputy paymaster presented the letter to the directors at Antwerp who paid him 200,000 florins (*Figure 19 and Illustration 18*). A little more complexity was added to the letter of credit cycle, when – for example- in Receipt No. 56 (September 5, 1696) Richard Hill verified that he

> "[r]eceived of m^{r} James Bateman Director of the Bank of England the summe of four hundred and fifty thousand gilders currant mony of Braband. by virtue of a Letter of Cred^{t} Endorst to me by the Earle of Ranelagh dated in London the 15 of august 1696 […]"

Another variation were "bills of credit" issued by the Antwerp directors in favour of third parties, for example the President de la Tour[161] or the Commissioners for

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[159] Archive of the Bank of England, Receipts for Money Paid Abroad on Account of the Bank of England, M5/11, Nos. 68-82. Note that the receipts for repayment reflect a period beyond the existence of the branch at Antwerp.

[160] Receipts for Money Paid Abroad on Account of the Bank of England, M5/11, Nos. 22 and 23, as well as 25 to 52 are for payments made by the directors of the Bank of England, who went to Antwerp in June 1695; Nos. 53 to 60 are for payments made by James Bateman, who alone managed the business in Antwerp from May 1696 until February 1697.

[161] Receipts for Money Paid Abroad on Account of the Bank of England, M5/11, Nos. 62 to 67.

Victualling H.M. Navy[162].

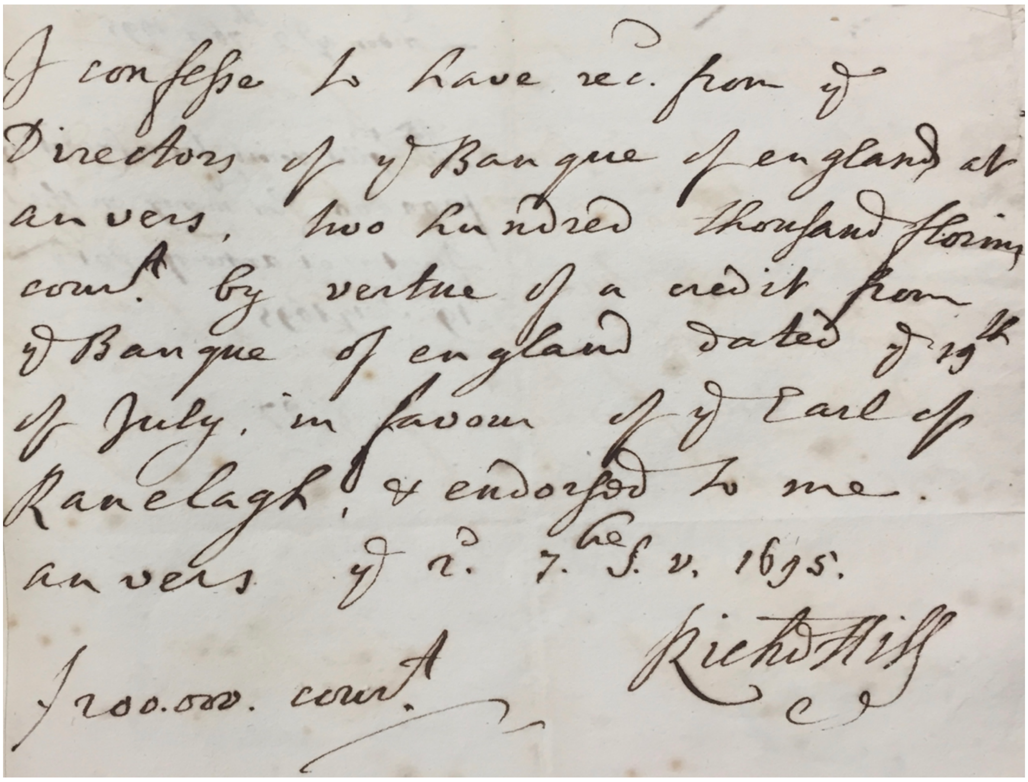
I confesse to have rec. from ye
Directors of ye Banque of england at
anvers, two hundred thousand florins
comt. by vertue of a credit from
ye Banque of england dated ye 19th
of July, in favour of ye Earl of
Ranelagh, & endorsed to me.
anvers ye 2. 7bre s. v. 1695.
Richd Hill
f200.000. comt.

Figure 19: Receipt for a payment to Richard Hill via the directors of the branch of the Bank of England at Antwerp via a letter of credit cycle ("Receipts for Money Paid Abroad on Account of the Bank of England", No 27).

In an additional note of Hill to a later Receipt (No. 53 of May 16/26, 1696), the deputy paymaster hints at the possibility of an *agent-principle cycle of a bill* (see in detail above 2.b.) by stating that he "would very gladly have given bills upon my Lord Ranelagh at 2. Usances […]" and in the receipt itself, he confirms the receipt of

> "six hundred thousand florins com.t mony of spaign, for the use of his majestyes forces in flanders wch summe he g.d to me by order & direction of the Banque of England."[163]

[162] Ibid., No. 83.

[163] According to the confirmation note, this was "Mr. Richard Hills receipt for f600,000: paid him by mr. James Bateman p order of the Bank of England, on acc:t of the new agreem.t for f1000,000."

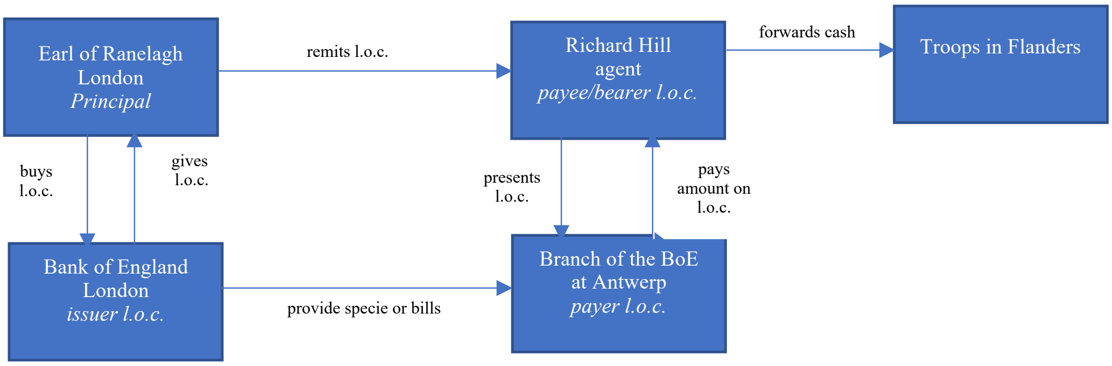

Illustration 18: letter of credit (l.o.c.) cycle in order to facilitate remittance payments to the troops using correspondents in London, their representatives (branch at Antwerp) as well as the Army paymaster's deputy in Flanders: correspondent-principal-agent-branch -agent.

In order to provide the branch at Antwerp with sufficient money, the Bank of England chose different options, ranging from shipment of specie to bills of exchange which they either acquired in London or drew on merchants/bankers abroad. This led to additional bill cycles.[164]

The decision to send a few directors to Flanders to run a branch at Antwerp obviously wasn't a success story. It would be slightly exaggerated to see the horrible fate of Michael Godfrey, deputy governor of the Bank of England, as exemplary for the fortune of the endeavour at Antwerp; Godfrey, also a director at Antwerp, who visited the trenches at the besieged town of Namur - "willing to flatter the King"[165] – was beheaded by a cannonball on July 17, 1695, allegedly whilst talking to William about possible loans from the continent.[166]

Until January 5, 1697, when the Committee of Remises was ordered to demand from the sole remaining director at Antwerp, James Bateman, "to clear all accounts in

[164] See above, 2.b.-h.

[165] Francis (1847), p. 72.

[166] Luttrell (1857), Vol. III, p. 503, not without cynicism, writes: "Being an eminent merchant he [Godfrey] is much lamented; this news has abated the actions of the bank 2l. per cent."

Flanders before he comes away"[167], no concise strategy for the outsourced operation in Flanders became visible.

In October 1697, the Treaty of Ryswick ended not only the Nine Years War with France, but also a tumultuous start of the Bank of England. Smoother times were about to follow in the next five years when the Bank had a chance to consolidate – before, in 1702, the War of the Spanish Succession brought new challenges.

