bulletin

Newsletter from the EABH

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European Association for
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History e.V.

Dear colleagues,

In this edition of the EABH bulletin Nathalie Schoon will introduce us to the `History of Prohibition and Interest`. Islam law sees interest (riba) as usury, but Aristotle already shared this perception: `Money was intended to be used in exchange, but not to increase at interest`. And this term interest, which means the birth of money from money, is applied to the breeding of money because the offspring resembles the parent. `Wherefore all models of getting wealth this is the most unnatural`; is what he stated Politics in the year 350 B.C.E.

Most Islamic financial institutions were, due to their asset basis more resilient to the financial crisis suffered by the conventional counterparts – particularly the strict rejection of gambling allows no space for ambitious high risk speculations. It is beyond doubt that more reliable ethical standard in banking would be desirable for the liberal capital system.
Since Islamic principles comply with equity based and property based instruments, and risk or loss fall upon the same person who receives the benefit from the transaction, a closer look at the development of `Islamic Finance in Europe` (investigated by Rebecca Schoenenbach) and the principals that make it different could provide alternative approaches to a worldwide financial system, which has developed to be risk affine and responsibility averse, and inter alia, for this very reason has failed.

We hope to shed some light on the alternative Islamic finance model and that you enjoy reading about new research, books and events.

The entire EABH team wishes you a Merry Christmas and a prosperous and happy 2012!

Yours faithfully

Manfred Pohl
Founder & Deputy Chairman

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The First Islamic Bank

The histories of Islamic banking and alternative German banking models are intertwined from the very conception of Islamic Finance. The Egyptian Ahmed El Naggar founded a bank in Mit Ghamr in his home country in 1963 after finishing his studies in Germany. During his study years, Ahmed El Naggar made the acquaintance of the savings banks concept, the Sparkasse, which has operated successfully in Germany since the end of the eighteenth century. Savings banks were set up for customers with small incomes who were not tended to by the major banks. They were set up as regional non-profit institutions with the main aim of providing their customers a secure way to save and invest their money. Ahmed El Naggar crafted his bank following the German savings banks' model. According to the German savings banks trust[1] the project was financially supported by the German and the Egyptian governments. Mit Ghamr operated on a profit and loss sharing bases, thus complying to the Islamic principle of avoiding "riba", meaning interest. Though it was the first bank to obey this main objective of Islamic economics, it did not call itself Islamic due to the political climate in Egypt at the time. The Mit Ghamr bank opened eight more branches up until 1968 but was then closed down by the government. According to its founder El Naggar, the cause for the shut-down was the fear of the growing strength of Islamic ideas. The Egyptian government was tracking down Islamist activists in the 1960s, and suspected members of the Muslim Brotherhood to be among the Mit Ghamr staff. Critics note that the real reason was a lack of possible investment alternatives as well as liquidity problems. Mit Ghamr is today regarded as the first Islamic bank.

The Provenance of Islamic Banking

The history of Islamic economic thinking is a very recent one, starting in the 1940s. The theories became popular among Islamic circles through such prominent figures as Sayyid Abdul-Ala Mawdudi, Sayyid Qutb[2] and Muhammad Baqir al-Sadr, the ideologues of Islamic instauration. As prescribed by Islamic tradition, they based their theories on the Quran and the Hadith, the traditions of the Prophet Mohammad, which impose several guidelines on economic behaviour. Today, the most important ones are interpreted as the prohibition of interest seen as usury, the unlawfulness of exchanging money for money, the renouncement of gambling in investment (speculation) and the exclusion of investment in

Sayyid Qutb, 1965

impure activities such as music, alcohol, prostitution, gambling, inter alia. Until then, these guidelines were applied to personal behaviour and situations but not in a broader economic context, especially not to set up a system of an Islamic economy. The three above-mentioned writers were among the first to consider an alternative economic system based on Islamic principles and therefore operating mainly on trade. As the Prophet Mohammad regarded trade as an honourable way to raise funds and he discredited revenues based on money transactions, today Islamic banking uses methods of trade financing to supply their customers with credits. These masterminds of a holistic Islamic society took on the challenge to consider every aspect of the economics of such a society. In this, they had to consider not only a banking system but also fiscal issues such as taxes and the administration. In the following generations, these different aspects of an Islamic economy became the centre of various academic undertakings. The tax aspect was progressed by the renowned thesis of Yusuf al-Qaradawi[3] on Zakat, a tax prescribed in the Quran as an obligatory duty for all Muslims. To give an example of how the traditions of the fourteenth century were retraced and then used as the base for the establishment of a contemporary economic system, Zakat is exemplary. Zakat flows into the seven predetermined channels, labelled, for example, by Prof. Nienhaus[4] as:

ZAKAT	
Provenance of funds	Distribution of funds
Historical assessment base: gold and silver cattle trade goods agricultural revenues	Beneficiary: the poor the needy the indebted travellers the liberation of slaves proselytising for Islam war for Islam
	Administration of Zakat

The challenge is to convert these traditional rules into a modern system of state tax. A few states today have developed a system of Zakat, among them Saudi Arabia and Pakistan.

The same method is applied to the traditional trade schemes, converting them into Islamic banking tools. Today, the prevalent finance method of Islamic banking is Murabaha. It is derived from simple purchase orders given to a commercial traveller by a merchant.[5] The banks buy assets and resell them to the customer at a higher price. The customer receives the asset immediately and is allowed to pay the mark up price at a later date, thus being provided with a loan.

The experience of Mit Ghamr showed that theories could be put into practice. Soon after the end of the Mit Ghamr experiment, Ahmed al Naggar was assisted with a study on the establishment of Islamic banks known as the Egyptian Study for the Organisation of Islamic Conference (OIC). The study ultimately led to the founding of the Islamic Development Bank (IDB) in Jeddah in 1975. The main goals of the OIC intended for the new international bank were the promotion of economic and social development in its member states and in Muslim societies at large in accordance with the principles of the Sharia. In 1975 the IDB was supported by 26 member states, and today boasts 57 members. Soon, the IDB was followed by several national Islamic banks, the Dubai Islamic Bank in 1975 and the Faisal Islamic Bank in Egypt and Sudan and the Kuwait Finance House both in 1977. The first European Islamic institution was set up in Luxembourg (1978) as the Islamic Banking System International Holdings, joined by the Swiss Da al-Mal al-Islami (1981) and the Danish Islamic Bank International (1983). The oldest Islamic bank in Switzerland is still operating successfully and in 2010 enjoyed growth after a decline in 2009[6].

Development in Europe

Britain

Despite this early start, Islamic banking in Europe remained on the side-lines until the middle of the 1990s. This changed with the help of the then governor of the Bank of England, Lord Edward George. The governor learnt from the plight of migrants in his own neighbourhood about the compulsion of prohibition of interest for Muslims, to which he reacted by pioneering the search for more suitable offers in the host country. Already in September 1995 in a speech given at a conference organised by the Islamic Foundation[7], Lord Edward recognised the 'growing importance of Islamic banking in the Muslim world and its emergence on the international stage' as well as the need to put Islamic banking in the context of London's tradition of 'competitive innovation'. Even though there were a number of potentially difficult questions to resolve, they were to prove 'more tractable'[8], the more they were understood by western supervisors. Following through with his promise, Lord Edward George presided over a newly established high-level working group with representatives from the City of London, from national government, the Muslim community and the Financial Service Authority (FSA) in 2001. They were given the task of examining the barriers faced by Islamic finance in the UK. Government legislation was changed in 2003 in favour of Islamic mortgage, which had attracted double stamp duty. This disadvantage came about due to the construct of the Islamic mortgage contracts based on Murabaha: First the bank and then again the customer would be charged resulting in high prices. Following the change of regulations the UK became a centre of Islamic finance and, to date, is still the leading financial hub of Sharia-compliant finance in Europe.

Several other factors promoted the introduction of Islamic financial institutions in Britain. One, purely institutional, was the replacement of eleven regional regulatory authorities with the FSA in 1997 which functions under a single piece of legislation thus standardising the formerly different sets of rules. Another is the introduction of a series of tax and legislative changes the government has brought about since 2003, which are specifically designed to remove remaining obstacles to the development of Islamic finance[9]. Last but not least the sharp rise in oil prices in 2003 has resulted in huge liquidity surplus in the Gulf region and a worldwide surge in demand for Islamic as well as conventional assets. This accelerated the formation of Islamic institutions in Europe where the means and resources of well trained staff and instruments were more readily available. Under the existing openness of the British establishment, the first genuine Sharia-compliant bank registered in the UK in 2004, the Islamic Bank of Britain. It was followed by four more banks offering only Sharia-compliant products and also by a large number of conventional banks such as HSBC[10] which opened 'Islamic windows', designated sections specialised on Islamic products. According to The Banker and Maris Strategies[11], Britain ranked ninth among the top 25 countries offering Sharia-compliant assets in 2010. With a total of US$18bn, the UK is the only major European country to be featured on the list accompanied only by Switzerland with a mere US$935m in 22th place. Sharia-compliant assets of the top 500 Islamic banks added up to US$822bn in 2009[12], with Iran and Saudi Arabia leading. In both countries, Sharia-regulated finance is obligatory, likewise in Sudan and Pakistan. Malaysia is the third biggest market for Islamic assets[13]. The growth rate is estimated to be at 10%-15 % world-wide with a potential of up to US$ 4 trillion.

Germany – a Showcase for Europe

Observing the fast growing Islamic industry in Britain, other European countries were considering following suit. But neither France nor Germany, the two countries hosting the biggest Muslim communities in Europe, have produced a genuine Islamic bank. Germany's history of

Sharia-compliant finance is a showcase of a European country that slowly examines the challenges of participating in a new market under new rules.

In contradiction to what the early start of El-Naggar would suggest, Islamic banking in Germany was not an issue until the middle of the last decade. In the Nineties, the country witnessed a very unpleasant episode: Several so-called Islamic 'Holdings' were extensively advertising 'Islam-compliant' investments among mosques mainly frequented by Germany's Turkish community. They promised high returns, up to 25% on company shares without resorting to riba or any other non-virtuous activity. The community was convinced with the help of imams of the opportunity to invest their savings in accordance with their faith and at the same time support their home country - the emissaries purported to finance mainly new businesses in Turkey. A lot of families entrusted all their savings to the emissaries of these 'Holdings'. Suspicion was muffled by the first pay offs, apparently financed through the next customers' deposits in pyramid schemes. Soon after, these 'Holdings' declared bankruptcy or simply disappeared. The damage caused by this Islamic fraud is estimated to reach up to €25bn. It financially ruined many Turkish families and left them deeply shocked: They had not only lost their savings and security but also the trust in their faith was severely shaken.

Although no further development was seen in the German markets in the aftermath of the fraud, German banks and institutions discovered the Islamic finance market abroad. Deutsche Bank opened Islamic windows in the GCC and in Malaysia. Germany's biggest insurer, Munich-based Allianz, successfully launched Allianz Sharia[14] in Indonesia in 2006, with continued annual growth. German banks still focus their Sharia finance activities on Islamic countries only. Demand in Germany so far has not been strong enough for the introduction of Sharia-compliant products in the home market, the banks maintained. In addition, there is the fear that this could alienate more traditional customers will can be gained. In 2005, the German Commerzbank even closed its Al-Sukoor European Equity Fund offered mainly in the GCC in cooperation with Dallah-Al-Barak Bank, after just five years, concluding that demand did not meet expectations: The funds had only managed to collect €4m instead of the targeted €20m. Critics held that the fund was not properly advertised in Germany and the real demand was therefore not even tapped. Other critics held that a period of little more than three years is not enough time to establish an alternative way of financing and thinking, to build up confidence among potential customers and raise the necessary awareness.

A surprising step was taken by the regional government of Saxony-Anhalt in 2004, when they issued the first Sukuk (Sharia-compliant bond) in Germany. It was the first ever Sukuk issued by a government body in Europe though not designed for the local Muslim community. Inspired by the possibility to attract new sources of state funding and hoping for an advertising effect for East Germany, the regional government was prepared to try out new methods of financing besides their conventional state bonds. The Sukuk was modelled on an Ijarah (leasing) structure; the underlying asset was a real estate portfolio in Saxony-Anhalt owned by the state. The issuing volume amounted to US$100m with a contract period fixed at 5 years. The shares of the lease were advertised and sold in the GCC. The return rate was oriented on the 6 month EURIBOR rate. Though advertising may have been successful in the GCC, Islamic finance remained nearly unnoticed by the public in Germany itself. This changed in 2009 when the BaFin, the German supervisory authority, offered its first conference on the matter, which was well received in the press. It was the first major event about Islamic finance in Germany and a major break-through in public awareness. BaFin officials, including its president, Mr. Jochen Sanio, have since repeatedly signalled their willingness to support

Islamic banking. The conference was seen as the starting point to build up a regulatory framework for Islamic banking in Germany, but so far, no Islamic bank has applied for a full banking license. BaFin officials, as well as representatives of conventional banks, question the real demand for Sharia-compliant finance.

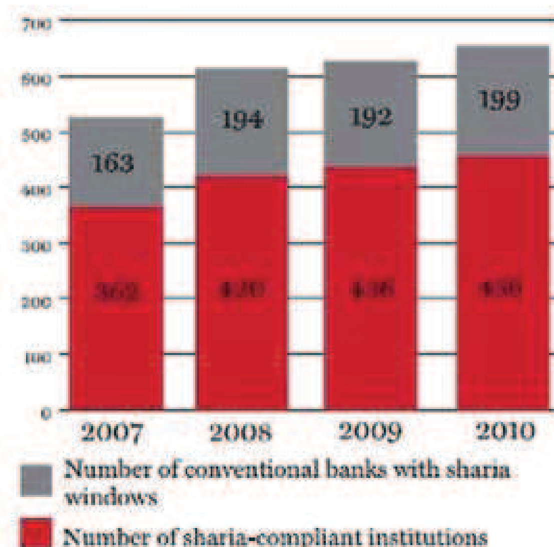
The estimates on the actual potential for Islamic banking differ greatly. A comprehensive study by the German Federal Office for Migration and Refugees (BAMF)[15] found that 50% - 70% of the 4.3m Muslims living in Germany call themselves religious. This correlates with the findings of another study supported by the Institution for Islamic Banking and Finance (IFIBAF)[16] in Frankfurt, Germany, in which 72% of Germany's Turks answered that they preferred to invest their money in Sharia-compliant products. Further findings of the study show the market potential for Islamic investment products to be about €1.2bn per year with overall cumulated savings of Muslim customers between €22bn - 38bn.