3. Conclusion: A pan-European chain of bills and letters

Throughout history, financing a war has usually always been a most inglorious task. Inventive and creative models have rarely turned into lasting success stories. However, over the millennia national and international conflicts, as well as bellicose ambitions, have repeatedly triggered innovations in banking (see also Chapter 4), and sometimes even the establishment of institutions that have flourished, to this day. The Bank of England is such an example, Its founding myth was, to a certain extent, based on the necessity to fund the troops of King William III in Flanders. Still, the Bank's models to remit funds across the Channel were not as revolutionary as they are sometimes described. They were mainly based on experiences and methods that had already been tried in the first years of the Nine Years' War, before the inception of the Bank of England in 1694. Moreover, while the founding myth describes the need and ability to remit gold to Flanders, by engaging in a standard, and already existing, banking practice, the Bank of England merely effected credit transactions, with only rare shipments of gold from England. The fact that very little gold was shipped abroad could, however, be argued by some to even call into question the very justification for the establishment of the Bank of England.

In order to gain a clear picture of the often tightly intertwined and highly complex procedures of war remises, we offer a new classification of remittance payments – based on primary sources like the Treasury's Entry books, ledgers of the players involved, and receipts. Instead of just pointing at the (sometimes multiple) protagonists

[167] Court of Directors Minutes, Lib. B, p. 195 (January 5th 1696[7]). According to the Court Minutes of March 30, 1697 "Mr. Bateman lately returned from Antwerp now took the several oaths appointed as a Director (Lib B, p. 215, March 30th 1696[7]). See also Richards (1964), pp. 234-5.

of domestic and international transactions, we identify transaction cycles, mostly involving bills of exchange, but also letters of credit that follow the course of these notes from their moment of being drawn to the last step when they were cashed in. Due to the fact that before and after the launch of the Bank of England, the relevant players in a bill- or letter-based transaction (drawer, drawee, payer, payee, principal) regularly changed, this model and clarification is a necessary step to avoid further confusion in literature. The constant shift of methods had many reasons, like the shortage of money of certain players, volatile exchange rates, or unreliable representatives abroad. The protagonists in London (and also in Flanders) tried a variety of bill of exchange cycles, where, at one point, almost all players involved became drawers or drawees. In other words, more or less almost every player involved drew on one another in varying constellations. This demonstrates that at the time of the founding of the Bank of England, there already was a fairly well-established network of mutual and interlinked credit relationships through which international transactions, but also to a large extent domestic transactions took place.

In order to compensate representatives abroad who had to provide direct payments, the initiators of the cycle would also rely on a second or even more bill cycles that gave the correspondents in Flanders the opportunity to profit from bills in their own networks. In cases where letters of credit were the preferred option to facilitate payments to the troops, additional bill cycles were regularly put in place. More options than so far identified were used or discussed to remit money to Flanders, even before the inception of the Bank of England (e.g., four different models of the correspondent-merchant cycle of a bill)

The newly founded bank, however, not only took over the role of two London-based goldsmith bankers, Evance and Herne, but also their role as correspondents of the Treasury[168], respectively of England's army paymaster, the Earl of Ranelagh. It was neither an agent or an "*institutio sui generis*". This finding is based on numerous reasons, ranging from its status as a private bank and its scope of independence from short-term contracts with the Treasury. In contrast to the literature on the years before and after the launch of the Bank of England, we offer a concise categorization of the different types of representatives that were involved in national and international transactions. Based on the results of the Chapters 3 to 5, we clearly distinguish between

[168] We identified Evance and Herne as "goldsmith correspondents" in Chapter 5.

agents, branches, subsidiaries, and correspondents. All these terms are regularly, and incorrectly, used as synonyms.

A key figure during the war was the Antwerp merchant banker, Jacobus de Coninck – however, he remains opaque in literature. A deep analysis of his work, services, networks, and interactions reveals that he was not an agent of Evance and Herne, or, later, the Bank of England. He actually resembles the prototype of a correspondent. Similar results were obtained for Benjamin Poulle from Amsterdam and William Schulenberg as the Dutch Paymaster in Flanders.

Particularly the instalment of the Bank of England's operation at Antwerp in May 1695, which, step-by-step, rendered de Coninck's services obsolete, shows how highly aware the protagonists were of the different models of representation (even if they did not use the terms that we would consider today). As opposed to the widely-used term "Agency" for the Bank's representation at Antwerp we have come to the conclusion that the directors, who were sent across the Channel, established a *branch* of the Bank of England. This step was a clear reaction to the difficulties the Bank and the crown had encountered with its remittance options. However, this solution turned out to be rather inefficient as well, due to the fact that the directors sent to Antwerp couldn't come up with consistent and stable remittance strategies. Instead, they echoed the plethora of options conducted from London which they initially tried to circumvent through outsourcing parts of the operation to Flanders.

Structurally, the Bank of England copied most transfer methods – or "bill cycles" – from the goldsmiths syndicate, but also came up with a few new, or at least refined alternatives; for instance, a dual cycle remittance option combining a letter of credit and bill of exchange cycle, or a reverse correspondent-correspondent cycle of a bill, where correspondents of the Bank of England at Amsterdam would draw on the Treasury's correspondent, the Bank of England. Also superficially peculiar models like an agent-correspondent cycle of a bill were in use. In this constellation Ranelagh's agent (and English Deputy Army Paymaster), Richard Hill would be allowed to draw on the Bank of England's correspondent (and Dutch Army Paymaster) William Schulenburg who appeared as a lender to the Bank of England.

Building on the trade experiences of earlier centuries, England established a *pan-European chain of bills and letters* to enable remittance payments for its troops abroad, especially in the multiple bill cycles, where correspondents would use their network of agents and other representatives across the continent to balance their own accounts. It should be mentioned that France was building on similar methods at that time.[169] It is not just coincidental that the inception of important central banks happened shortly after or during major military conflicts. Take for example the founding of the Swedish Riksbank right after Sweden's involvement in the Second Northern War (1655-1660); the Bank of England, as seen, in the course of the Nine Years' War (1688-1697); and also the Banque de France, created in 1800, in an attempt to enhance the financial situation during Napoleon's wars.

[169] In more detail, Rowlands (2015), pp. 73-95 and 128-95; see also the author's instructive appendices.

Chapter 7: Conclusion

For centuries practitioners and researchers have struggled to find a fitting and clear definition of correspondent banking. It would seem that many had given up on it. At first sight, this may appear peculiar, as we are dealing with one of the oldest transaction methods in banking and finance. However, it is not sufficient to explain this deficit by only referring to a potentially large spectrum of players involved in correspondent relationships or to hold forth on regional differences around the globe. The latter argument is especially inadequate as correspondent arrangements were put in place to overcome payment obstacles over long distances.

Global connectivity is constantly rising, and payment flows and transactions could potentially reach almost every corner around the world. Thus, the necessity to come to a common understanding of a model that stands for the daily movement of enormous amounts of money is evident.

A clear categorization serves many purposes. A lack of terminological clarity can easily lead to a lack of compliance. There are numerous examples where countries and banks are non-compliant with regulation, regardless of whether it is public-sector driven or self-installed by the banking and finance industry. We pointed at a recent OECD Study (2014, pp. 33-4), according to which 50% of the OECD countries were non-compliant with the FATF Recommendations regarding correspondent banking. Although the reasons for this outcome may certainly differ, terminological confusion is never beneficial for regulatory success.

In addition, imprecision in wording potentially creates loopholes for criminal activities. An example: In today's interconnected world, it is not any longer a hard task for non-bank parties to move the starting and ending points of transactions to jurisdictions with unclear definitions of correspondent banking – or, more precisely, to a regulatory landscape that still lives up to a bank-only approach. Another (geopolitical) example: circumventing sanctions that involve payment and transaction methods is easier if international bodies only work with the least common denominator of a definition – or if sanction regimes are even exposed to distinct definitions. The rapid developments in the digital sector will also create more and more innovative substitutions of the classic bank-to-bank relationship - and have already. However, new methods must not drift into regulatory twilight but should be aware of existing thresholds of potentially damaging behaviour.