Despite these findings, up to now conventional banks targeting Muslim customers in the German market disprove the assumptions and instead engage in ethnic banking only, for example Bankamiz by Deutsche Bank. It advertises conventional products but provides Turkish language advisory and support services along with offers such as free transfer payments to Turkey. An article published in Financial Times Germany[17], which asked major banks why they react reluctantly to the impressive numbers featured in the studies, corrected the estimates for real demand to between only 3% - 15% of resident Muslims. In that same article the studies were further alleged to be carried out on a non-representative basis, grossly overestimating the need for Islamic finance.

Indeed a study[18] carried out by the federation of the savings banks of Westphalen-Lippe, Germany, showed different findings: 25% of the interviewed Muslim customers displayed interest in the subject but 50% were not aware of the matter. Another 25% did not have the means to consider investment at all. The study came to the conclusion that only 2% - 5% of the Muslims were seriously interested in Sharia-compliant finance, but the potential might rise to 15% - 20% if properly advertised. It further showed that answers varied depending on ethnic origin of the customer. Whilst only half of those with Turkish origins disapprove of interest, this fraction was much higher among those of Arab origin. For comparison: Islamic banks in Turkey have a market share of about 5% even though they have one of the longest practices in Islamic finance and an overwhelming majority of its population is Muslim.

Like the UK banks, several German banks opened successful Islamic windows but, in contrast to the UK banks, are offering them exclusively in majority Muslim countries. Their focus on the Islamic finance market abroad may indeed be a sign that the home market is still too small. The following diagram shows the development of Islamic banks world-wide and the proportion of conventional banks providing Islamic products.

The discussion of real demand for Sharia-compliant products is not restricted to Germany. It is brought up at every major conference about retail banking in the Islamic finance sector in Eu-



rope. In contrast to projections of high demand among Europe's Muslim immigrant populations, the first Islamic banks that started business in the UK met with failure in retail banking[19] as did an Islamic car insurance company[20].

The disputed question of demand for Islamic retail products will be answered by the market. The opening of the first Islamic bank in Germany was reported in the media in March 2010. Until now, the institute only set up a representative office of a Turkish-Kuwaiti bank[21] but the bank announced plans to go all the way to attain the necessary permissions for a full banking licence from the BaFin. Another important worry to be tackled is the consumer protection scheme of deposit guarantees. The deposits in an Islamic bank are seen as shares that can be traded and the shareholder, in Islamic Finance the depositor, is submitted to accept the possibility of loss. In the UK, Muslim customers are allowed to sign an agreement that exempts their deposits from the regular security scheme. The tax obstacles already dealt with in Britain have not yet even been examined in Germany. There are no official statements from the German tax authority on the way changes are intended to be made to accommodate Sharia-compliant finance.

The above-mentioned issues are primarily of a technical nature. A completely different challenge is Sharia-compliance itself. In 2008, German officials were set back by the well-known paper on Sukuk by Sheik Taqi Usmani, one of the top Sharia-scholars in the world, who questioned the Sharia-compatibility of commonly used leasing structures in Sukuk. His ruling would have rendered the Sukuk of Saxony-Anhalt haram (prohibited). The transactions were nevertheless successfully completed in 2009, but the German practitioners of Islamic finance were forced to pay attention to the sensitive issues of Sharia-compatibility. The problem has even been dubbed the Sharia trap[22].

Excursus: Sharia Diversity

Possibly owing to these experiences, France chose to stress the investment side of Islamic finance rather than concentrating on retail banking for its Muslim community. They decided from the very beginning to seek a standard framework for Sharia-compliant finance. The administration turned to the regulations of the Accounting and Auditing Organisation for Islamic Financial Institution (AAOIFI) based in Bahrain. The organisation was registered as an Islamic international autonomous non-profit corporate body that prepares accounting, auditing, governance, ethics and Sharia standards for Islamic financial institutions and the industry since 1991. Its members are mainly institutions from the GCC. It has no legislative power, but is highly respected in the Gulf region as an authority in deciding whether a transaction is halal (permissible) or haram (prohibited). One of the intrinsic hindrances to Islamic finance is the diversity of Sharia judgements (fatwas) and their lack of transparency. Every Islamic product has to be approved by a board of Sharia scholars, mostly constituted of three scholars. The scholars' qualifications range widely, most of them having studied Islamic jurisprudence for years but not necessarily economics or business matters. The main qualification of a scholar is his reputation and the authority given to his judgement by the Ummah, the community of believers. Depending on the Islamic school and knowledge of business matters, Sharia scholars can judge differently on the same transactions. As the fatwas on Islamic finance are usually not accompanied by explanations for the judgements but by the simple declaration of halal or haram, the definition of standards poses difficulties for Islamic financial institutions. It also complicates the product development for bank managers and it tends to confuse customers. AAOIFI´s main objective is the clarification of binding regulations. Another such institution is the Islamic Financial Service Board (IFSB) based in Kuala Lumpur, inaugu-

rated in 2002. The IFSB is also an independent, non-governmental, non-profit body.

The systems of the GCC and Malaysia are different in method and judgements. In Malaysia, the government assigned a Sharia- high court whose judgements are binding for all Malaysian Islamic financial institutions. This system avoids diverging standards for same products and therefore continued discussions on whether or not specific products are Sharia-compliant. As in the GCC there is no superior authority, judgements can differ depending on the scholars sitting on a board. Each financial institution chooses its own Sharia-board. The GCC system allows for the diversity of opinions to coexist and for each company to choose the Sharia-scholars that their clients trust most to be authorities in their field. The Malaysian system is very efficient and transparent and therefore easier to handle for companies. Additionally Sharia scholars are restricted to one board membership only by Malaysian law, whereas in the GCC AAOIFI has until now opposed a cap on the number of memberships.

Conventional banks with Islamic windows implement the system of the host country, therefore engaging different Sharia-boards for each country they are serving.

In Europe, the diversification of possibilities causes problems. On one hand, no regulatory authority is able to, or wants to, decide on the Sharia-compliance of institutions or products. On the other hand, missing standards can cause unpredictable financial risks to investors and bank clients. Furthermore, as a strategy consultant[23] specialised on Sharia-networks notices, the power of Sharia-scholars in Islamic financial institutions raises questions on corporate governance that the managements of the banks as well as regulators will have to address. They must fully understand the Sharia scholars' role in each authorised Islamic financial institution, and in particular, whether the role is executive or advisory.

France

France started by ensuring a stable environment for the emerging market, deciding to adopt the AAOIFI regulations, which are currently being translated from Arabic into an official French version. Christine Lagarde, the then Minister of Economy, Finance and Industry, asked the committee Paris Europlace[24] and the Treasury to assess and develop France's potential to attract Islamic money. Representatives of both government and regulatory authority (FMA) point out that French legislation poses no specific tax obstacles to the implementation of Islamic financial products, so only minor status adjustments had to be made. In order to help Paris become a Sharia-finance hub, the FMA published a comprehensive hand-out of questions and answers on Sukuk to provide access for possible investors. The declared goal of the French government is a first French Sukuk to be issued before 2012.

Furthermore, the committee is working together with four Sharia-boards established in France to ensure the compatibility of all taken measures with Sharia jurisprudence. This is a new interesting approach to solve the above mentioned uncertainties in a developing market. If it stands the test of practice, it would also help to overcome the bottleneck of renowned Sharia scholars. For the time being, the 20 top scholars sit on 621 Sharia-boards of Islamic banks, whereas the remaining 260 scholars are represented in only 520 Sharia-boards[25]. This is a direct result of the mechanism whereby approval of new products is the more valuable the higher the authority of the scholar issuing the verdict. To be credible in the eyes of potential clients, the Islamic institutions based in the GCC tend to engage scholars with high reputations in the general field of Sharia ruling. The incentive to introduce new scholars in a board of an Islamic bank is therefore low, thus preventing a new generation from building up a reputation. The newly established Sharia-boards in France are not yet accredited by the Muslim community but could use the advantage

of interlinking the knowledge of the economic matter with that of the canonic custom.

Luxembourg

While France opted for the AAOIFI standards, Luxembourg is inclined towards the IFSB standards. In 2002, the Luxembourg stock exchange was the first in Europe to receive a Sukuk listing. In 2008, the Grand Duchy of Luxembourg set up a task force to identify possible hindrances to the local development of Islamic finance. Tax treatment for common Islamic finance transactions has been adjusted to ensure tax neutrality compared to conventional transactions. The Central Bank of Luxembourg became a member of the IFSB in 2009 and, as such, is the first central bank of the European Union to become a member of that institution. In May 2011, the country hosted the first IFSB summit ever to take place in Europe. According to the governor of the central bank, Luxembourg is the leading location for Sharia - compliant investment funds in Europe[26].

Though the number of Sukuk listed in Europe rose substantially during the last years, Sukuk are originating mainly from South East Asia (with a share about 80%) and the GCC. In 2010, Sukuk issuances hit a record US$47.78bn[27]. In 2009, global Sukuk issuances surged by 58.8%

Source: www.zawya.com/Sukuk

on a year-on-year basis to US$24.7bn compared to the US$15.5bn raised in 2008[28]. Being the second largest investment fund centre in the world[29], it thus makes sense for Luxembourg to adopt the guidelines of the world region with the biggest market size in Sukuk.

A secondary market of Sukuk is virtually non-existent. Sukuk are best described as Islamic certificates indicating a share of asset similar to asset backed securities[30]. Due to the underlying excellence, Sukuk tend to be bought and held. This leads us to the problem of liquidity management of Islamic banks. For Islamic financial institutions, liquidity management is more unique due to the fact that most available conventional instruments used for liquidity management are interest-based, therefore, not Sharia-compliant. It follows, then, that in the absence of Sharia-compliant instruments, there can only be limited development of the Islamic interbank money market. Specially short-term liquidity management poses a challenge to Sharia-compliant institutions. On the other hand, Islamic institutions due to their asset basis are more resilient to financial crises suffered by the conventional counterparts.

As Yves Mersch, governor of the Central Bank of Luxembourg, put it: 'From the perspective of a European central banker, Islamic finance should be a complement to conventional banking and capital markets, not a substitute. Due to their characteristics, Sharia-compliant financial products can enhance the stability of the financial system. Shortcomings in standardisation and liquidity management must be tackled, however.'[31]

Conclusion

As the history of Islamic finance is indeed a short one and even more so in Europe where it became noticeable just at the beginning of the last decade, the development of this new industry will be particularly interesting to observe. It not only needs to hold its ground in a very diversified and highly developed market but also to address

the internal restrictions given to its dual role: On the one hand maximising profit on behalf of their clients and, on the other hand, upholding Islamic moral conduct, i.e. rejecting profit as the main objective. In Europe, government support has so far been crucial for the implementation and the success of Islamic finance, as it had been for Mit Ghamr at the very beginning.

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The History of the Prohibition of Interest[1]

"The most powerful force in the universe is compound interest"
Albert Einstein

As a result of the growth of Islamic financial services, the prohibition of interest has gained renewed attention. Contrary to popular believe, however, the ban on interest is not unique to Islamic finance and has a long history going back at least as far as the Code of Hammurabi. Through the ages interest has been a controversial subject and has extensively been debated by philosophers and theologians. In practice, however, it was common to charge a fee for money or goods lent often by finding ways to circumvent legal restrictions on interest such as partnership and trade transactions. This paper reviews the prohibition of interest over time from the Babylonians via the Greeks and the Romans to the anti-usury laws of the United Kingdom and the United States.

Evidence exists that as early as the eighteenth century BC priests in Babylon acted as money lenders to the merchants, and the Code of Hammurabi, believed to be the first codified law which was written around 1760 BC, includes laws governing banking operations in ancient Mesopotamia. It was a comprehensive set of laws which, although essentially humanitarian in intent and orientation, also contained concepts associated with behaviour such as corporate responsibility[2]. In addition, rules regarding repayment of debt, and permissible levels of payments for storage, safekeeping, and the amount of rent to be paid for obtaining the legal right to use and derive profit or benefit from property, such as land and different species of livestock belonging to another, were clearly defined. Article 93 of the code has been quoted to state that compound interest is not permissible[3], but although not unlikely, most other sources refer to this article as being illegible.

The Ancient Greeks and Ancient Romans used to freely charge interest and generally secured both the debt and the interest on the borrower, as a result of which the borrower would automatically become the slave of the creditor in the event of default. King Bocchoriss (Egyptian 24th Dynasty (730 – 715 BC)) went as far as to forbid all taking of interest in excess of the principal[4]. During the fourth century BC, Aristotle, building further on the works of earlier philosophers, argued that although money was intended to be used in exchange, it was meant to be consumed, and could therefore not increase and does not have an intrinsic value of its own since it is merely a human social invention with no utility in itself[5]. In addition, he specifically defines the term usury as "the birth of money from money", which he rejected as the most unnatural way of making money since money does not have any self replicating properties.

At this point in time, the Jewish money lender was already long established, a situation that in part occurred due to the difference in interpretation of Deuteronomy 23:21 between Judaism and Christianity. Where Christians were not allowed to lend at interest to any human, Jews were only banned from lending at interest to a fellow Jew. They could, however, freely charge and pay interest to anyone gentile or, in other words, any non-Jew.