We gave evidence in this research of the sheer magnitude of different definitions of correspondent banking, and we tie the results to necessary consequences. Yet, we do not limit our research to an overdue survey of contemporary structures of correspondent relationships, their deficits, challenges, and opportunities. We have also used our findings to partially surmount another remarkable shortfall in literature, namely, to write a concise history of correspondent banking. It is only superficially surprising that we have not yet encountered such an academic project: Without a clear concept of what correspondent relationships are and are not, it is almost impossible to reflect on such a barely-disputed method throughout centuries or even millennia, and across different legislations, with an intellectually solid basis.

Therefore, we began our initial survey of contemporary correspondent banking by identifying discrepancies and gaps of today, and we tried to resolve them and "translate" them into the lenses that we needed for a new review of the history of correspondent banking. Our conclusion, for instance, that correspondent relationships are not necessarily tied to banks on both sides, leads us, on the one hand, to recommend a definition that no longer mentions correspondent *banks*, but rather uses the term *institution* on the correspondent's side. A correspondent banking relationship is traditionally - and, as we have observed, also historically - a liaison between financial institutions. However, to be precise, it is only the correspondent that needs to fulfil the criteria of a financial service provider. A respondent could be any first-, second- and third-grade account holder or party via a contract with a correspondent that asks for correspondent services. As an alternative to the traditional term *correspondent banking,* we consider the expression *correspondent relationship* or *arrangement* as less misleading.

In order to gain a clearer picture of the advantages of this business model, we developed a new system of factors of correspondent relationships. It comprises (1) the access and influence factor, (2) the savings factor, (3) the local and global networks factor, (4) the efficiency factor, (5) the interconnectivity factor, (6) the business accelerator factor, and (7) the predictable revenue factor. All seven points are relevant for correspondents and respondents alike (at least in the constellation of so-called *first order correspondents/respondents*).

But, consequentially, existing (traditional) lists of risks and disadvantages of correspondent banking need to be scrutinized and expanded. We presented the first survey in Chapter 3 where (1) geographical and geopolitical risks, as well as (2) risks from new, disruptive technologies, and (3) reputational risks are mentioned. We also call for the recognition of "cross-cutting risk clusters" (societal, economic, geopolitical, technological, and environmental risks). Again, any historical approach needs to at least keep these factors in mind as well.

Another aspect has been widely neglected: This research concisely and clearly distinguishes correspondent relationships from any other type of inter- and multinational banking. It may only sound like a facet, but the consequences of a lack of precision are enormous, especially from a regulatory perspective or in light of an urgently needed global standardization of this model. However, until today and for hundreds of years, different types of representations have repeatedly been confused: Agents are called correspondents and vice versa, and correspondents are actually branches or subsidiaries, etc. A sharp distinction makes it, for example, easier to detect correspondent relationships already in ancient times where others would only see agents. As another novelty in the literature, we also find a differentiation from a modern method, mainly in developing countries, so-called "banking correspondents" and come up with a proposal for a fitting terminology of the latter, namely "business correspondents".

After showing the typical characteristics of correspondent banking, and especially its accounting methods, we demonstrate why a correspondent (banking) relationship does not need to be based on the traditional nostro/vostro account relationship. This finding also bears major consequences for any historical view as it is critical for the evaluation of potential participants in a correspondent relationship. A correspondent relationship can be initiated and maintained through correspondent services contracts and/or through opening and holding accounts with one another. A restriction to account arrangements would also exclude financial institutions or players in the finance business from falling under the definition of a respondent or correspondent. In turn, such an exclusion would make it even harder to apply present regulatory or compliance rules to certain participants in financial services procedures and open opportunities for potential misconduct and circumvention of, for instance, AML rules. It also may simplify regulation efforts of alternatives based on digital solutions.

Therefore, even this detail of our work may contribute to a potentially more efficient regulatory landscape. Modern regulation in the wake of 9/11 imposed sanctions and the financial crisis of 2008 initiated changes of perception of correspondent banking: from a "matter of trust and reputation" to a matter of "must and regulation". We also witness a slow shift from more and more "self-regulation" by the industry to processes that involve many different stakeholders. This is the first time that correspondent banking is named as a core example of a "private-public regulatory hybrid".

Aside from public-sector imposed regulation, the role of self-regulation through the industry is remarkably forceful. We call for international standards but realistically see a Sisyphean task. A too-tight approach regarding the players involved in correspondent banking relationships makes it more difficult to reach further – and necessary – steps of industry standardization. Recent regulatory developments ask for even more international standardization and regulation leading to predictable compliance costs, amongst other effects.

Our results regarding the general concept of correspondent banking include the finding that the majority of definitions used previously have been flawed or even wrong. It also gives us the opportunity to offer a systematic and essential categorization of correspondent relationships. No doubt, the strongest bonds exist when two banks or at least two financial institutions with a banking license and a nostro/vostro account relation are correspondent and respondent. They reflect a "classic" understanding of correspondent *banking* as a sub-concept of correspondent relationships, and they are theoretically (as correspondents) capable of offering the widest range of potential correspondent services. Today, the majority of commercial banks fall into this category. We call these players with, at least, a banking license *first-order correspondents* and *respondents*. In order to prevent further confusion in international and domestic accounting procedures and its legal fundamentals, we have to overcome the terminological polyphony in respect of the accounts involved. Globally, and especially in the influential financial environment of the U.S., the words vostro/nostro/loro accounts should be established as well (instead of, for example, "due to" and "due from" accounts).

In our novel categorization, *second-order correspondents* and *respondents* are also holders of a banking license, but are limited in their scope of services (examples are central banks, the CLS Bank or the BIS). As correspondents, they can manage vostro accounts.

Third-order correspondents and *respondents* would normally not have a banking license, and therefore, not be allowed to hold and manage the bank accounts of others, but regularly act like parties in a correspondent relationship with a reduced span of services. Clearing houses (that are not at the same time central or commercial banks) reflect such a categorization as they took over a characteristic subject of correspondent banking networks – without being involved in mutual account relationships.

The consequences of this new framework are logical, and, again, a useful element for more stringent regulatory steps: *First-order correspondents* can be tied to second- or third-order respondents on a contractual basis or – typically - via vostro/nostro accounts. *Second-order correspondents* can have a correspondent relationship with first-, second- and third-order respondents and would – in most cases – be connected through vostro/nostro accounts or through contracts. *Third-order correspondents* would naturally be linked to first-, second- and (rarely) third-order respondents via alternatives to nostro/vostro account, therefore usually on a contractual agreement. When third-order correspondents engage in accounting-related services, they could reach out to a first or second-order correspondent to become part of the service chain. One aspect that all forms of correspondent relationships have in common is their on-going, recurring character[1] which excludes unrepeatable and one-off arrangements.

Our concept of three levels of correspondent relationships also helps to overcome deficits in other approaches that try to categorize banking systems related to clearing and settlement methods. For that reason, we developed (correspondent) criteria for clearing, settlement, and payment systems and demonstrated that certain payment systems can very well be parties in a correspondent relationship. The criteria are: (1) The value of payments cleared or settled, (2) market share, (3) cross-border relevance, (4) provision of typical correspondent services to

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[1] The Wolfsberg Group (2014, p. 1) speaks in its Principles for Correspondent Banking of an “on-going, repetitive nature” of a correspondent relationship.

other infrastructures[2], (5) a direct relationship to participants of the system, (6) a lasting relationship, (7) system is subject to regulation or an instrument to circumvent regulation that would normally be in place for similar services, (8) system has marginalized or diminished existing correspondent relationship structures.

In respect of recent outside influences on correspondent arrangements, we conclude that the financial crisis and the establishment of the Eurozone led to a significant concentration process in correspondent banking – with the larger players in the financial industry as temporary profiteers. Many smaller banks are not aware of the risks of this development. In the Eurozone, correspondent banking relationships are progressively in decline - also due to centralized Euro clearing and settlement systems like SEPA. In the financial crisis, correspondent relationships were a predictable "safe haven" for global banks. The rising compliance and regulatory costs superficially played into the hands of the larger players in the financial industry. On the other hand, the consequences of the latest money-laundering scandals led to sharply reduced correspondent arrangements. Technological developments like the blockchain and open distributed ledgers pose a threat to traditional banking models.