The Romans recognised the right to lend and borrow against a specified return, but did not permit excess returns on the mutuum, loans of money, oil, or other fungible goods. The mutuum were only permitted as long as the same kind and quality was returned to the lender, since

fungible goods could not be separated from the substance and their main purpose was to be consumed[6]. Fungible goods were defined as those that could be weighed, measured, or numbered[7]. In addition, interest was prohibited unless it was contractually agreed between the parties up front. The one contract in which interest was permitted was the foenus nauticum, a contract to lend money for large projects.

Roman law embodied in the Lex Unicaria of 88 BC recognised an interest rate of up to 12 per cent, which became the legal maximum in 50 BC by decree of the Senate. This decree remained in place until Justinian introduced a tiered structure in 533 AD in which 12 per cent was the legal maximum that could be charged for foenus nauticum; 8 per cent for business loans; 6 per cent for those not in business; and 4 per cent for distinguished persons and farmers[8]. Although it is unclear how the different rates were determined, it is likely that consideration had been given to the perceived risk associated with the transaction as well as the economic necessity of the loan.

With the demise of the Roman Empire from the late fourth century AD onwards and the subsequent development of the European nation states, the individual countries over time developed their own laws. In the initial stages, the Canon laws of the Church would generally be the leading body of law, but as time went on, they developed into a separate body of law. In the United Kingdom this process took place by means of a series royal decrees and, later on, acts of parliament.

The "Laws of Edward the Confessor", a compilation of 39 laws, dealt with Jewish as well as Christian usury and evidence exists that Henry II actively prohibited Christian usury as early as 1136[9].

The Code of Canon Law from around 1187 clearly states that, as far as the Church is concerned, the basic definition of usury is that it is everything that is asked in return for a loan, beyond the value of the loan itself. In itself, the earning of money through usury is deemed to be a sin forbidden by both the Old and the New Testament, as is just hoping to receive additional property beyond the property itself. Requesting a higher price for a sale on credit is also seen as an act of usury, albeit an implicit one. The Code further states that all gain acquired through usury must be reimbursed in full to the true owner[10]. Around the same time, Innocent III argued that no interest could be charged to Crusaders, but for all others, moderate interest was acceptable and Christians should only be protected against immoderate or excessive usury. Innocent III's decree specifically refers to the Jewish money lenders, implying that the charging and paying of interest between Christians was still not permissible[11].

In 1215, King John of England signed the first version of the Magna Carta which included two clauses dealing with any loans at interest that might be outstanding on the borrower's death. Neither of the clauses, however, made it into any of the subsequent versions[12].

At the same time, the Fourth Lateran Council, which was conducted by Pope Innocent III, prohibited Jews from taking oppressive and excessive interest from Christians, but allowed them to lend money at interest as long as the rates were deemed to be reasonable. The ban on Jewish interest was, therefore, not absolute.

During the middle of the thirteenth century AD, Thomas Aquinas and his contemporaries including Ibn Rushd (Averroes) further explore Aristotle's views on the charging of interest and consider charging money for something that has been consumed to be unlawful[13]. In this respect, Aquinas also refers back to the civil law of the

time which states:

> "things which are consumed in use do not receive a usufruct, either according to natural reason or civil law, and that the senate did not create a usufruct in their case (for it could not), but a quasi usufruct"

They did not reject the idea that capital could be put to productive use and that anyone providing capital should be rewarded for making it available, but purely rejected the providing of a loan at interest without any economic purpose, or without the lender taking at least some form of risk[14].

In the years 1274, 1275, and 1290 Edward I issued proclamations and statutes against usury, strongly condemning any form of it. In 1290 he expelled all Jews from England on the pretext that they were money lenders and thus committing a criminal offence. Although the charging of interest was banned and there is evidence that some royal action was taken against usury, the ban on usury, which carried a penalty of excommunication under Canon law, was hardly enforced under any of the Royal decrees. It was not until 1363 that the first usurers were finally taken to trial[15].

One of the main challenges has long been the fact that the term usury in itself was rather loosely defined as the excess return on something that was lent. It was therefore unclear whether late payment penalties or selling at inflated prices for payment at a later date would fall under the prohibition or not. In addition, different rules appear to have been applied to Jews and Christians regarding the permissibility of applying an addition charge when selling on credit. Jews would be allowed to charge an additional amount over and above the sale price but Christians, to the contrary, were not. Until 1290 Jewish usury was, within limits, generally accepted and it was allowed for them to make a profit on loans. Besides the ban of charging usury to minor heirs that is defined in clauses 10 and 11 of the 1215 version of the Magna Carta and reiterated in the fifth clause of the Statute of Merton in 1235/6, Jews could freely charge usury and were not hindered by the government. This is, for example, evidenced by a charter of Henry III to the University of Oxford that allows the Jews of Oxford to take up to 2 pence (2d) per Pound per week from the scholars of the University as long as the interest would not be compounded[16]. There were other limitations in place specifying the percentages that could be charged. The draft Statute of the Jewry (1284-6), for example, limited the interest the Jewish money lenders could charge to "no more than half a mark for a loan of 20 shillings (20s) or 8 pence (8s 8d) per year, and for 40s, one mark, or 17s 4d, 'and for more, more, and for less, less'". In addition, the period of the loan was limited to a maximum of three to four years[17]. For Christians, however, all profit over and above the principal was banned, a ban that extended to profits on credit sales. In the year 1363 rules were put in place to be able to act against circumvention of the usury laws. These rules applied in London, but did not get introduced in the laws until 1487. The rules ware particularly aimed at the practice known as chevisance that consisted of entering into a combination of artificial sales transaction, one at a higher price for future payment and the resale of the same asset at a lower price for immediate payment thus facilitating a loan against interest[18].

During the period leading up to the introduction of the 1571 Bill against usury, money lenders were occasionally taken to court. Actions taken to reduce the practice of usury, however, were fairly inconsistent. During the first part of Edward I's reign (1272 – 1307) any instance of usury was actively investigated and punished accordingly, and he went as far as to evict all Jews when they continued to charge usury after the statute of Jewry in 1275. Subsequent royal decrees

tended to refer to canon rules, thus making the charging of usury more like a moral sin rather than a criminal offence. A special usury tribunal was instated by the Court in 1363, but only very few cases were pursued. The cases that were tried in the tribunal did not tend to result in severe punishments, a situation that remained as long as the prohibition was in place. It cannot be ignored that the royal actions were, at least in part, driven by financial motivations. The court of Edward I, for example, benefitted financially when actions were taken against the Jews and the Italian merchant usurers, and when Edward III included an anti usury article in 1341-3 this was at least in part driven by the fact that he needed funds to meet the cost of his war with France. Although tempting as it might be to assume that anti usury action was largely governed by a desire to enhance the financial position of the Crown, this is unlikely to have been the case. Only few cases were taken to court and there is no evidence of widespread confiscation of funds by the Crown. It is therefore reasonable to believe that, for at least a significant part, any action taken to combat usury was related to the desire to eradicate wrongful conduct and to avoid any adverse economic consequences for the country. Moreover, the laws were mainly aimed at the Christian usurers and only marginally dealt with the Jews and the Italian merchants, which would lead to the conclusion that the bans were mainly motivated by religious principles[19]. Around the same time, in the Ottoman Empire, all economic activity was subject to principles and rules in the Quran and the Sunnah, which prohibit all charging of interest. In practise, however, interest rates as high as 50% have been recorded.

In 1468, Henry VII introduced a law which defined usury as something that occurred when anyone lent:

> “money to and for a tyme, taking for the same lone any thing more besides or above the money lente by wey of contracte of covenaunte at the tyme of the same lone, Savyng laufull penaltees for nounpament of the same money lent”,

Although this definition prohibited the general charging of interest, it did allow lenders to charge penalties on default[20]. In 1546, Henry VIII repealed this act and replaced it with an act on usury in which it was declared that all interest in excess of 10 per cent usurious and thus unlawful. This act was subsequently repealed by Edward VI, who again prohibited all charging of interest. The act appears not to have had the desired effect of eradicating lending at interest. To the contrary, there is reason to believe that instead it increased the amount of lending and in addition resulted in higher percentages charged[21]. The latter is likely related to the fact that the money lender would need to be compensated for the higher risk he was taking as a result of the prohibition.

In 1571, a Bill against Usury was presented in the House of Commons, which, after having been subject to some debate in the months before, was eventually passed in May[22]. Law started to play a larger role in society, and the concepts of usury as defined by Aquinas, who viewed it mainly as a factual and contractual matter, were redefined to make it a crime of intent[23]. As long as the money lender could prove that the interest charge was not intended to be usurious the loan and the interest charge would be permissible. The comments made in Parliament clearly identify that the Law itself did not prohibit usury, since the act of Edward VI was repealed by Elizabeth on the grounds that it

> “hath not done so much good as was hoped it should but rather the said vice of usury and especially by way of sale of wares and shifts of interest hath much more exceedingly abounded to the utter undoing of many gentlemen, merchants, occupiers and others.”

Elizabeth not only revived the statute of Henry VIII, but also the maximum legal interest rate of 10 per cent, which remained in place until 1624 when it was reduced to 8 per cent[24]. The maximum interest rate was subsequently reduced to 6 per cent soon after the Restoration with the introduction of an act of parliament called “An Act for restraining the takeing of Excessive Usury” simultaneously introducing a penalty of £20 and imprisonment[25]. In 1714 the legal maximum was reduced to 5 per cent where it remained until 1854[26].

The legal maximum interest rate was not intended to set the market rate of interest but appears to have been determined based on the rate a borrower of good credit quality could obtain in the market. The main justification for the introduction and subsequent maintaining of a maximum level of interest was that it was in the interest of advancing trade relations and agriculture[27]. Eventually, the law on usury was repealed, although this did not happen at once, but in a number of steps including the removal of Bills of Exchange up to three months from the scope of the law by the Bank Charter Act of 1833. All usury laws in the United Kingdom were finally abolished in 1854[28].

The Statute of Usury of 1714, which limited the interest rate that could be charged in the United Kingdom to 5 per cent, is generally accepted to be the basis for all anti usury legislation in the United States. Contrary to European countries, where usury laws were repealed between 1854 and 1867, usury laws in the United States largely remained in place. There were, however, differences in individual states in the implementation of the laws. In 1850, New York State amended the law so that the maximum rate of usury only applied to individuals and excluded corporations from using the act on usury to reduce the interest they were charged, an example that was followed by many other states. In 1867, Massachusetts fully repealed their usury law on the basis that a market rate of interest could not be fixed without due consideration for the duration of the loan, the amount, or any collateral provided[29]. Massachusetts has since reinstated their usury law and a legal maximum rate of 20 per cent is now in place[30]. On the 31st March 1980, President Carter signed The Depository Institutions Deregulation and Monetary Control Act into law. The purpose of title two of this law, the Depository Institutions Deregulation Act, was to “provide for an orderly phase-out and ultimate elimination of interest rate ceilings” effectively repealing the anti usury laws at federal level[31]. To this date, however, most individual states enforce a maximum interest rate although there are significant changes between them. The determination of the exact maximum interest rate is, however, not straight forward. District of Columbia, for example, limits the interest to 24 per cent, except for loans in excess of USD 1,000 which are not a mortgage, where the borrower is a not-for-profit corporation, the loan is made for business purposes, or for the acquisition of property as an investment. For any other loan no maximum applies[32]. Nevada, on the other hand, does not apply any limits to the interest rate that can be charged provided that it is contractually agreed between the parties[33]. Virginia has set the legal maximum rate of interest to 12 per cent and allows for certain exemptions such as payday loans for which no legal maximum is defined, and pawnbrokers who are subject to a maximum rate of 10 per cent per month on amounts up to USD 25, 7 per cent per month for loans between USD 25 and 100, and 5 per cent for amounts in excess of USD 100 provided the loans are secured by tangible personal property[34]. The state of Washington has set the maximum legal rate of interest to 12 per cent or 4 per cent above the average Treasury Bill rate over the previous 26 months, whichever is higher. The rule applies to consumers only, and has a large number of exceptions such as lease and hire-purchase transactions, retail instalment transactions, credit card debt, and deferred

payment sales contracts[35]. The legal maximum rates vary significantly between states and, as of May 2011, range between 5 per cent over the Federal Discount Rate, which currently equates to a total of 5.75 per cent[36], and 36 per cent[37]. More recently, an Interest Rate Reduction Act was introduced to congress on the 19th January 2011 which is designed to amend Section 107 of the Truth in Lending Act to introduce a maximum interest rate of 15 per cent[38]. In the current version of the Act no such restriction is in place[39].

In conclusion, the prohibition on interest is not a new phenomenon, but rather one that has been around for a long time. Even though it was recognised that a cost was associated with providing capital, the charging of interest in return for a loan was deemed to be disadvantageous for individuals as well as the economy. Even so lending at interest has always taken place in practice. With the changes in the economy from largely agricultural to more rural, the advent of the Industrial Revolution and the separation of Church and State philosophers started to revise their view on the charging of interest. Adam Smith, for example, argues that the lowest rate of interest charged should be just above the level to compensate for occasional losses to which lending is generally exposed, thus recognising the credit risk the lender is exposed to, but not much else. Although he does strongly believe that a maximum rate of interest should be fixed in such a way that it would be slightly in excess of the market rate on a good security, but not too much above since that would result in speculation[40].

Jeremy Bentham on the other hand, opines that there is no requirement for a legal maximum interest rate since interest should instead be based on free choice, negotiation between the parties, and demand and supply. The agreed rate of interest should, in his view, depend on the price someone is willing to pay for the use of money in a similar way as the price for any other asset is determined[41].

In the end, the ability to use capital has a cost associated with it, and interest is still the benchmark that allows for the pricing of cost of funds, risk, opportunity cost, and future growth.