Due to the identified risk factors, the loopholes in regulation and the breathtaking pace at which technological innovation takes place, it is not too late to call for a single global institution for regulation of correspondent relationships. Still, reality shows that such an attempt still bounces against the rubber walls of national resistance. Giving up the necessary sovereignty for functioning control, monitoring, and even sanction mechanisms still face predictable opposition from many governments, and also some industry-led bodies. Several of the multinational developments - described above, regardless whether they are of private, public, or hybrid nature - are promising, but they urgently need coordination. If we keep calling for better, not constantly more, regulation, we first and foremost need to achieve a common platform of the

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[2] These first four principles are developed and used by the ECB (see https://www.ecb.europa.eu/press/pr/date/2014/html/pr140821.en.html.) to evaluate the quality of a payment system to be systemically important – whereby only two of them need to be fulfilled.

subject that is to be regulated. With a widely differing definition of correspondent relationships, respectively, correspondent banking, this task is doomed to fail.

One of the few researchers who touched upon correspondent banking, Chan (2001), called correspondent banking a "subsystem within the banking system". In our opinion, it would not be too far-fetched to consider correspondent banking – based on its historical development and significance – as a principal element of the banking system, fulfilling even the functions of a financial system. Of course, one can only come to this conclusion if we widen the scope and not only see the admittedly already substantial global "value" of correspondent banking within the financial scenery, but also the role of all players involved. This role cannot be limited to commercial banks, but it comprises central banks and certain clearing houses as well. In addition, major parts of day-to-day business in banking would (still) be unthinkable without correspondent banking arrangements. Correspondent relationships still echo a crucial component of banking with its national *and* international dimensions, and especially, its "network"-function within the financial world.

Many of our results and recommendations help us to close another gap in research: correspondent arrangements have not yet been part of a *functional approach to finance*. Referring to Iqbal and Llewellyn's (2002, pp. 3-4) findings, we can subsume correspondent relationships of our days under the *four universal functions of a financial system* as well as under the *six basic functions of a financial system* developed by Merton (1993 and 1995).

The field of application for our newly developed criteria, factors, and categorization of correspondent relationships as well as for the functions of a financial system is much broader than just our present times. De facto, it reaches back to antiquity and it allows us to pioneer first steps into the development of a history of correspondent banking.

Our case studies, applying the methodology of business history and analytical evaluation in Chapters 5 and 6, showcase that these functions were fulfilled in many constellations at the end of the 17th century when the newly incepted Bank of England used correspondents (amongst others) to facilitate war remises. In those chapters we made extensive use of original archival material in order to utilize first-hand sources on how one of the longitudinally most important banks in the world did actually go about in its international transactions, whether correspondents were important for the first international transactions – for which purpose the Bank of England had officially been created – and to what extent, its methods were novel. These will be discussed further below.

In most (rare) cases, when correspondent relations are mentioned in historical surveys, they are connected to Renaissance Italy. And, yes, the *re-invention* of bills of exchange in that time and place successively unfolded across Europe and surely contributed to fostering international financial services as they were created as a legal instrument to allow safer international trade. Italian banking of the Renaissance certainly promoted and widened the establishment of multinational banking. They created and used some state-of-the-art elements of correspondent banking, but only, if no other or better controllable alternative – like dependent agents or branches - would have been possible or feasible. The birth hour of *modern* correspondent banking is hard to detect as some developments from the 11th century onward took centuries while others happened quickly in parallel. It could be seen in the first steps that Venetians undertook at home and abroad, but also in some early local arrangements by Genoese bankers and moneychangers. In any case, especially newly established mechanisms, namely forerunners of "interbank clearing" and certain settlement procedures should be valued as unique contributions to our history of correspondent relationships. Here, the involvement of some prominent Tuscan families in Lübeck, Flanders, and England, proved to be a game-changer, specifically in medieval Bruges or even earlier at the fairs (as long as bills of exchange in the described sense were involved).

However, looking only at Italy and Europe in late medieval times would keep us from significant findings in the history of trade, banking, settlement, and even accounting. We need to remind ourselves of the fact that the fundaments of correspondent arrangements had been already laid in ancient times. Some of the earliest methods are very similar to the correspondent banking system that would emerge in the United States in the 19th century with the cheque payment system. But almost 4,000 years earlier, we see elements of transaction banking in Mesopotamia and surprisingly innovative features of what we would later call letters of credit and bills of exchange.

Building on these experiences and regional interactions the concept of banking was constantly refined in Greece from eighth century BC onwards, later in fourth century-

Egypt under the rule of the Ptolemies and on the island of Delos – places where we already clearly notice indicators of correspondent arrangements. Roman merchants and bankers adopted these structures, and their correspondent relations grew conceptually and geographically into advanced payment and financial intermediation methods used far beyond the city walls of ancient Rome. Yet, late imperial Rome did not directly influence medieval Italy.

We highlight another important but almost completely underestimated impulse: Near Eastern experiences in trading and payment systems, namely the innovative payment instruments stemming from the Persian Sasanian Empire (the development of a cheque system) and from Arab, respectively Jewish, merchants (the *suftaja* and *hawala*). Historically, the missing link in the history of correspondent arrangements between Near Eastern merchants and medieval Tuscan merchant bankers are the Crusaders - equally as neglected as the aforementioned group -, who gained knowledge of payment systems that were either forgotten or undeveloped in the medieval "Western world". Supported by the Curia, they used correspondent arrangements mainly for remittances, but also for trade relations. All those who still applaud Renaissance Italy for "creating" correspondent banking need to be reminded that the clergy and crusaders – many of them with family ties to influential Italian families – learned about long-existing payment systems even from their own relatives. Regarding correspondent banking, Italian merchant bankers were not protagonists of a financial *revolution*, but actually stirrup holders of an *evolution*.

After identifying timeless criteria, factors, and parameters of correspondent relationships which more or less already fully materialized between ancient Babylon, respectively Assur, and Renaissance Italy, and not only afterward, we can even apply the *four universal functions of a financial system functions*[3] much earlier in (not just correspondent) history.

[3] Here, we refer to the "four universal functions" of Iqbal and Llewellyn (2002, p. 3). In the conclusions of Chapter 4, we have already analysed that Merton's (1995) "six core functions performed by the financial system" are widely fulfilled.

The first function (*intermediation function*), as cited above, "providing intermediation services", thereby "channeling funds from ultimate savers to ultimate borrowers and removing budget constraints" during this process, can already be seen in Mesopotamia, and doubtlessly, in Greece and Rome. Resources were moved between agents, branches, and later, correspondents over time and across regions far apart from each other. And although accounting methods that served correspondent relationships were only rudimentarily developed in Mesopotamia, their basic structures stem from there. The preconditions to fulfil the third (*asset and liability*) function were only partially covered in those times: a wide spectrum of assets and liabilities with distinct characteristics for liquidity or certain risk-sharing elements were mainly put in place and refined in ancient Greece and Rome. We come to a similar conclusion regarding the second (*financial services*) function: although we see early payment services and transaction services by the temples and some other players, more sophisticated trade-related services, clearing or cash management began to prosper only in ancient Greece fully and later in Rome. Eventually, the fourth function, the "creation of incentives for an efficient allocation of resources within an existing economy" as well as the distribution of "scarce financial and real resources between competing ends" (*allocation function*) cannot be seen as fully advanced in Mesopotamian times. But in Greece and especially Rome, the organization of long-distance remittances and of options to optimize trade using correspondents and early models of bills of exchange and letters of credit reached a level of sophistication that comes close to the banking activities in the Renaissance. A financial system in the shape of correspondent relations was therefore created much earlier than in modern times or even in late medieval Italy.

North of Italy, financial services and banking developed heterogeneously. In the 16th century, the creative forces in international banking shifted from Italy to the north. The triumphant progress of the bill of exchange not only revolutionized payments in Europe, but it also transformed the methods of trade and led to a remarkable increase and geographical expansion of correspondent relationships.

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Finally, our focus shifted - based on our findings in the preceding chapters - to England where we explore different aspects of correspondent banking until the late 17th century in several case studies, and also alternatives, by mainly utilizing original primary sources.

We emphasize that the use of cashless transaction methods by English merchants was already highly developed in the 14th century. Although these businessmen had created an original model of letters of commitment for long-distance payments as early as the 13th century, the prevailing method that should serve as the role model for the remises to Flanders four centuries later was the bill of exchange that paved the way for trans-European trade on the basis of the Italian re-invention of an ancient idea. On another note, it is a myth that only Italian merchants supplied other merchants with money for trading as the court records of these times clearly show. Important evidence for this assumption is hidden in the Calendar of Plea and Memoranda Rolls, where the protocols of a case between 1381 and 1383 not only prove the existence of bills of exchange, but even include a list of "moneychangers", respectively merchants that have been involved in the transaction procedures of the plaintiff and defendant of the case, and where the nationalities of the parties can be determined.

By analysing early business and trade correspondence like the famous Cely letters we demonstrate and confirm that remittance payments from England through intermediaries and by means of bills of exchange in order to fund soldiers overseas – and especially in Flanders - occurred (in similar forms to those we found in the first ledgers of the Bank of England) already in the 15th century. All these documents help to shed light on some rather abstract descriptions of England's use of bills of exchange before the 17th century, particularly between London and the so called Low Countries on the Continent.

We conclude that different types of representation found its way into English trading procedures already before bills of exchange were even fully established. In the 14th century, so-called 'letters obligatory' could entail assigned parties with attributes of correspondents for the settlement of debts. And original letters of attorney give hints that England's merchants were more and more involved in correspondent structures and not only relying on agent-relationships.

Since the 15th century, the main impulses for the refinement of trade instruments used between and both on the continent and England stemmed from Antwerp. London and Antwerp advanced a thriving interaction of agents and correspondents on both sides of the channel outmanoeuvring the importance of Amsterdam, even after the foundation of the Wijsselbank. The fact that London based merchants established strong trade relationships using the same set of instruments to other European trade hubs leads us to the conclusion that the modus operandi for cashless transactions of the newly-established Bank of England was not as innovative as some think.

This is also supported by the following example: We identify already in the 15th century three groups of businessmen - Mercers, Staplers, and Merchant Adventurers - who formed a geographical and de facto "trading triangles", and they provided remittance services between England, Calais, and fairs in the Low Countries, mainly via bills of exchange. Their transactional focus and respective independence strongly lead to the suggestion of correspondent arrangements.

Finally, England's "specificum", the goldsmiths: Heavily involved in domestic and international transactions, they gradually cultivated networks, in which they used correspondents and acted as intermediaries themselves in "inter-goldsmith correspondent networks" and from time to time appeared as "dual correspondents" when involved in two different locales. They even became relevant parties in international remittance payments to troops abroad via bills of exchange decades before the founding of the Bank of England, thus setting standards for structuring these rather complex undertakings. The last intermediaries used by the crown for remitting soldiers in Flanders preceding the launch of the Bank of England were two goldsmith correspondents named Sir Stephen Evance and Sir Josiah Herne.

However, not only were correspondent *relationships* well-known arrangements in England's finance community, even correspondent *banking* had already been discussed in the early 17th century and, therefore, way before the Bank of England had been founded.

Compared to continental developments, England cannot be called an innovative stronghold in international banking until the late 17th century, and the inception of the Bank of England was more an eclectic adaptation to a desperate situation than a "kairos" or revolution embraced by financial geniuses.

Throughout history, financing war was usually a thankless task. Inventive and creative models rarely turned into lasting success stories. However, over millennia, military conflicts repeatedly triggered innovation in banking, sometimes even the establishment of an institution that blossoms until today. The Bank of England is such an example; its founding myth is to a considerable extent based on the necessity to fund the troops of King William III in Flanders. Still, the Bank's models to remit funds across the Channel were not as revolutionary as sometimes described. Our research based on primary archival sources shows that they were mainly based on experiences and methods that had already been tried in the first years of the Nine Years War before the inception of the Bank of England in 1694. We found that correspondents in continental Europe played a significant role in what was a central task for the Bank of England at the time, and the methods used were not novel. This is a conclusion that mirrored our finding in the history of correspondent banking until the time of Renaissance Italy

Moreover, while the founding myth of the Bank of England describes the need and ability to remit gold to Flanders, by engaging in standard (and already existing) banking practice, the Bank of England merely effected credit transactions, with only rare shipments of gold from England. The fact that very little gold was shipped abroad could be argued by some to even call into question the very justification for the need to establish the Bank of England.

In order to gain a clear picture of the often extremely complicated procedures of war remises, we created a new classification of remittance payments – based on primary sources like the Treasury's Entry books, ledgers of the players involved, and receipts. Instead of just pointing at the (sometimes multiple) protagonists of domestic and international transactions, we identify transaction cycles mostly involving bills of exchange, but also letters of credit that follow the course of these notes from their moment of being drawn to the last step when they were cashed in.

Due to the fact that before and after the launch of the Bank of England, the relevant players in a bill- or letter-based transaction regularly changed, our model and clarification is a necessary step to overcome further confusion in literature. The repeated shift of means and methods had many reasons, like the shortage of money among certain players, volatile exchange rates, or unreliable representatives abroad. The protagonists in London (and also in Flanders) tried a variety of bill of exchange cycles where almost all players involved at one point became drawers or drawees. Or in other words: More or less, almost every player involved drew on one another in varying constellations. This demonstrates that at the time of the founding of the Bank of England, there already was a fairly well-established network of mutual and interlinked credit relationships through which international transactions, but also to a large extent, domestic transactions occurred.

In order to compensate representatives abroad who had to provide direct payments, the initiators of the cycle would also rely on a second or even more bill cycles that gave the correspondents in Flanders the opportunity to profit from bills in their own networks. In cases where letters of credit were the preferred option to facilitate payments to the troops, additional bill cycles were regularly put in place. More options than so far identified were used or discussed to remit money to Flanders, even before the inception of the Bank of England (e.g., four different models of the correspondent-merchant cycle of a bill). Illustrations of most alternatives shall also help to widen the limited scope of literature.

We then contribute a further novelty to the literature, namely our finding that the newly founded Bank of England not only took over the role of two London-based goldsmith bankers, Evance and Herne, but also their role as correspondents of the Treasury, respectively of England's army paymaster, the Earl of Ranelagh. It was neither an agent nor an "*institutio sui generis*". This finding is based on numerous reasons, ranging from its status as a private bank and its scope of independence from short-term contracts with the Treasury. In contrast to the literature on the years before and after the launch of the Bank of England, we offer a concise categorization of different types of representatives involved in national and international transactions. Based on the results of our research in the chapters before we clearly distinguish between agents, branches, subsidiaries and correspondents. All these terms were previously regularly and incorrectly used as synonyms in the literature.

We are also describing a key figure during the Nine Years' War, whose role and background remained entirely opaque in literature (although he was regularly mentioned): the Antwerp merchant banker Jacobus de Coninck. A thorough analysis of his work, services, networks, and interactions uncovers that he was not an agent of Evance and Herne or later the Bank of England. He actually fully resembles the prototype of a correspondent. Similar results are obtained for other protagonists in the remittance business.

Our analysis of Court records, contemporary protocols and receipts regarding the instalment of the Bank of England's operation at Antwerp in May 1695 (that step by step rendered de Coninck's services obsolete) shows how highly aware the main players were of the different models of representation (even if they didn't use the terms we would consider today). As opposed to the widely used term "Agency" for the Bank's representation at Antwerp, we come to the conclusion that the directors sent across the Channel established a *branch* of the Bank of England.

Intellectually and structurally, the Bank of England copied most transfer methods – or 'bill cycles' – from Evance and Herne's goldsmiths syndicate, but it also tried a few novel, or at least refined alternatives, for instance, a dual-cycle remittance option combining a letter of credit and bill of exchange cycle, or a reverse correspondent-correspondent cycle of a bill, where correspondents of the Bank of England at Amsterdam would draw on the Treasury's correspondent, the Bank of England. Also, superficially strange models like an agent-correspondent cycle of a bill were in use.

In conclusion we have to state that - building on the trade experiences of earlier centuries - England established (but not invented) a *pan-European chain of bills and letters* to enable remittance payments for its troops abroad – especially in the multiple bill cycles, where correspondents would use their network of agents and other representatives across the continent to balance their own accounts. France was relying on similar methods at that time. Others should follow.