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The French Savings Banks from the 1990s
Issues, Crisis, and Challenges

Despite some managerial concerns and a few crises of distrust, the French Savings Banks enjoyed stable growth under the protection of the State (guaranteeing deposits) and a public financial institution, Caisse des dépôts et consignations (CDC). The high bourgeoisies patrons and local authorities made it their mission to encourage "integrated" lower classes to insure themselves against risks of life (in parallel with mutual health and retirement institutions) through "preventive" savings, and to encourage middle and upper classes to put part of their savings in Savings Banks to support and broaden the financial stability of an over-fragmented marketplace of about 400 little companies, particularly because such savings were exempted from tax on revenues. Such a social mission, somewhat philanthropic[1], also had negative aspects: a rather low ceiling was put on deposit accounts; no credit operations were allowed; no cheques could be emitted; and except for current reserves (which could be used for social sponsorship), all collected funds must be deposited in Paris at CDC, which used them to invest in State bonds, then later in social lodging (from the interwar period, particularly 1950, onwards), and loans to local authorities to develop collective equipments. This situation[2] prevailed till the 1970s, and it differentiated the French Savings Banks from their sister companies in the Rhine and Danubian area and in Spain.

Minor incremental reforms took place in the 1970s-1980s (use of cheques for current accounts, cooperation between Savings Banks through regional institutions, distribution of life insurance products managed by Caisse nationale de prévoyance, supervised by CDC, assimilation of marketing and commercial practices, etc.), but changes in growth and revenues were affected less by such tactics as by the formidable increase in living standards. This promoted savings, particularly after a second type of saving account was set up with no tax exemption but without a ceiling for the amount. A revolution was still pending. In this article we will therefore focus on the different aspects of this revolution, gauging the hurdles ("weaknesses" in a SWOT matrix[3]) met by the new banking strategy, and assessing the "strengths" of this brand new banking group.

1. Revolution of French Savings Banks

Under the pressure of French and European authorities and the philosophy of fair competition, several successive laws little by little removed all distinctive marks inherited by Saving Banks from their socio-economic history. Liberalisation and privatisation prevailed (and the same for the Crédit agricole institutions), even if the lobbying forces, either from the Savings Banks or from regional representatives, put the brakes on such a move. In line with the original European directive in 1977, a first law in 1984 opened the doors to "universal banking", ending the silos which isolated each type of bank, particularly in respect of the specialised credit institutions, which ultimately paved the way for the opening up of all species of banking, trading and financing institutions. Savings Banks felt the threat of losing their specificity and commenced a long-term process of adaptation against the new backdrop that was the market of Paris banking[4]. In a nutshell, every bank was allowed to open non-tax exempted savings accounts for its customers, and a mutualist group could even open tax-exempted ones (Crédit mutuel). Savings Banks were from this time onwards authorised to deliver the whole range of credit for individual customers (for consumer goods and housing), as well as to local institutions and small and medium sized enterprises (SMEs). They adopted, in

fact, the model of "universal banking" and, from 4 August 2008, tax-exempted savings accounts ("livret A") became available at every bank[5] – even if CDC was still responsible for collecting and managing most of the collected money.

Forced into becoming commonplace banks, Savings Banks had to revolutionise their organisation and management, through a relatively rapid process, conversely with Crédit agricole which had been evolving since the mid-1960s. Designing and practicing a new business model demanded the need to invent a fresh organisation of firms, against intense lobbying from regional managers, trade unions, and also regional representatives. Internecine struggles occurred within the Paris institution of Savings Banks.; Against the majority a few managers saw the need to accelerate this process in the face of intensifying competition: While Savings Banks came to terms with the challenges imposed upon them, the other banks were modernising their way of business and structures ("threats" in the SWOT analysis). Even the CEO of the head Paris institution was toppled in the mid-1990s, facing stiff hostility to what was perceived as a too rapid change…

Ultimately, Savings Banks had to merge into regional banks (17 of them), each one as a medium-sized company that had to adopt the business model of universal banking, to train and refurbish its workforce, to diversify the strategic portfolio of activities towards SMEs (credits, risk capital, capital development, leasing, etc.) and local authorities, and lastly to provide a broad range of credit and asset management services to individual customers. Progressing rapidly, the chairmen, boards, and head managers had to assimilate banking management, marketing practices, and the art of relationship-building with decision-makers of firms and local institutions, etc. There was a chance that both leftists and rightists (alternatively at power) would cling to such a strategy, which convinced the lobbies that the move was not reversible.

Indeed, even the leftists were committed to this movement: they decided to 'privatise' the Savings Banks group. Till then, no-one and nobody was officially the owner of local Savings Banks; they existed, without capital, as mere systems of collecting and transferring deposits. Their permanent funds were fuelled only through a commission perceived on the mass of deposits (commission for funds management), which had been piled up into thin layers of reserves. From 1999, mutualist members (about 3.7 million at that time) became the shareholders of 354 "local societies"; these so-called cooperative bodies became themselves the shareholders of the regional Savings Banks, which in turn became the shareholders of CNCE – with elections of representatives (5,000 locally) sealing the reform. The State collected around FRF 15 billion as a fee for opening the doors to this, arguing that it had provided the Savings Banks with its guarantee since the mid-nineteenth century… thus, what we might call a "racketeering" decision deprived the regional Savings Banks from funds that could have been useful later on!

In 1999 a group was created and structured as follows[6]: 17 regional Savings Banks; a head company, Caisse nationale des Caisses d'épargne (CNCE, the result of the transformation of a non-executive body itself set up in 1983, the Centre national des Caisses d'épargne); and common operational subsidiaries. Thereafter a whole range of national-sized companies were successively purchased:

- In 2001, CDC ceded its subsidiary earmarked to market and finance banking, CDC Ixis, to a common affiliate, Eulia, evolving towards thorough control by the Savings Banks group in 2004, thus equipping the group with a wholesale banking body.
- Feeling that Ixis lacked skills and scale, it was merged with an affiliate of another cooperative group evolving in parallel from specialised corners of the market to overall universal banking, the Banques populaires group (issued from some kind of Raiffeisen institutions dedicated to SMEs and petty shopkeepers and craftsmen,

dating back to the interwar period). In 2006, just before the crisis, Ixis merged with Natexis, itself constituted through the aggregation of Crédit national (loans to middle-range companies) and Banque française du commerce extérieur (loans to middle-sized and big companies for international trade). It resulted in the creation of a joint daughter company, Natixis, to be quoted on the Paris stock exchange with a capitalisation of €22.1billion on 29 August 2007, before the crisis.

- In 1995 in the field of mortgage, property and housing financing, Crédit foncier de France (established in 1852, latterly becoming privatised and then collapsing in 1993), which had also absorbed Entenial (the ex-Comptoir des entrepreneurs, financing real estate developers) in 2003.
- In 2003 in the field of SMEs, San Paolo France (an ex-merchant bank, Vernes, which had been bought by Italian San Paolo), resulting in Banque Palatine.
- In 2007 in the field of financing real estate development, a big stake in Nexity, a recent but powerful specialist of property financing and management.

In the meanwhile, CNCE asserted itself as a holding company, which intended either to broaden the strategic scope of the young group, or to supply the regional Savings Banks with technical bodies in favour of their clients. Expectations were raised that the legacy of “old-style” non-bank institutions could be overturned and that the “path dependency” weight could be vanquished to create a big universal bank[7].

2. A Structural Crisis because of the (Re-) Organisation Process

Expectations were great among the stakeholders in the Savings Banks group that a promising banking firm was gathering momentum, that a portfolio of skills, an art of management, a code of good practices and compliance, and an entreprise culture or identity were in the offing. But what we must realise is that such a firm was only in the embryonic stage; it had only recently been designed and built and its capital of competence was still under construction – in contrast to the big players of the Paris marketplace (BNP-Paribas, Société générale). Certainly, a few other groups also followed in the same footsteps (Crédit agricole, Banques populaires, Crédit mutuel), as the French banking industry underwent a deep revolution of structures, strategies, and skills. Yet, with such extensive change came a period of fragility as the changes were integrated (=SWOT: weakness). The Caisses d’épargne group certainly lacked any corporate culture, cohesiveness, and common processes of reporting, compliance, control, etc. It had been too recently designed, and remained an aggregation of bodies, rich with talents and market shares, but functioning more or less independently under an almost “feudal” power from the centre, allowing internal or decentralised “fiefdoms”, or lacking high-end education, culture and knowledge of the several activities that were being introduced at the heart of the young group (SWOT: weaknesses).

A key point was the lack of profitability and efficiency on the level of retail banking. The more the group intended to diversify towards nationa l universal banking, the more it needed an extended production of cash flow. Conversely, the legacy of decades of local benign neglect (under the protection of stable decentralisation in favour of several dozens of local Caisses d’épargne) and the result of light layers of regional teams of modern management explained high costs of intermediation, and a high ratio of exploitation, among the highest at the bigger banks.

Factors of organisational crisis had first to be reconciled (=SWOT: weaknesses): The building of the organisation, nationally and regionally, resulted in high costs of execution. Firstly, the decentralisation that had prevailed until recently resulted in eight software platforms, which necessitated the design of a unified IT system, demanding years in time and investment, swal-

Table 1. A few clues about the ratios of exploitation									
	Ratio of exploitation			Ratio of current profit (return on assets, after tax)			Ratio of return on equity (ROE)		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
BNP Paribas	62.5	69.1	57.5	0.61	0.13	0.41	19.5	5.2	15.1
Crédit agricole	67.7	74.3	58.8	0.44	0.12	0.31	9.8	2.9	7.5
Société générale	68.1	73.2	70.2	0.57	0.28	0.09	20.2	9.7	2.4
Caisses d'épargne	88.1	98.7	BPCE 84.4	0.15	-0.21	BPCE -0.10	4	-6.5	BPCE -3.3
Natixis	87.8	176.6		0.23	-0.63		6.4	-19.8	
Banques populaires	79.3	86.7		0.32	-0.06		5.2	-1.2	
Crédit mutuel Centre-Est Europe	61.3	74.3	58.8	0.66	0.10	0.50	14.25	2.4	11.6

Source: table in Frederic Mishkin, Christian Bordes, Pierre-Cyrille Hautcœur, Dominique Lacoue-Labarthe & Xavier Ragot, *Monnaie, banque et marchés financiers*, *op.cit.*, p. 489, itself inspired by Fitch Ratings data

lowing current liquidities, and causing deficits in some regional bodies (in Aquitaine, in 2008, for example).

The "mutualisation" of the operational elements also consumed funds. The key part played by trade unions throughout the process of broadening the networks of outlets and the regional headquarters had led to an imbalance of power within each body, resulting in high running costs of exploitation, far more than those of the major banks. Several years of harsh social relations but also of deeper and patient negotiations were necessary to "adapt" the structures and daily modus operandi to commercial needs, in order to change the "administrative culture" into a real "enterprise culture" that was concerned with operating costs, the reduction of intermediation costs, and the production of cash flow.

The funds needed to refurbish, complement, diversify, structure, and develop the head group and its affiliated bodies exceeded what had been budgeted. Crédit foncier had to be completely reorganised to become more inventive and reactive. Natixis lacked efficiency, connections, and fire power.

But the group chose to accelerate the development of this investment and corporate banking company, in order to compete with its competitors at Société générale and BNP Paribas, and with the American subsidiaries in Paris (Goldman Sachs, Merril Lynch, Morgan Stanley, etc.). Senior managers were seduced by this fad, whereby each bank had to assert itself as a big player in the field. Meanwhile their counterparts at Crédit agricole were practicing the same herdism with Crédit agricole-Indosuez, then Calyon. This called for the recruitment of high-flying financiers, investment bankers, analysts, lawyers, etc., to achieve in less than a decade what the main institutions had fostered over several decades (think, for example, of Paribas, dating back to 1872 and merged into BNP in 2000). Disproportionate programmes of expenses were conceived, that were still being implemented on the verge of the crisis. There existed a permanent crisis of development; though a commonplace process in every firm, it was far from reaching its overstretched objectives in 2007/2008.

Last (but not least, as history would reveal…), both at Natixis and even at CNCE, trading platforms were set up to respond to the common needs of the group (FOREX, swaps, trading on financial assets, etc.). While some capital of competence had been transmitted by CDC Ixis, it had to be extensively built upon, and progress in this area was only just being concretised in the mid-2000s, which explains why the crash hit deep into assets and profits, and why those losses must be impaired. The same unfortunate events were seen at CNCE, where managers dared to practice "trading for own account" through a somewhat small, but brilliant, unit: high-flying financiers and traders succeeded in building connections between the young bank and bigger markets and thus with the financial revolution. In this case, consultancies (Equinox Consulting, BCG, etc.) had provided the senior managers with thick dossiers of critical analysis

and propositions, which revealed the extent of the gaps in management (=SWOT: "weaknesses").
Moreover, reports from inspectors of the banking regulation authority, at that time the Commission bancaire, had underlined the gaps and "black holes" in the management of risks and the organisation of these bodies in a report dating from 2006… But the implementation of reforms had lagged behind; action had been postponed because no actual "high authority" within the group either could understand the activities of these units, or feared that missing such opportunities of "market" or "finances" activities could seem old fashioned. Lucidity was gravely missing in the upper levels of the group[8], but there was also a lack of reactivity, or spirit of reform to adapt structures and processes to strategies. Rotten branches had grown far beyond the reach of the communities of interests involved in the construction of the group. The very cause was the absence of contestability from stakeholders and therefore of any accountability from the head managers. Local cooperative bodies, the regional banks, and the Board of CNCE were jointly responsible for checking compliance, goods practices, and management, but ultimately, nobody was controlling the controllers. The latter, in fact, were actually more protected from internal inquiries because they had surrounded themselves with political, inter-regional, and even franc-maçon, networks of influence and power. The chairman of the group, Charles Milhaud, epitomised such a position: he had successfully and forcibly contributed to cementing the new group, and his legitimacy had been built at the head of the Provence-Côte d'Azur regional Savings Bank; he had established strong connections within the State financial apparatus and among politicians at the Parliament or at the government; he had federated an array of co-heads of regional Saving Banks and members of the national Boards, which helped him to neutralise sources of criticism. In a nutshell, experts concluded that the top management lacked professionalism, an actual understanding of what "banking industry" meant in terms of risk management, management control, audit of organisations, particularly because of the constraints increasingly imposed through regulation (Basel II/III, the European directive on financial markets, etc.) on rations of liquidity and solvability. The key issue of the allocation of resources along with clear-cut strategic priorities seems to have been badly tackled, despite so many assertions of self-confidence at the start of the crisis.