The experiences of the 17th century had a long prologue – starting in Mesopotamia – and we are contemporary witnesses, and even subjects, of an ongoing epilogue of correspondent relationships.

This is the first comprehensive work focusing on correspondent banking that adopts the historical methodology, uses primary archival research in major case studies, and clarifies the actual scope and significance of correspondent banking based on a clear and consistent taxonomy. This is a major task. As a result, there are other limitations: While it had been originally planned to expand this thesis to include a detailed chapter on the current and novel digital challenge to the long-standing and so far fundamentally largely unchanged model of correspondent banking, the scale of the task so far has meant that this must be reserved for further research when, no doubt, more data points, and more history, will have accumulated.

Thoughts on the future of correspondent banking

Correspondent relationships are currently exposed to fundamental changes in the financial sector - despite resilience and almost unchanged procedural structures over centuries - mainly driven by technological advancements connected to the so-called digital revolution.

Numerous protagonists of the existing correspondent banking community would even call the latest developments existential threats, whereby these threats not necessarily put the banking sector as such at risk.[4]

“Disintermediating the intermediary” is the catchphrase aiming at the marginalization of service providers or additional players that are involved in interactions between two individual parties. In our case, we are witnessing countless attempts to sideline or minimize the impact and influence of traditional financial institutions that offer specific banking services. Innovative concepts focus on either direct transaction relationships between the originator and the receiver of payment or on limiting the players involved in financial services. A few elements accelerate this process. On the one hand, we are facing changing customer expectations. The idea of digitally facilitated real-time payments is not only gaining ground related to domestic retail payments where digital solutions are more and more popular, but it also triggers similar expectations among customers for cross-border payments. Banks are considered to be an expensive obstacle and brake block for a real-time payment chain. Thus, digital innovators are concentrating on solutions and messages where customers are lured by value propositions with

[4] It has to be noted, though, that cross-border payments are still a major factor of revenue for the banking sector. According to the McKinsey Global Payments Map, covering the year 2015, international transactions stood for “20 percent of total transaction volumes in the payment industry, […] [generating] 50 percent of its transaction-related revenues”, see the McKinsey paper by Denecker et al. (2016), p. 3, and Exhibit 1, p. 4.

looser, or even severed ties to traditional financial institutions. Repeatedly used keywords by digital entrants are “cheaper”, “more convenient”, “transparent”, and “faster”.

At the same time, objectives like financial stability, cyber resistance, and the provision of trustworthy instruments to counter AML and KYC related risks must not be abandoned in any cross-border payment model. After the latest financial crisis, many traditional banking institutions left the impression that correspondent arrangements would steadily (and only marginally altered) remain in existence. They argued that costly, but wide-ranging regulations not only improved stability, transparency, and safety in the aftermath of the turmoil that had hit the markets, but also secured the future of an ancient transaction and banking method.[5] This turned out to be a remarkable – and potentially costly - misperception as the crisis also sparked innovative ideas by new technology providers. .

Some ideas resemble a hybrid of established and modern methods. They range from expanding and interconnecting existing clearing bank structures, such as the Automated Clearing House, to the integration of regional RTGS systems or to the connection of country RTGS systems with commercial banks.[6] However, all these approaches would have to struggle with challenges like sufficient network adoption, interoperability, and the alignment of manifold regulatory regimes; some of these models have already been regional success stories (like connected RTGS systems in the Gulf region and in Africa), but will most probably bounce against rubber walls of resistance as soon as they try to expand onto a differently-shaped global stage.

For the traditional banking sector, these observations remain to be a call for action in order to avoid being rolled over by disruptions and powerful players from the digital world. The need to embrace change and creativity for efficient solutions and therefore, attractive customer solutions is evident. It won’t be sufficient to only refer to some prevailing advantages of the

[5] See the description of Bellacosa (2018).

[6] Wandhöfer and Casu (2018, pp. 34-42) thoroughly describe the limitations and illusory aspects of these models.

existing correspondent banking network like its ubiquity, certain safety features, and global accessibility.

Because of their unsatisfactory efficiency and high margins of cross-border payments, it is, of course, not the first time that traditional correspondent banking arrangements are challenged by other players; so-called money-transfer operators (for example Western Union or MoneyGram) aimed with their payment solutions at C2C relationships mainly for the un- or under-banked consumers – and therefore, did not grow into serious competitors for correspondent banks.[7] However, this competitive stalemate is about to change due to a few new protagonists in the C2C cross-border payments environment that are targeting banked and unbanked customers alike and thus, forcing money-transfer operators to widen their spectrum. As a result, Western Union has already expanded its offers to an increasing number of B2B and B2C customers to counter the services of new companies such as PayPal and TransferWise.[8]

PayPal was the first successful digital competitor for banks' traditional payments and transaction businesses. Its original vision to create a world currency independent of traditional banks and political influence has not prevailed though, despite its undeniable economic success. TransferWise, in contrast, has developed a method for cross-border payments that reflects core elements of the *hawala* money transfer system known since the early medieval times (see in broader context Chapter 4); according to Denecker et al. (2016) TransferWise has

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[7] See Denecker et al. (2016), p. 5.

[8] Ibid., p. 6, pointing at some "banks, including India's ICICI, [that] have also started offering customer experiences comparable to those provided by digital attackers, and are bypassing the traditional correspondent banking infrastructure." Kovalchuk (2019) values Western Union's modernized cross-border payment service as "fairly straightforward and traditional in form. This, plus the fact that the recipient in most cases can immediately obtain cash is to [Western Union's] credit." However, the service is also seen as slow, expensive and at risk to be used for money laundering and fraudulent schemes (ibid.).

"gained traction with banked as well as unbanked customers by offering superior consumer value propositions for C2C cross-border transfers, outperforming traditional correspondent banking offerings on key dimensions such as price, speed, convenience and transparency"[9]. Still, this system is relatively insignificant on the global stage with 4 million users transferring about USD 4bn a month.[10]

Noteworthy are also new and rapidly growing Chinese schemes like AliPay and WeChat Pay. Some of the biggest payment tech players are seeking partnerships with domestic payment solutions in order to grow into global interoperability. Alipay, for instance, aligned with the Swiss mobile payment company TWINT.[11]

As already mentioned in Chapter 3, *blockchain* and *distributed ledger technology* (DLT) are essential technological tools to ease cross-border payments.[12] Both are not to be confused or interchangeable. Although blockchain could be seen as a form of distributed ledger, and DLT, in turn, can be perceived as an initial step towards blockchain, the former will not inevitably create a chain of blocks. Amongst other things, blockchain technology allows the introduction of payment systems that use transactions instead of messages and therefore, making traditional clearing mechanisms obsolete. It is not widely known that DLT systems existed before Bitcoin

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[9] Denecker et al. (2016), p. 6.

[10] Kovalchuk (2019).

[11] Accenture (2017), p. 7.

[12] See Chapter 3 1.a.dd. More detailed on blockchain technology in banking and finance, Tilooby (2018) with a useful bibliography (pp. 132-46); see also Peters and Panayi (2016); Shah and Jani (2018); Guo and Liang (2016). Although the sudden prominence of cryptocurrencies like Bitcoin helped to shed light on the blockchain technology, both are still and often seen as synonymous terms – mistakenly so, as Bitcoin is based on blockchain technology.

and blockchain technology.[13] The definitions for DLT are as inconsistent and confusing as those for correspondent relationships (see above, Chapter 3). According to Rauchs et al. (2018, p. 13), DLT "has established itself as an umbrella term to designate multi-partite systems that operate in an environment with no central operator or authority, despite parties who may be unreliable or malicious ('adversarial environment')".[14]

Many of the "disrupters" in the financial sector are building their alternatives to classical correspondent banking with blockchain and/or DLT based solutions – technologies that speed up the disintegration of the intermediaries. One example is the Californian company Ripple that invented a method allowing cooperation with banks as opposed to other players intending the elimination of banks in cross-border payments. However, it also breaks with traditional correspondent banking infrastructure as it offers banks to connect directly without SWIFT or other banks involved providing alternative methods of settlement. Ripple created an internal currency (XRP) that is quoted by authorized market makers. A payment can be processed and completed in minutes by sparing the dependence on message exchange. This solution is not challenging traditional currencies as XRP is not a genuine digital currency; therefore, any involved bank still needs money to guarantee the payment process. Although Ripple executives repeatedly stated that they are focused on disrupting correspondent banking, they are reflecting

[13] Rauchs et al. (2018, p.13) give evidence of the emergence of DLT systems already in 1982, while the earliest blockchain model can be traced back to 1991.