3. Savings Banks Struggling to Resist the Recent Crisis

The convergence of two crises explains the extent of damage to the Caisses d'épargne group in the 2007-2010 international crisis, which bit severely into its weakened structures.

A. A Risk-taking Policy

When the crisis struck, it revealed a high-voltage policy of risk taking: the Caisses d'épargne group was revealed as facing a critical "leverage" effect, because its permanent funds had not followed the growth of its assets or that of its common affiliate Natixis. Sure, the other major groups had also shown risk-taking attitudes, but, as a majority, they were more established than the Caisses d'épargne group and could fall back upon a broader capital of experience:
The Caisses d'épargne group had agreed on its tactics like a child, discovering new games and aspects in banking and financial fields, rushing to discover or extend new activities (=SWOT: opportunities) to follow the herd in the transatlantic boom. On one side, it left its parent company developing a unit of market finance which ought to have been put within the affiliate Natixis. Conversely, under the guidance of a brilliant head of finance, the trading platform grew in size and risks – resulting in a €751m loss in October 2008 (caused by bad positions on the market for derivatives on equity). Even

Table 2. A few clues about the leverage effect (billions euros)

	Assets			Own capital funds			Financial leverage ratio		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
BNP Paribas	1 695	2 076	2058	50,3	46,2	70,1	33,7%	44,9%	29,3%
Crédit agricole	1 541	1 784	1 694	69,9	69	74,7	22	25,8	22,7
Société générale	1 072	1 130	1 024	26,9	33,9	38,9	39,8	33,7	26,3
Caisses d'épargne	602	650	BPCE 1 029	22,4	18,7	BPCE 36,6	26,8	34,7	BPCE 28,2
Natixis	520	556		17,5	16,7		29,7	33,3	
Banques populaires	349	?		20,8	17,7		16,8	?	
Crédit mutuel Centre-Est Europe	413	441	434	18,7	17,5	21,9	22	?	19,8

Source: table in Frederic Mishkin, Christian Bordes, Pierre-Cyrille Hautcœur, Dominique Lacoue-Labarthe & Xavier Ragot, *Monnaie, banque et marchés financiers, op.cit.*, p, 490, itself inspired by Fitch Ratings data

the banking authority imposed a €20m fine on CNCE in the name of bad management of risks, which “had not respected the official rules fixed for controlling market trading”…

Beyond this mere state of affairs, such torrid events revealed the blatant fault in the architecture of the group: as CNCE was the parent company of the group, owned mainly by the regional Savings Banks, it ought to have focused its activity on the guidance of the operational subsidiaries of the group, instead of putting its permanent funds directly at risk. The financiers were dismissed, reforms were implemented, but one could still argue that “trading for own account” ought not to be the mission of such a mother company[9].

Second, instead of devoting all its resources to the development of its bodies serving the overall philosophy of regional banking, the group wasted energy and funds in financial investments in the US, as if it were a big player in investment banking… Natixis thus revealed that it owned a company, CIFG (Caisse des dépôts-Ixis-Financial Guaranty) which it had inherited from CDC Ixis, and which had invested funds into the now famous insurance products that CDS had intended for the guarantee of loans granted to investors in the US (mainly on the mortgage market). Breaking with the “path of dependency”, the group ought to have steered clear of quit such legacy.

B. Delving into the Crisis

When the crisis hit, the Savings Banks group had to impair losses on several lines of assets (bonds tied to commercial loans, credit derivatives, guarantees to CDS, CDOs, etc.), for 2.4 billion in 2008 and 3.6b in 2009. Natixis was shaken by the swirling international crisis and declared huge losses (€2.8b in 2008 and 1.6b for the last quarter; €1.839b for the sole first quarter 2009). Its capitalisation fell from €22.1b on 29 August, 2007 to 8.9b on 30 June, 2008. Sure, such petty amounts might not seem of any importance in comparison with the infernal losses of RBS, ABN-Amro, Lehman, Citicorp or elsewhere, but they questioned the global philosophy of the Savings Banks group: Was it to rush behind the big players (=SWOT: opportunities) or (for instance like Rabobank, a Dutch cooperative group) to conceive its own strategy and connect with the “regional banking” priority (=SWOT: strengths)? The very strategic matrix of the group might retrospectively appear to be “blurred” or void of judgment, unable to distinguish between the competitive advantages and the potholes of such ambitious strategies.

The crisis of the French Savings Banks group resulted in financial losses, in the questioning of its managerial methods, and in the shake-up of “trust” nationally. Cuts into the availabilities had to be completed to neutralise the losses

and provisions; the regional Savings Banks had to supply CNCE with fresh funds, themselves collected through the basic cooperative shareholders. Consultancies were called in to search out bad practices and to set up frameworks of compliance, goods practices, and accountability. Members of the Board, the chairman, head managers, and teams of market and investment banking were dismissed.

Moreover, the State intervened[10], from the Presidency of the Republic (to break into feudal baronies within the Caisses d'épargne group and drive the consolidation of the French banking industry) to the ministry of Finance (to allay fears of systematic tensions and moreover to appease concerned savers, a key social base at regional Caisses d'épargne), the supervision authority, the Commission bancaire (to calculate ratios), and lastly the Council for fair competition (to agree to the merger). Let us not forget that the European institutions kept close supervision on the process (the General Direction of competition, the European Commission) to avoid the risk of unfair advantages to the banks involved[11]. The deputy general secretary of the French Presidency himself, François Pérol, was sent to head the Savings Banks group on 2 March, 2009; and in October 2008 a new CEO, Alain Lemaire (the chairman of the Provence-Alpes-Corse Caisse d'épargne) replaced his dismissed predecessor, Nicolas Mérindol (financial head-manager in 1996, CEO since September 2006). First they implemented a rescue operation in 2008-2009: €3b were granted by the State as "preferred shares without voting rights", later raised to €6.6b to be repaid by 2013. A €2b issue of bonds was completed by the bank, with a public guarantee. And a supplementary €3b was raised in June 2010 among the regional Savings Banks (1.8b) and Banques populaires, as the mutual stake-holders (7 million for both networks) subscribed to the increase in equity. In the meanwhile, Natixis had to be rescued: fresh funds were generated during the first half of 2008 (€3.7b of loans from its two big shareholders, among which €1.3b was raised by the Caisses d'épargne group, before an issue of equity in September 2008 on the stock exchange), and later on in spring 2009 (€3.5b through advances and bonds from its two mother companies).

Despite such rescue funds and guarantees, the State imposed the merger of the Caisses d'épargne group with the Banques populaires group, an action already considered by both firms since autumn 2008 but not yet implemented because of manoeuvres for power. The decision was taken in October 2008, when the leaders of the Caisses d'épargne group were toppled and replaced by a new team. The Finance minister urged them to accelerate the process, which was at last officialised[12] in February 2009, and was completed in July 2009. The head company Banques populaires-Caisses d'épargne (BPCE) was born and absorbed CNCE, which removed the word "Caisses d'épargne" from the apparent national denomination of a mother company.

Thus, the Savings Banks group avoided complete oblivion, a fate met by the American Savings Banks in the 1980s, by the Spanish Savings Banks since 2007, and the German Landesbanken. Like the Austrian Erste Bank, it could be rescued, refuelled with permanent funds and cash, and regain trust on the market for liquidi-

Table 3. Crisis of the Savings Banks group and of Natixis

	Savings Bank group		Natixis co-affiliate	
	2007	2008	2007	2008
Net banking product	9,768	8,409	6,043	2,934
Net returns (part of the group)	1,367	-2,015	1,101	-2,799
Cost of risk (provisions and bad debts)	-259	-1,441	-244	-1,817

Source: Réjane Reibaud, and Guillaume Maujean, "Sur fond de pertes record, les Banques populaires et les Caisses d'épargne officialisent leur union", *Les Échos*, 27 February 2009, p. 27.

ties, etc., but its very nature had changed: on a national level, the legacy of Savings Banks had been broken up. Regional Savings Banks had failed to build a mother company in Paris: the whole process had to be restarted, and it is still in the making.

4. A Legacy Preserved: Capital of Skills, Trust and Brand Image

Thanks to the creation of BPCE, a French body of Savings Banks had been preserved. BPCE could still therefore assume its mission to be part of the French policy that promoted "national champions", either in insurance or in banking, thanks to amalgamation moves (BNP + Paribas; Société générale + Crédit du Nord + Société marseillaise de crédit; Crédit mutuel + CIC; Crédit agricole + Crédit lyonnais) and to the consolidation of the capital of competence. Like at Erste Bank in Austria, the State continued to protect the legacy of the Savings Banks. A large group was established, rich with 7,700 outlets for retail banking (in two main networks), and 110,000 employees. Recent events have somewhat blurred the legacy of almost two centuries of history; indeed, the ranking of BPCE by the agencies might seem worrying, graded "C-" as of mid-September 2011, which may taint the perception of the institution (among shareholders, investors, etc.) and ultimately increase the cost of its refinancements on the market.
The new team has fixed objectives to increase the mobility and reactivity of the group and its three core locations (one in Paris and the two networks). The portfolio of strategic activities is being stripped down and several affiliates are to be sold or reduced in size. The investment and corporate banking body Natixis was submitted to drastic reforms to improve reliability, compliance, accountability, etc. Expectations are that it will fulfil its mission to supply the BPCE group and regional banks with efficient, innovative, mutualised financial products and processes (=SWOT: opportunities). The process of rationalisation, mutualisation and IT modernisation is being intensified, to cut into the exploitation ratio and alleviate overheads. the Caisses d'épargne network alone aims to cut into expenses by 35 per cent or €1b imposed as cost-savings in 2001-2013 and its "exploitation cost" will be curtailed by seven per cent from 74 per cent in 2011. In parallel with the move within the Banques populaires group, a few regional banks are expected to enter a new round of mergers.

A. The Prospection of New Markets

Far from the low-key historical missions of Banques populaires and Caisses d'épargne, the group cannot but emphasise its strategy of universal banking, far from focusing only on retail banking. The new head of commercial banking since 2010, Olivier Klein, was the former chairman of Caisse d'épargne Rhône-Alpes (in post since 2007 – after holding the position of executive chairman of Caisse d'épargne Ile-de-France Ouest since 2000) and he has to relaunch a commercial strategy for both networks, and to spur osmosis between them and between regional managers.
The BPCE group has focused on one key priority to develop: in common with the regional banks, they will develop a large range of banking products in favour of SMEs and medium-large companies. While a classical array of credits, of leasing products, of treasury management, of transaction banking, etc. aims to compete against rivals, several regional banks differentiate themselves by accentuating their skills in development capital and start-up capital in order to promote innovative SMEs, to accompany them through their growth and to bolster them through layers of permanent funds and financial facilities (=SWOT: opportunities). The south-western Savings Banks, for example, Caisse d'épargne Aquitaine-Poitou-Charente, can rely on an investment company that it purchased in the 1990s (Expanso) and on a body, Gallia, which sets up medium-sized investment funds

to support start-ups. The competitive edge of the new BPCE seems strong, because it has inherited a portfolio of skills and subsidiaries created by the two previous groups and their regional banks.

A parallel strategy oriented towards the support of local authorities (for loans, treasury facilities and management, public-private finance projects on a low scale – thanks to the recent expertise piled up by Natixis, etc.), social housing regional institutions (either public or private), and social institutions (dedicated to social insertion, health-care and age-care bodies, etc.) has been put into action. This market segment is gathering momentum and offers paths to growth (=SWOT: opportunities).

B. Retail Banking for Individuals

The most competitive advantages of BPCE result from its retail banking networks (rich with 4,770 outlets, 27m customers, and a huge majority of the 51,000 employees inherited from the previous group), and therefore of the regional legacy of the Savings Banks. A broad portfolio of skills has been kept alive through the crisis (=SWOT: strengths), and have been mobilised in favour of “core activities”.

The first skill may be “brand management” in order to rekindle an already “strong” brand, with its strong red colour, the memorable squirrel logo, and a vocabulary that expresses, through flyers and ads, the values of “the bank of proximity”. The fresh offensive of institutional advertisement in 2011 is a clue to their commercial focus.

Second, priority has been given to “customer relationship management”, to bolster market share and fighting commercial spirit of the regional outlets and teams, despite stiff competition. One might presume that progress in commercial banking is promoted by the retirement of “old style” employees (more oriented towards the administrative treatment of files) in favour of “commercial-spirited” juniors and experts. But, as everywhere,the mastership of “scoring” has paved the way to a far more fine-tuned commercial offering alongside wealth, evolution in professional and family life, style of life, etc.

Third, the commercial offering includes an asset management unit and an important stake in Caisse nationale de prévoyance, the products of which were distributed by the retailing network – CNP being co-owned by CNCE, CDC and La Poste (afterwards, La Banque postale). The outlets can therefore offer a broad range of assets management dedicated to individuals (life insurance, etc.).

Last, even wealth management gained momentum in Savings Banks, through a specialised affiliate, Compagnie 1818 (evoking the date of the first Caisses d’épargne), but also through experts of the regional Caisses d’épargne.