[14] The formal and sophisticated definition of Rauchs et al. (2018, p. 24) is as follows: "A DLT system is a system of electronic records that (i) enables a network of independent participants to establish a consensus around (ii) the authoritative ordering of cryptographically-validated ('signed') transactions. These records are made (iii) persistent by replicating the data across multiple nodes, and (iv) tamper-evident by linking them by cryptographic hashes. (v) The shared result of the reconciliation/consensus process - the 'ledger' - serves as the authoritative version for these records."

– as opposed to other fintechs – a more complementary attitude toward the traditional banking sector.

Cryptocurrencies (like the infamous Bitcoin) have long been perceived as *the* logical successor of contemporary cross-border payment solutions. One of cryptocurrencies' founding myths was the expectation to create a decentralized alternative to the existing banking system. In the meantime, we witness that cryptocurrencies, and especially Bitcoin, are also not entirely immune against fee and speed volatility, typically shortcomings and flaws of more established players in the transaction field. In the light of a shift from Bitcoin's function as a means of cross-border payments and circulation to some sort of "digital gold"[15], it currently cannot be seen as one of the main competitors for correspondent relations. Nevertheless, the importance of cryptocurrencies for the entire financial sector will gradually rise in accordance with successful responses by the so-called "crypto community" to the inherent deficits.

More recent developments in the tech space are efforts of IBM and Facebook to revolutionize the conventional payments system. IBM announced in March 2019 the launch of "World Wire", a global payment system uniting banks by using the "Stellar Digital Asset Network". The participating international banks agreed on creating "stablecoins"[16] for the new system. In IBM's own words: "Using blockchain technology and the Stellar protocol, IBM Blockchain World Wire makes it possible for financial institutions to clear and settle cross-border payments in seconds. Two financial institutions transacting together agree to use a stablecoin […] as the bridge asset […]. The institutions use their existing payment systems […] to convert the first fiat currency into the digital asset. World Wire then […] converts the digital asset into

[15] Kovalchuk (2019), pointing at the growing "store of value function" of Bitcoin.

[16] Stablecoins are cryptocurrencies that are designed with price stability characteristics (in order to keep the volatility close to zero).

the second fiat currency, completing the transaction."[17] Here, we face a creative amalgam of structures that we find in both modern fintech solutions and traditional payment models.

Only lately, in mid-June 2019, the social media colossus Facebook announced the launch of Libra, a new crypto coin and payment infrastructure that already has the initial advantage of stemming from a company with the largest userbase worldwide. In a white paper, Facebook's aspirational mission is described as "a simple global currency and infrastructure that empowers billions of people."[18] With that ambition, Libra's creators are obviously aiming at stepping into a role that other cryptocurrencies haven't been able to occupy so far, namely processing cross-border payments on a large scale outside the existing correspondent banking network. The potential impact reaches further, though. Pisa (2019) is correct when he states that "Facebook and the Libra Association are trying to create a global digital currency that (whether they intend it to or not) could one day rival the role of national currencies and, in doing so, undermine the ability of central banks to control domestic monetary policy." It is still too early to predict how the international community and domestic regulators will react to this bold step by a tech company. Not surprisingly, Facebook's move immediately sparked intense reactions by stakeholders of the financial industry, policymakers, and competitors around the globe.

The fate of becoming a disintermediated intermediary also looms over SWIFT. For decades, it was the leading provider of a network and messaging platform that today connects more than 11,000 financial institutions and other customers (roughly 3,000 banking groups) in more than

[17] Website of IBM: https://www.ibm.com/blockchain/solutions/world-wire.

[18] The White Paper can be found at: https://libra.org/de-DE/white-paper/?noredirect=de-DE (German version). An in-depth description of the processes leading to Facebook's step into the payment world give Levy and Barber (2019).

200 countries and territories.[19] The actual transfer of funds is usually conducted from a pre-funded nostro account that a bank holds with a local correspondent bank.[20] It is no exaggeration to call SWIFT the current industry standard. However, even SWIFT was forced to adapt to the dynamics of the digital revolution. Challenged by the new players in the payment-processing and settlement world, SWIFT launched in 2017 SWIFT Global Payments Innovation (gpi), a cloud-based service (accessible via APIs or MT 199 messages) that allows its customers to track their payments in real time by deploying a "Unique End-to-End Transaction Reference (UETR)" for every gpi transaction.[21] Self-confidently advocating higher transparency and significantly faster solutions, SWIFT even speaks of "the new standard in global payments [that] dramatically improves cross-border payments across the correspondent banking network"[22]. Still, SWIFT's advantage of a large existing user base is tested by competitors. Critical voices are pointing at SWIFT's old infrastructure and principles as a questionable basis for its "new standards".[23] Others are focusing on the fact that SWIFT's gpi does not imply a settlement solution as it is solely constructed around a messaging system.[24] However, in order

[19] See SWIFT's website: https://www.swift.com/about-us/discover-swift.

[20] Wass (2019).

[21] In all technical detail: SWIFT (2018).

[22] See the organisation's website: https://www.swift.com/our-solutions/swift-gpi.

[23] See, for instance, Kovalchuk (2019).

[24] Wandhöfer and Casu (2018), p. 34 and p. 48, who also describe a "gpi Next Generation" that tackles the settlement risk on clearing banks and could be "very impactful in terms of achieving messaging-based transparency for high-value interbank transactions" (ibid., p. 49)

to combine new technological efforts with the necessity of settlements, several of the world's major banks have recently created a digital cash system based on blockchain technology.[25]

But not only new players in the tech and digital realm are seeking opportunities to eliminate the middlemen. Even established financial service providers have launched new networks. Visa Inc, for example, surprised the markets with a model for its corporate clients that is called "Visa B2B Connect" and partly based on distributed ledger technology, especially on elements of Hyperledger Fabric - that would also lead to the abolishment of correspondent banks.[26]

JPMorgan initiated in 2017 a B2B blockchain settlement ecosystem, called Interbank Information Network (IIN), that is challenging traditional correspondent arrangements by sharing payment information among partner banks. Observers identify a level of "speed and efficiency, including low cost of operations [that] is already turning out to be much better than traditional methods, with more than 220 banks using IIN globally."[27] JPMorgan calls IIN "the firm's first scalable, peer-to-peer network powered by blockchain technology"[28]. The bank sees itself as a competitor to some of the more powerful tech players like Ripple, and its invention

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[25] This project – called "utility settlement coin" – was initially proposed by Swiss bank UBS and the tech startup Clearmatics in 2015; some banks that were working on the project include UBS, Banco Santander, Bank of New York Mellon Corp, State Street Corp, Credit Suisse Group AG, Barclays PLC, HSBC Holdings Plc, and Deutsche Bank AG, see Irrera (2019a).

[26] See the Reuters report by Irrera (2019b), according to which the new network is not a distributed ledger itself, but using certain aspects of it.

[27] Ullah (2019).

[28] See JPMorgan's website, https://www.jpmorgan.com/global/treasury-services/IIN, where the bank also provides more details such as that IIN is "[p] owered by Quorum®, a permissioned-variant of the Ethereum blockchain, developed by J.P. Morgan, [and it] allows member banks to exchange information in real-time as a way to verify that a payment has been approved."

deserves the classification of a “new blockchain correspondent banking network”[29]. The sheer economic size of JPMorgan, its global outreach and influence currently form the most powerful response to the digital disrupters in the fintech cosmos.

Even some central banks have started to establish new ways to counter, or better still, to selectively utilize the digital revolution affecting payments. The Bank of England and the UK’s Financial Conduct Authority (FCA), for instance, started several interesting initiatives – opposing the general view of a “traditionally sleepy world of regulators and central bankers”[30]. While the FCA launched a “Project Innovate” where a “sandbox” offers fintechs a testing ground for their inventions in a live environment, with temporary FCA authorization, the Bank of England is considering an overhaul of its Real Time Gross Settlement (RTGS) system. In April 2018, it already opened access to RTGS for digital non-bank payments providers. Until then, this access was only given to traditional banks holding settlement accounts. Sir Dave Ramsden, Bank of England’s deputy governor, affirmed that as part of the new strategy, the BoE is “making sure our Real Time Gross Settlement system can interface and be interoperable with blockchain and distributed-ledger technology (DLT)”[31]. These latest moves of the Bank of England are also driven by expectations of lower processing and transaction costs.

In November 2018, the Bank of Canada, Bank of England, and Monetary Authority of Singapore published a report “which assesses alternative models that could enhance cross-border payments and settlements”. The project covers present challenges and reflects on alternative technical and non-technical models that could potentially create “improvements in

[29] Morris (2018).

[30] Binham (2019).

[31] Interview at CNBC, published April 30, 2019, online at: https://www.cnbc.com/2019/04/30/bank-of-england-deputy-governor-warns-against-curbing-financial-regulations-post-brexit.html.

speed, cost and transparency for users".[32] In the report[33], the three institutions describe the reduction of typical counterparty risks in the context of using blockchain to settle payments. It has to be noted that for a few years, Ripple's XRP based transaction model already resembles similar features and solutions. Yet, it might be a deliberate and potentially standard-setting example for central banks to rely solely on an own and autonomous payment network rather than giving in to the embrace of a third-party payment service.

Other important factors and initiatives with repercussions for the correspondent sector need to be taken into account: The European payment sector will be substantially influenced by the EU's latest PSD/2 directive. Together with the UK's Open Banking Standard, these are two examples for significant steps towards so-called *open banking*. It aims at enhanced collaboration between banks and third-party providers, for example, through the requirement to share account information and access to client accounts with third parties (regularly fintechs with client approval). Classical correspondent relations are (1) challenged by the possibility for clients to use only one interface for the management of all accounts held at different banks and (2) by the opportunity for third-party providers to initiate and facilitate online payments without the intermediation of a bank and by drawing straight from a client's account.

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It is foreseeable that in the next five to ten years, solutions based on digital and other technological developments will step by step refine and most likely replace the existing traditional correspondent-respondent system. Yet for the first few years, we still expect the

[32] Joint Media Release of the Bank of Canada, the Bank of England, and Monetary Authority of Singapore, 15 November 2018, online at: https://www.gov.sg/~/sgpcmedia/media_releases/mas/press_release/P-20181115-2/attachment/Joint%20media%20release%20-%20BoC%20BoE%20and%20MAS%20share%20assessment%20on%20emerging%20opportunities%20for%20digital%20transformation%20in%20cross-border%20payments.pdf.

[33] Bank of Canada, Bank of England, and Monetary Authority of Singapore (2018).

coexistence and partly overlapping of “classical” correspondent banking as it will take considerable time to find internationally common grounds regarding regulation, compliance, and governance of new concepts. Many young companies dramatically underestimate cross-cultural and geopolitical complexities tied to their inventions as numerous examples from the tech world have shown (such as the scandals around Facebook and Uber). Payment providers, regardless whether they are established or new, have never had more and stricter responsibilities regarding risk management, (cyber)security, and transparency. Threats to a business model can emerge unexpectedly and rapidly; this asks for coordinated reactions and sustainable (and yet potentially flexible) standards that apply to both the “old” and the “modern” financial players.

For the near future, it is unfeasible that fintechs or large multinational tech companies will be in the “driver’s seat” for shaping regulation. A push back from governments and international bodies that are still heavily influenced by behemoths of the “old industry” is to be expected. It will take time until the typical characteristics of two industrial generations “merge”: on the one hand, we have the flexibility, nimbleness, and scale-driven pace of the tech and digital protagonists; on the other, we still encounter a business philosophy of sizable traditional institutions that seek the exploitation of advantages like global presence, experience, and proven safety records. Numerous fields of tension need to be tackled, for example between slow conventional payment processes (regularly manual and error-prone) and immediate, entirely digitized (respectively automated) payment execution and value chains. We also expect conflicts regarding the fee structures of payment transaction services: those tied to the value of a transaction and not on cost-to-serve will be challenged by free digital services. Many corporate customers are still leaning toward established banks that offer trusted and well-known high-value payment processes. However, this observation is eroding step by step as fintechs are becoming increasingly attractive with options such as virtual accounts that also guarantee highly competitive security standards. According to a study by Accenture (2017, p. 5), “[b]anks might even lose this business completely, if and when their inherited role as intermediaries is made redundant by corporates and consumers starting to use crypto-currencies, thus completely bypassing the central bank money system.”

If banks aren't capable of reacting properly to these trends and changes their impact on the institutions' overall business models could be massive. According to Denecker et al. (2016, p. 3), a decline in cross-border revenue margins to those of domestic levels would lead to a drop in industry revenues "by 70 percent, inflicting losses of $230 billion on banks globally." These numbers are based on the knowledge of 2016, though, and we recognize that a good number of major banks have not been paralyzed by the new dynamics.[34] In addition (and partly redundant) to our timeless criteria, factors, and categorization of correspondent relationships Wandhöfer and Casu (2018, p. 25) identify seven valuable key requirements "for a future cross-border correspondent banking payments model": (1) settlement (including synchronization), (2) liquidity efficiency, (3) availability (technical access and uptime), (4) ubiquity (relevant connectivity between systems and players), (5) transparency, (6) predictability, and (7) interoperability of systems.[35]

Understanding the past, present, and future challenges of correspondent relationships must not be limited to experts in finance or emerging tech industries. Policymakers, regulators, and also the top management of companies (from SMEs to Fortune 100) would act recklessly if they delegate the knowledge of traditional and modern methods for payment processing and cross-border transactions to some hidden corners in their structures. The future of money and financial services is digital - a view that is shared by most economists around the globe. According to Bofinger (2018), four areas have the potential to modify not only traditional forms of money and credit, but also theory and practice of monetary policy: (1) the substitution of cash with electronic money; (2) the substitution of traditional bank deposits and banknotes with cryptocurrencies; (3) the substitution of bank deposits with central bank deposits for

[34] In their slightly outdated paper, Denecker et al. (2016, pp. 8-9) propose "three initiatives that banks need to pursue in parallel": (1) redefining core processes and customer value proposition, (2) moving to correspondent banking 2.0 and (3) investigating new infrastructure technologies with a mid-to long term view.

[35] Wandhöfer and Casu (2018), pp. 25-7, in greater detail.

everyone ('universal reserves'); and (4) the substitution of bank lending with peer-to-peer lending on the basis of digital platforms.[36] All these points directly or indirectly affect the future of correspondent arrangements.

Accenture (2017) issued a report according to which the overall value of cross-border payments is expected to rise by 5.6 percent per year and the overall growth in the value of these transactions "should translate into $100B of global banks' revenue in 2022". This would mean a rise of $30B between 2016 and 2022 whereby only $5B are predicted to remain with global banks as revenues and $25B "will not end up with banks" due to the impact of digital disruptors.[37] Signs of a continuing decline of active correspondents globally (8 percent between 2011 and mid-2017)[38] are only superficially in contrast with the rising demand for cross-border payments. In reality, this observation is nothing more than a reflection of a revolution in banking and finance – almost dwarfing the evolutions by the Medici centuries ago. Long distance payments will look different in the future. However, without the knowledge of their historical roots and present-day challenges, any new systems are at risk of failure and with them businesses, remittance efforts, and regulatory frameworks.

One triviality prevails: Knowing the history allows to navigate the present and to prepare for the future.

[36] See, in more detail, Bofinger (2018).

[37] Accenture (2017), p. 4.

[38] Financial Stability Board (FSB) (2018), p. 5, pointing at a "reduction of 7.9% of active corridors (from 13,072 to 12,034) and 8% of active correspondents (from 510,619 to 469,684)."

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[1] In contrast to some popular referencing guides (such as Harvard Referencing, APA, MLA, Chicago, Turabian etc.) we (1) don't abbreviate the first names of the principal authors (wherever possible), (2) use commata within the reference (wherever possible), (3) mention the publisher before the location of the publication. Online sources have been last accessed on July 10 2019.

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