Conclusion

The project conceived since the 1980s-1990s to transform the regional Savings Banks into reactive and agile universal banks, and to insert them within a big national group, was rich with positive purposes. The reforms that it fostered almost succeeded, as resources of energies, locally or in Paris, were mobilised, at a management or base level, to undertake such a metamorphosis. But the process drifted from its original course due to huge gaps in the governance of the group, in the management of the national units (at Natixis and CNCE), and in the day to day completion of far-fetched operations. An actual discrepancy occurred therefore between the philosophy of building a group earmarked for territorial and social developments on one hand, and bad practices of governance (despite thick reports from the regulation authorities or consultancies) or amazing errors of management on the other hand. This discrepancy also impacted the design of the new enterprise culture with several departments in Paris dedicated to high-flying market operations for the sake of immediate returns, while in the regions the Savings Banks struggled to preserve or conquer

markets shares in retail banking or in the field of territorial and social institutions and SMEs. Some experts and academics even questioned the issue of "ethics"[13].

Happily, the losses were not substantial enough to imperil the group (in comparison with collapsed groups on both sides of the Atlantic). It lost a few billion and had to face a crisis of confidence, whilst its ratios of solvability (in line with Basel II and IIbis) were at stake. The State and the regulation authorities intervened harshly, as life-guards and risk-guards. The new BPCE group can thus entertain the legacy of old but thoroughly rejuvenated Savings Banks, which, even now, allows the recent universal bank to fare better than many Spanish Saving Banks or German Landesbanken. The crisis of the Savings Banks group was not caused by stupid bets on diversification and risk, as had been the case in the US in the 1980s. Indeed, the regional basis of Caisses d'épargne itself remained all in all sound, despite a lack of profitability, as the causes of the crisis were well limited to a few departments or bodies of the Paris headquarters or the main subsidiaries[14].

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3 SWOT= "Threats, opportunities, weaknesses, strengthes".

4 See Dominique Lacoue-Labarthe, chapter 15, "Le système bancaire en France : ouverture et crises", in Frederic Mishkin, Christian Bordes, Pierre-Cyrille Hautcœur, Dominique Lacoue-Labarthe & Xavier Ragot, Monnaie, banque et marchés financiers, Paris, Pearson Éducation, 9e édition, 2010,

pp. 461-500. Dominique Lacoue-Labarthe, Les banques en France. Privatisation, restructuration, consolidation, Paris, Économica, 2001. Dominique Plihon, Jézabel Couppey-Soubeyran & Dhafer Saïdane, Les banques : acteurs de la globalisation financière, Paris, La Documentation française, 2006. Dominique Plihon, Les banques : nouveaux enjeux, nouvelles stratégies, Notes et études documentaires, n°5078, Paris, La Documentation française, 1998.

[5] See “Audition of Charles Milhaud”, Minutes of the session of the Commission of Finances, General Economy and Plan, National Assembly, on 20 February 2007.

[6] See Daniel Duet, Les Caisses d’épargne, Que Sais-Je?, Paris, Presses universitaires de France, 1991, réédition, 2000. Jean-Louis Hébert & Laure de Llamby (avec Jean Borenstein), 60 ans de construction du Groupe Caisse d’épargne. Une histoire pour demain (1945-2005), Paris, Gallimard, Caisse nationale des Caisses d’épargne, 2006. La métamorphose des Caisses d'épargne, Les Éditions de l'épargne, Paris, 1986. Laure de Lamby, Les métamorphoses de l’épargne, Paris, Gallimard-Découvertes, 2003.

[7] See Renaud Belleville, “Les sauts de l’Écureuil. Comment transformer un dinosaure de l’épargne en grande banque universelle”, Les Échos, 4 April 2007, p. 12.

[8] See Hubert Bonin, Des banquiers lucides dans le boum et la tempête ? (2004-2010), Paris, Textuel, 2011.

[9] See Guillaume Maujean, “Groupe Caisse d’épargne : Milhaud et Mérindol sur la sellette après une lourde perte de trading”, Les Échos, 20 October 2008, p. 32.

[10] See Elsa Conesa, Réjane Reibaud, and Guillaume Maujean, “Inquiet de la santé de Natixis, l’État veut prendre en main la fusion Écureuil-Banque populaire”, Les Échos, 9 February 2009, p. 30. Réjane Reibaud, and Guillaume Maujean, “Banque populaire-Caisse d’épargne : l’irruption de l’État suscite des remous”, Les Échos, 26 February 2009, p. 26. Guillaume Maujean, “Banque populaire-Écureuil: « Je t’aime, moi non plus »”, Les Échos, 26 February 2009, p. 11.

[11] See Frederic Mishkin, Christian Bordes, Pierre-Cyrille Hautcœur, Dominique Lacoue-Labarthe & Xavier Ragot, Monnaie, banque et marchés financiers, op.cit., pp. 448 and 495 (especially footnote 45, quoting reports from the French Cour des comptes).

[12] Réjane Reibaud, and Guillaume Maujean, “Sur fond de pertes record, les Banques populaires et les Caisses d’épargne officialisent leur union”, Les Échos, 27 February 2009, p. 27. Line Cousteau & Benjamin Masse-Stamberger, “Banques populaires-Caisses d’épargne. Les noces rebelles”, L’Express, 12 July 2009, pp. 47-50.

[13] See Denis Malherbe, “La crise financière, révélateur d’une dérive éthique dans la gouvernance des groupes bancaires mutualistes français ? Les Caisses d’épargne et Banques populaires face aux pertes de leur filiale Natixis”, working paper, Tours University & ESCEM School, 2010.

[14] We thank Michel Salvaing and Dominique Lacoue-Labarthe for their useful suggestions about our text.

Quantitative Performance of Reinsurance Companies during the Interwar Period

Research Interest

Specialised reinsurance companies that provide insurance coverage for primary insurance companies are commonly assessed by their solvency. This is due to the fact that in order to deal with low-probability high-cost events – such as earthquakes - they have to maintain large capital reserves even for prolonged periods. Since the majority of reinsurers is privately owned, they also have to meet the profit expectations of the respective owners. In this context, publically-traded companies are of special interest. The effect of irrational investor profit expectations formulated in an irrational capital market environment is called endogenous financial market risk. Maintaining a sound long-term solvency whilst simultaneously having to comply with irrational profit expectations creates a dangerous area-of-conflict for the companies. This was suggested by a pioneering Master dissertation that analysed the quantitative performance of reinsurance companies during the Interwar Period. This work was initiated and supported by the Department Corporate Underwriting Casualty of Munich Re, which had realised the practical necessity for lessons-learnt from the Great Depression when confronted with the uncertainty about the potential effects of the 2007 Global Financial Crisis in 2009. The proposed PhD project will further develop the work already conducted in the Master dissertation.

The Interwar Period provides necessary conditions to analyse this very issue. The recent Financial Crisis does not qualify as its full effects have yet to be fully realised. The Post-War Period on the other hand does not feature major global economic crises that caused sudden and fundamental change in investor expectations.

The following summary will introduce the PhD project 'Quantitative Performance of the Interwar Period' and will especially comment on the motivations for the different research questions at hand.

Results of the Preliminary Master Thesis

The preceding Master Thesis, called "Reinsurance during the Great Depression – Professional Reinsurance Companies in liability and accident insurance, 1924 to 1935" ("Rückversicherung in der Weltwirtschaftskrise Performanceanalyse professioneller Rückversicherungsunternehmen in der Schaden- und Unfallversicherung 1924 – 1935"), was written from April until October 2008 at the Ludwig Maximilians-University in Munich, Germany. The objective of the dissertation was to provide a first analysis of the quantitative performance of reinsurance companies in the period between 1924 and 1935. It was motivated by the interest of Munich Re in the robustness of reinsurance companies during economic crises following the Subprime Crisis of 2007. The two research questions under consideration were:

1. Which strategies and business models did reinsurance companies follow during the Interwar Period?
2. How robust were the analysed reinsurance companies during the Global Economic Crisis?

The dissertation relied on the extensive use of original research. Main case studies were Münchener Rück, Schweizer Rück and Kölnische Rück (German names are used to distinct from historical and current topics). Furthermore, data for the German reinsurance market as well as the benchmark German primary non-life insurance sector were analysed. The main source for quantitative information was the specialised reinsurance magazine "The Review". Additional qualitative information was collected from the historical archives in Germany, Austria and Switzerland.

A two-stage approach was applied: First, an intuitive 'model of irrational reinsurance markets' was developed that incorporated leading insurance business management and irrational financial market theories. Its purpose was to provide a simple explanation of the interdependences between the variables 'market size', 'investor expectations' and 'risk appetite'. Second, the performance of professional reinsurance companies in the Interwar Period was analysed by using qualitative and quantitative information. The first part was an investigative assessment of the principal development of the reinsurance market in the Interwar Period and the experiences of the case studies Münchener Rück, Schweizer Rück and Kölnische Rück. In the second part performance indices of reinsurance data were provided and then discussed.

The Master thesis concluded that the Great Depression had led to a formalisation of the business relationship between primary insurers and reinsurers as trust was substituted by control. The assumption of overall robustness has to be questioned, since insurance in general experienced a favourable period of a historically low cost ratio. Although solvency ratios decreased significantly, the absence of major loss events led to the creation of the hindsight bias that reinsurance is generally robust during economic crises. In the end, the experiences of AIG and Swiss Re during the Financial Crisis of 2007 were explained by using the 'model of irrational reinsurance markets'.

Hypothesis and Research Questions of the PhD Project

Given the insights provided by this preliminary research, the PhD project hypothesises that irrational investor expectations in the performance of reinsurance companies created endogenous financial market risk. This was then transmitted to the sector as companies struggled to meet these expectations. The actual quantitative performance was further biased by active business management decisions as well as the external effects of crisis economic policy. The research questions are as follows:

1. How did investor expectations affect the business strategy of reinsurance companies during the Interwar Period?
2. How were reinsurance business operations affected by the depression in the real economy?
3. Which impact did external policy changes have on the performance of reinsurance companies?

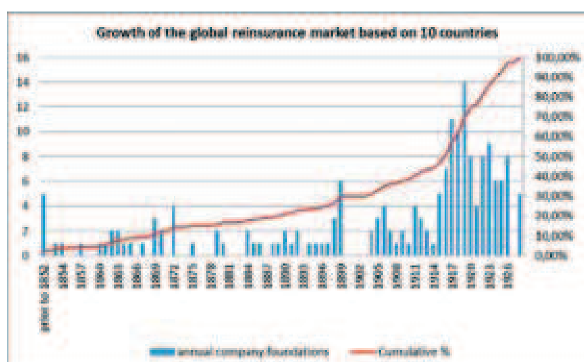
All research questions came up in the course of the writing of the Master thesis. This will be outlined in the following.

Research Question 1 and 2: In which Shape was the Global Reinsurance Market prior to the Great Depression?

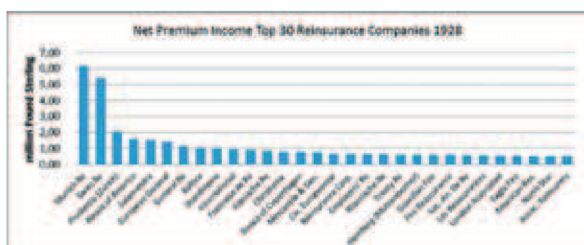
Prior to 1914, the Münchener Rück was the dominating company in the global reinsurance market.With the onset of World War I, German companies were excluded from the international reinsurance market. The main beneficent of this development was the Schweizer Rück. Until the end of the German hyperinflation, the company took over the pole position as the world's largest reinsurance company – if measured by net premium income.

The German hyperinflation also raised general awareness to the industry’s exposure to exchange rate fluctuations and the devaluation of currencies. As providers of financial services and large-scale institutional investors, insurance as well as reinsurance companies were especially exposed to periods of monetary con-

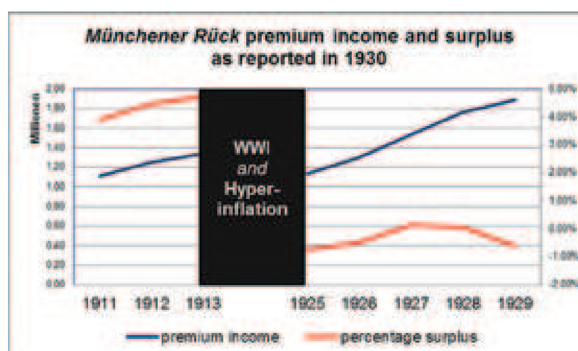
fusion. In 1922 and 1923 alone, 192 reinsurers were founded in the hope of securing additional capital from abroad.
Whereas the vast majority of the German crisis foundations did not survive the 1924 currency reform, new reinsurers in other countries were more successful. Especially the U.S. market experienced great activity following the onset of World War I. Whereas prior to 1914 only three of nine registered companies were of American origin, their share increased to 21 of 40 in 1928. In the UK, the number of domestic reinsurers increased from three to ten between 1913 and 1928. In 1928, 78% of US, 70% of British and 58% of French companies had been founded after World War I. Even in Switzerland and Germany, 36% and 50% were new as well. The total amount of operating reinsurers increased from 87 in 1913 to 200 in 1928 and hence more than doubled.



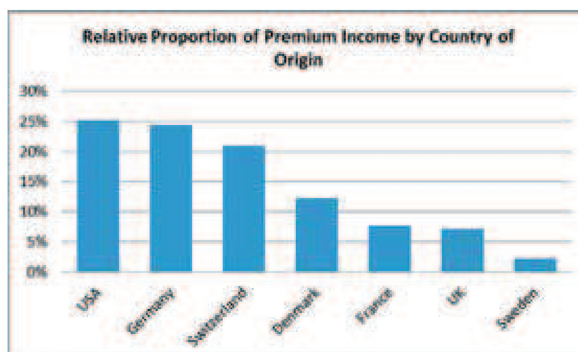
The dominance of the old market leaders Münchener Rück and Schweizer Rück remained unchallenged, however leading to decreased overal profitability of the companies. Although Münchener Rück had a nominally higher net premium income, the Schweizer Rück group also included the Swiss Prudentia (Zurich) and European General, the British Mercantile & General and the German Bayerische Rück.



Considering domestic markets and taking the total net premium income as a measure, the biggest companies from the United States had collectively surpassed their German competitors in 1928 slightly that still were struggling to re-gain old strength. The direct impact on the performance and premium income was specifically mentioned in the 50th annual report of the Münchener Rück in 1930.



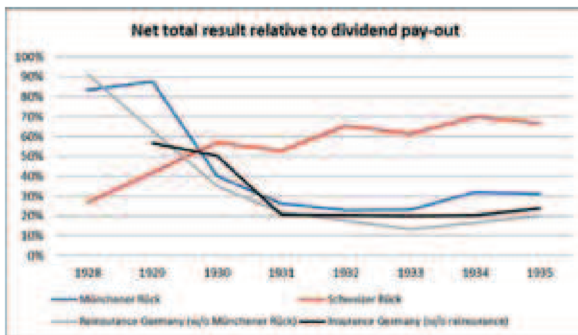
Of the Top 30 companies in terms of net premiums written, 25% came from the United States, with German and Swiss companies following with a share of 24% and 21% respectively.



It is obvious that the strong growth of the global reinsurance market attracted considerable amounts of capital. The crucial question hence is: Where did these companies get the required capital from? And what impact had the expectations of the potential investors?
To answer the first it needs to be taken into consideration that especially in the United States the majority of companies established after the onset of World War I was subsidiary companies. As of 1931, the only year for which information regarding that matter is available, the number of

truly independent specialised reinsurance companies was rather small. Of companies founded before 1914, 15 were still specialised reinsurers and – not counting the subsidiary reinsurers of Schweizer Rück, only 9 were independent from other reinsurers. Additionally, Wiener Rück and Cie. Europeenne had siginificant links to brokerage agencies. For the United States, only Rossia can be assumed to having been fully independent. In how far this translates into a different performance in the stock markets remains to be seen and motivates to analyse the development of reinsurance equities.

Additional research interest stems from the specific performance of dividend pay-outs. Although the dividend rates were not altered significantly, the real value of dividends paid relative to the annual income experienced a dramatic change. Prior to the crisis years, the net (technical and investment) income was almost completely redistributed as dividends. This implies that no additional reserves were built up.



From 1929 onwards, reinsurers re-arranged their business portfolios, discontinued loss-making business and thus especially improved the technical result. Of utmost importance was that claims were at a historical minimum throughout the crisis years. The falling ratio however suggests that investors did not participate in the improved competitivity of their companies. Hence the assumption at hand is that prior to 1929 demand for capital was especially high and reinsurers struggled to meet high investor expectations. With the onset of the Great Depression the focus changed and the companies became more risk averse. Whether it was the decreased interest in low cost-of-capital bt the companies or a re-evaluation of the possibilities by the investors needs to be analysed. It also needs to be understood whether this happened exclusively in Germany, as the differing pattern of the Schweizer Rück suggests different developments in Switzerland.

This considerations of vital interest regarding the second research question concerning the actual performance during the Great Depression. Were reinsurers simply able to offload less qualtitative contracts in order to boost the actual results? To conclude that reinsurance was specifically robust during financial and economic crises would be misleading, if this assumption was based on the simple cancelling of disadvantegeous contracts. Here, it is necessary to analyse the actual loss ratios and performances in respecitive primary insurance markets, which derivatively translated into the results of reinsurance lines of business.

Research Question 3:
How trustworthy were asset portfolios during the Great Depression?

A phenomenon that greatly differentiates banking from insurance is that the latter does not know an equivalent to a bank run. Payments by insurers are connected to the occurrence of a specific trigger event, known as the risk event. Even in life insurance, early terminations by the insured are followed by high deductions on the already accumulated value. It is often argued that this suggests that (re-)insurance are not a source of systemic risk. As providers of financial services, they are nevertheless by themselve highly exposed to systemic risk.

Starting in 1930, the global banking sector experienced a crisis of unprecedented magnitude. Starting with the failure of the Bank of United States in the U.S. and the Austrian Creditanstalt in Europe in the following year, a series of bank runs put the whole financial sector in distress. In order to meet their obligations, banks liquidated their asset holding and essentially caused glo-

bal asset prices to deflate. To protect still held assets, legislators discontinued market-market valuation. By doing so, banks alike were prevented from further reducing lending or selling on assets to balance their accounts. The deposits held by insurance companies were also heavily exposed to this price deflation. In the United States, the National Association of Insurance Commissioners recommended to the state insurance supervisory offices the valuation of assets – stocks and bonds alike – with the prices of 31 July 1931 for the annual reports of that year. This was applied in every state. Mark-to-market – or fair – valuation was hence discontinued. The date was arbitrarily chosen as it was simply copied from the last time such measure were applied in the financial crisis of 1907. This continued until the devaluation of the US Dollar stopped the deflationary pressure in 1933. It was this very efficient policy that especially saved life insurers and life reinsurance business from grave investment losses. The dangers it held for other insurance companies – including reinsurers – are still not fully researched. The case of Germany underlines the necessity to do so:

Whereas financial systems in continental Europe remained relatively stable throughout 1930, the situation deteriorated substantially in the following year. The first institute that went bankrupt was the Austrian Creditanstalt created a domino effect that soon led to a major banking panic in Germany, when foreign investor withdrew capital in fear of similar defaults.

The government reacted with a self-inflicted debt deflation on the bursting of the financial bubble that was created by excessive borrowing in foreign countries. The German insurance companies were especially affected by an emergency decree of 8 December, 1931, which reduced the nominal interest rate on all outstanding governmental debt from 8% to 6%. It also extended the protection against the enforcement of payments and increased the maturity of mortgages. Especially the last intervention led to sharp criticism from the insurance sector. Further efforts to take pressure off the German financial system also affected the insurance sector: The “Decree about the Simplification of Accounting Standards” (“Bilanzierungserleichterungs-Verordnung”) of December 15, 1931 temporarily repealed §56 of the German Insurance Supervisory Law (Versicherungsaufsichtsgesetz) that dealt with the valuation of assets. It was overridden by §261 of the German Code of Commerce (Handelsgesetzbuch), which itself had been changed on September 19, 1931. As in the United States, (re-)insurance companies were now allowed to value strategic assets by the purchasing price and not by the market value. All long-term investments in the asset portfolios of insurers, which were not necessary to provide short-term liquidity, were hence protected from the process of debt deflation and price fluctuations did not need to be adjusted in the investment portfolio. This fundamental simplification, however, caused significant misunderstandings in which assets were strategic and which not. Life insurers, for example, had a long-term perspective due to their business model. In this line of business, a much larger share of the asset portfolio was held for a longer term than it was the case in non-life insurance that required a higher level of asset liquidity. The condition of the German financial sector at the end of 1932, a lack of clarity in the relevant legislation and the copying of the life insurance sector ultimately finally led to an incoherent asset evaluation across the German insurance sector. In his presentation on the 2nd annual general meeting of the German Insurance Association (Reichsverband der Privatversicherer) on the December 15th, 1931, the General Director of Gotha Versicherung, Hans Ulrich, outlined the new evolutions: Of a sample of 53 assessed life insurers, 30 companies valuated their complete asset portfolio as strategic, whereas 7 of 34 Non-Life insurers did the same. The following table indicates the general uncertainty about which accounting method was now considered to be appropriate. Amongst the most troubled companies was also Germany's oldest

Valuation of asset portfolio as strategic	Total No. of companies	Treated asset portfolio as strategic		
		Fullly	Partially	Not
Life	53	30	14	9
Non-Life incl. Reinsurance	34	7	8	19

It is hence of crucial interest to understand how reinsurance companies would have performed during the Great Depression, if management had to reacted and emergency legislation had not been in effect? Is it really fair to say that reinsurance is specifically robust during financial crises, if crucial contemporary circumstances got forgotten? Again, the question is as to how this experience remained limited to Germany. Given the similarity of crisis legislation in the United States, it can be assumed that comparable misunderstandings also occurred elsewherel.

Research Design / Methods

Publically-traded, specialised and globally operating reinsurance companies will be the focus group of the PhD project. This provides a high degree of cross-border comparability due to the relatively internationally similar business models. The theoretical framework of the PhD project follows the state-of-the-art of insurance economics. It especially connects the de Finetti Theorem of optimum dividend payments for insurance companies with theories and models of irrational behaviour in financial markets.

The PhD project is based on the quantitative interpretation of two original datasets. The first will consist of stock price quotations of a representative number of reinsurance as well as primary insurance companies in the period from 1919 (respective 1924 for Germany) until 1939 (1935 for Germany). It will be augmented by a sub-set of announcement dates for dividend changes. The second dataset collects core insurance as well as reinsurance performance indicators, such as, including, but not limited to premium income, claims-paid, return on investment and dividend payment in the period 1919 to 1939.

The data sets will be analysed using descriptive quantitative methods as well as standard financial and econometric tests. To understand the impact of the Great Depression on the direct business performance, it is planned to set up a vector-autoregression model. It will analyse the response of different dependent reinsurance indicators on changes in the equivalent explanatory variables of primary insurance lines. Secondly, in order to analyse external policy effects, a model reinsurance asset and liability portfolio will be constructed. This enables counterfactual stress- and backtesting procedures to especially prove the quantitative impact of external effects. In order to answer the research question concerning the effect of investor expectations, average cumulative abnormal returns at the time directly after dividend announcements will be constructed by applying the Capital Asset Pricing Model (CAPM). These will be compared with the actual performance and by doing so, irrational price movements will be identified. Further tests based on the CAPM will especially interpret the performance of the dividend yield.

Empirical Data

Sources are specialised journals and newspapers, especially ‘A. M. Best’s Insurance Guide’ together with ‘A. M. Best’s Key Ratings’, ‘von Neumanns Zeitschrift für Versicherungswesen’ and ‘The Review’. These publications are available at the historical archives of Swiss Re Germany in Munich, Germany, of the Deutscher Verein für Versicherungswissenschaft e.V. (DVfVW) in Berlin, Germany and of the Insurance Library Association of Boston, United States. Historical stock price quotations are available from sources such as – but not limited to - the Berliner Börsen-Zeitung, the London Stock Exchange Daily Official List and the Wall Street Journal.

To contribute to the historical singularity of the period under consideration, descriptive research methods will also be applied. A large collection of contemporary doctoral dissertations, located in the archive of the DVfVW, provides considerable insights into the functioning of reinsurance during the Interwar Period.

Specific Aim / Long-term Objectives

The specific aim is not only to provide a first comprehensive quantitative analysis of the global reinsurance market during the Interwar Period. The focus on investor expectations was especially chosen to establish “lessons-learnt” for both, future crises as well as the upcoming new EU insurance regulatory regime, Solvency II. This new framework, which will be implemented from 2013 onwards, will lead to imminent changes in investor expectations on the performance of re-/insurance companies. Raising awareness to this new source of risk is an important objective of the PhD project. The conducted research is thus not only of academic interest but also provides relevant insights for practitioners.

Stephan D. Werner

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The ‘Open Secret’ of Danish and Swedish Mortgage Finance[1]

Why ‘Open Secret’?

Considering the problems mortgage finance has caused for various financial institutions in several countries in recent years, starting with the collapse of Northern Rock and other building societies, and culminating with the melt down of Lehman Brothers, Fannie Mae, Freddie Mac, etc, etc, etc, it seems natural to ask the question why Danish and Swedish mortgage institutions have been so relatively successful for more than 160 years. If they have any ‘secret’, we may ask, like Antonio in the first scene of ‘The Merchant of Venice’; what stuff it’s made of, whereof it’s born? So, what are the origins and history of these institutions and what does their business model look like? If they are so successful, it may be a better idea to copy the business model elsewhere rather than forcing the Danish system into a common European mould (banking legislation) based on other, less successful models, e.g. the British building societies and Spanish savings banks.

Sweden had a deep financial crisis in 1990-03, which included a 25 – 50% drop in property prices and the collapse of several large banks. Yet, the mortgage institutions suffered only manageable losses, though mortgage finance is their only business. Similarly, Denmark had a severe financial crisis in 2007-11, also with steep drops in property prices and the failure of several (small and medium sized) banks, which had dabbled in mortgage finance. Yet, the mortgage institutions, which do nothing but mortgage finance, survived without major problems. In fact, no Danish mortgage institution has failed since a first priority association in 1860 and a second priority agricultural association in 1931. In Sweden, no mortgage institution has ever failed, but that is a slightly different story.

There is nothing particularly ‘secret’ about the business models practiced by the Danish and Swedish mortgage institutions, except that they do not appear to be very well known or understood outside their respective countries.

The purpose of this paper is to explain the origins and history of these institutions, including the main points of their regulatory framework. Hopefully, this will facilitate an understanding of the ‘secret’ of their success.

I. Denmark

1. The Origins: The Prussian ‘Landschaften’ and the Danish Report of 1839

In the 1820s times were lean in most of Europe, but in the 1830s business conditions improved, and landowners found good investment opportunities in land improvements, acquisitions, mechanisation, etc. In both Denmark and Sweden the challenge was how to find ways to finance such investments on a scale larger than what was possible through purely bilateral personal loans between landowners and their tenants, or among family members, etc. In Denmark, there was only one bank, the royally chartered Nationalbanken i København, formed in 1818 as a private joint stock company, whose main task it was to sanitise the monetary chaos, i.e. mop up the excess circulation of paper notes issued by its predecessor, ‘Kurantbanken’, the state owned bank which failed in 1813. With monetary stabilisation as its main task, the new bank had neither the capacity nor the inclination to indulge in accommodating lending policies.

The mortgage credit institution – Kreditkassen for Husejere i Kjøbenhavn - had been in existence since 1797, when it was created to facilitate the financing of the rebuilding of Copenhagen after the ravaging fire of 1795. It was active only in central Copenhagen. It was an association of creditors, i.e. bondholders, and its bonds were guaranteed by the Crown, i.e. the State. The bonds could be called at any time, and the loans could be repaid at any time. There was,

however, no symmetry between these rights for bondholders and borrowers. Because of these features, there was no inclination to expand this institution or to copy it when other financing needs arose in the following century. The state guarantee was politically absolutely unfeasible after the bankruptcy of the Crown in 1813.

In Sweden, the situation was very similar. After the demise of the 'diskontar' (discount houses)[2] in the years 1813-1817, The Riksbank was the only bank on the scene until 1830, and, like in Denmark, its main task was monetary stabilisation after the upheavals of the Swedish-Russian war 1809-10 with the loss of Finland and the collapse of the discount houses.

In Denmark, Adolph F. Bergsøe, a well-known jurist, economist, and statistician was commissioned by the government to produce a report with recommendations based particularly on the mortgage institutions existing in Prussia, Schlesien, and Pommern, and known as 'landwirtschaftliche Kreditinstitute', or just 'Landschaften'. Bergsøe visited a number of these institutions, talked to their officers, studied their bylaws, and learnt from their experience. The description of the earliest five of these institutions, known as 'die fünf Alten'[3] and formed in the years 1770-1788, makes up the bulk of his 147 page report[4] of 1839 together with references to other more or less similar institutions in Hannover and Bayern, just as he included some of the features introduced in the 1820s and 1830s, particularly the provisions introduced for installments and improved symmetry for the calling and repayment options. He concluded his report with a draft set of bylaws for a Danish mortgage institution, which incorporated most of the features he had seen in the Landschaften. Their main principles will, therefore, be briefly described below. The 'fünf Alten' were not identical in all respects, but their main characteristics can be summarised as follows:

a) The 'Landschaften' were non-profit associations of borrowers without any capital of their own, except for reserves they gradually built up[5]. Membership of the associations was restricted to the landed nobility in the respective regions ('Länder'). In most of the Landschaften membership was compulsory for noble owners of estates exceeding a certain size, whether the member had a loan or not. Membership of a Landschaft implied joint liability for the obligations of the Landschaft, whether the member had a loan or not. Membership also implied an automatic borrowing right.

b) The Landschaften were pure service organisations. They arranged credits by placing bonds with investors/lenders. They did not take deposits, they did not lend, and they did not operate on a fractional reserve basis. They were definitely not 'banks', although the definition of 'banks' is certainly open for discussion[6].

c) The size of the loans to which each member was entitled was purely a question of the estimated value of the land offered as collateral, as estimated by the Landschaft. The financial standing of the member was irrelevant. Upon request, the borrower would receive a number of round sum fixed interest 'Pfandbriefe' (mortgage bonds) in nominal amounts up to one half (in some Landschaften two thirds) of the estimated value of the land, and the borrower could then sell these Pfandbriefe or ask the Landschaft to sell them on the borrower's behalf. These pfandbriefe became quite popular on the Berlin Stock Exchange. For the investors, the Pfandbriefe represented a claim against the Landschaften. In exchange for these Pfandbriefe, the borrower woud issue a mortgage deed to the Landschaft in an amount equaling the total amount of Pfandbriefe received, and carrying the same nominal rate of interest.

d) In the (unlikely) case that the Landschaft could not pay interest (or redemption) to the holder of the Pfandbrief on time, the holder could try to collect the claim directly from the borrower, since the Pfandbrief included the text: 'Pfandbrief, welcher auf das im Kreise X. gelegene Gut Y. ausgefertigt worden'[7] (the 'Spezialgarantie'), and if that did not work, the claim could be col-

lected from any or all of the other members of the Landscshaft (the 'Generalgarantie'). How this would work in real life seems unclear. Apparently, it was discussed only in theory, but never actually tested[8].

e) There was never any fixed amortisation plans. This was asymmetrical, since the Pfandbriefe could be called at six months notice. In principle, this could cause liquidity problems for the Landschaften, but it was assumed that investors´ demand for Pfandbriefe would roughly match redemption calls from other Pfandbrief holders, so that no problems would emerge. This assumption actually proved correct (until the Napoleonic wars proved too disruptive). This asymmetry was modified in the 1820s and 1830s, when amortisation plans were introduced in the old as well as new institutions.

Bergsøe's recommendations did not copy any of the existing institutions in all details. He recognised that differences with respect to economic and agricultural conditions, and the legal framework in general, had to be taken into consideration, cfr:

> '…da ville det ingenlunde være tilstrækkeligt …at tage en af de hidtil bestaaende Creditforeningers Statuter og overføre samme paa dansk Grund. Saavel de locale Forhold som Tidsforholdene, Agerdyrkningens Tilstand, Landets politiske og oekonomiske Forfatning, … og Lovgivningen saavel i Almindelighed som in Specie …angaande Hypotek- og Matrikelvæsenet…betinge saa væsentligen Statuterne…at hvad der er passende og hensigtsmæssigt for eet Land, ikke er det for et andet…'[9] ('…so, it would be far from sufficient…to take the bylaws of one of the so-far existing institutions and transfer them to Danish territory…Both local and temporary conditions, the state of agriculture, the country's economic and political status, …and the nature both in general and in particular regarding mortgage and land registration…are so important for the bylaws that what is suitable for one country may not be suitable for another.'[10])

The essence of this observation, written in 1838, has not changed very much in the intervening 173 years, even if later legislation, including common EU regulation, is directed at all kinds of financial institutions, including different types of 'mortgage banks'.

2. The Mortgage Institutions Act of 1850, and the First Ten Years.

It took 11 years from the publication of Bergsøe's report in 1839 until action was taken. There were doubts that bonds without government guarantees could be sold, and there were fears that access to credit would become too easy and tempt farmers to indulge in over-indebtedness. Eventually, these concerns were overcome, and the Lov om Oprettelse af Creditforeninger og Laanekasser for Grundejere af 20.Juni 1850 was passed ('The Mortgage Institutions Act of June 20, 1850'). It was not unthinkable that mortgage institutions could be set up without having an act of this nature passed by the newly formed (1849) Rigsdag ('parliament'), but for the institutions to succeed it was considered necessary to endow them with certain privileges, which could only be conferred upon them by an act of the Rigsdag, and to require their bylaws to be subject to approval by the Ministry for the Interior.

With only seven paragraphs, the Mortgage Institutions Act of 1850 was a model of brevity. The penchant for including all sorts of technical details in a law text is of more recent origins, and the inclination to do so developed much more slowly in Denmark than it did in Sweden[11]. The 1850-Act said that on certain conditions, mortgage institutions would be given the privileges to be exempt from stamp duties, the right to arrange foreclosures on defaulting debtors without otherwise normal court procedures, the right to issue negotiable bearer bonds, to exceed the otherwise prevailing interest ceiling of four per cent, and to make the bonds eligible for investment by funds held in trust on behalf of

widows and orphans, under-aged, public offices, etc. Finally, the 1850-Act required the mortgage associations to submit quarterly accounts for scrutiny by the Ministry for the Interior.

The conditions to be fulfilled in order to be granted these privileges and have their bylaws approved by the Ministry for the Interior can be summarised as follows (§4):

a) Mortgage institutions were required to be associations of borrowers with a total loan volume of at least one million Rigsbankdaler (DKK 2 mill). An association could accept mortgages only inside an area, where its directors could be expected to know and assess the mortgaged properties personally.

b) Mortgages and loans not to exceed 60 per cent of the value of the property as estimated by the association.

c) The volume of circulating bonds could never exceed the volume of underlying mortgage loans.

d) All members of an association (i.e. the borrowers) to be jointly liable for the obligations of the association with 100 per cent of the value of their mortgaged property, and personally liable for their own loans with all of their personal assets. The underlying loans were to be amortised by a percentage left to the associations to decide for themselves. The amortisations to be used fully and exclusively for redemption of the bonds, to be drawn by lottery. In real life, amortisations turned out to be very small, giving the loans and bonds lifetimes of up to 75 years or more.

The strongest resemblance to the Prussian Landschaften lay in the following points:

- The legal status of the institutions as non-profit associations of borrowers;
- The automatic right for property owners to obtain loans exclusively on the basis of the value of the property as estimated by the association;
- The joint liability among all members of a mortgage association to the extent of a member's mortgaged property and full personal liability for a member's own loans to the extent of all of a borrower's assets;
- The limitation of the amount of a mortgage association's total circulating bonds to the amount of its underlying mortgages, and the identical rates of interest on the mortgage deeds received and the circulating bonds;
- The disbursement mechanism, whereby borrowers were given bonds in exchange for their mortgage deeds, and the borrower would sell the bonds (or ask the association to sell them on their behalf) at whatever price they would fetch in the market;
- The absence of any paid in capital and any particular requirements for the amount of reserves to be built up. In the Landschaften as well as in the Danish associations, reserves were built up from reserve fund and administration contributions paid by the borrowers simultaneously with their interest payments, usually in the order of magnitude of about 0.05 per cent p.a. Also, bonds were usually issued in amounts of only 96 or 98 per cent of the underlying mortgages, but none of this was stipulated in the law.
- Arranging long term mortgage loans on cultivated land and, in Denmark, inhabited urban properties the only activity. No construction finance, no project finance, no current credits or overdraft facilities, and no deposit taking, no bank borrowings, and always 133-150 per cent fixed property collateral.
- No interest rate risk, since the interest rates and amounts of the bonds issued matched completely those on the mortgage deeds received (apart from the administration and reserve fund contributions).

The main differences between the Danish mortgage associations and the Landschaften were:

- No call options for the bondholders, but borrowers could make voluntary early repayments. In times of falling interest rates bondholders would therefore have to accept lower yields, as borrowers would repay their loans, the corresponding bonds were withdrawn, and new lower-yielding bonds would be issued.
- The Danish associations were open to

all classes of borrowers, and all types of properties, although Bergsøe had recommended that, at least initially, the associations should offer mortgages on agricultural properties only. Urban properties were generally considered more risky, since they could fall into disrepair or burn. A few of the earliest associations would offer mortgages on both urban and agricultural properties, but most of them would specialise on either one or the other type, just as some would specialise on either larger agricultural properties, and some on smaller ones.

- The Danish bonds were/are truly 'collateralised mortgage obligations' in the sense that the bond holders have no way of identifying the properties serving as collateral for their bonds. The above mentioned 'Spezialgarantie', which was a central feature of the bonds issued by the Landschaften, was never copied in Denmark (or Sweden).

Although there were no formal reserve or capital requirements, reserves did creep into the 'system' through the conditions set by the Ministry for the Interior for approval of the bylaws of the individual associations. Thus, the approval for the successive changes of the bylaws of the Østifternes Kreditforening required the association to build up an 'administration and reserve fund' equal to three per cent of its circulating bonds[12].

The formation of mortgage institutions and the sale of their bonds developed rather slowly during the early years. During the first ten years after the 1850-Mortgage Act was passed, only four mortgage associations were formed[13]. The reasons for this initially modest growth were both of a technical and a market oriented nature. The open-ended nature of the associations made ownership of the reserves contentious as older members reduced their loans and new members joined, and for prospective investors the unpredictability of the redemptions was unsatisfactory. In the 1860s and 1870s the fast growing urbanisation and railway construction increased demand for capital sharply, leading to higher rates of interest. Since the mortgage associations could not bring themselves to increase the coupon rates on their bonds, the bonds could only be sold at continuously lower prices, and borrowers sought other sources of capital, particularly the growing number of savings banks as well as banking firms in Hamburg. In addition, two other incidents influenced developments, but in opposite directions: First, the severe financial crisis in Hamburg in 1857 cut off a source of credit, which had for a long time been of essence for the Danish business and agricultural communities, and therefore had severe ripple effects in Denmark. It also meant that domestic credit sources had to be found to replace the collapsed Hamburg houses. Secondly, the collapse of 'The Mortgage Association for Urban Properties in Northern Jutland' (MAUP) in 1859-61 (cfr. fn.13) did not, of course, stimulate the confidence in the relatively new mortgage institutions.

Considering the later pattern of mortgage finance problems in several countries, it could seem interesting to take a brief look at the collapse of the Kreditforeningen for Kjøbstadsgrundejere i Nørrejylland (MAUP). It is one of only two such cases in the 160 years of Danish mortgage associations, during which approximately 30 mortgage institutions were formed, whose circulating bond issues came to dominate the stock exchange, and the total credit volume of which came to equal the combined loan volumes from banks and savings banks during most of the twentieth century. So, even if the case of the MAUP is quite exceptional, it is of interest both because of the factors which caused its demise and because of the reactions to the collapse.

First, property prices boomed in most of Europe during the first half of the 1850s, followed by a bursting of the bubble when the Crimean War was over, leading to, i.a. the collapse of several Hamburg banking houses (1857). At the MAUP, the ballooning property prices had been believed to be an almost permanent development, but its property valuations proved too optimistic when its debtors went bankrupt (at least partially because of the crisis in Hamburg) and defaulted

on their mortgages. Secondly, those MAUP borrowers who were in a position to do so, repaid their loans when the problems began to surface, refinancing themselves elsewhere, in order to escape from their joint liability. This left the MAUP with only the weakest of its borrowers whose assets turned out to be insufficient to cover MAUP's obligations. Third, the risks were concentrated on too few borrowers, partly because of the few years MAUP had been operating, and partly because of the repayments by those who could do so. Finally, because of the short life time of the institution, there had been little time to build up reserves.

3. The Mortgage Institutions Act of 1861 and the Next One Hundred Years.

The collapse of the MAUP, as well as the other difficulties, convinced the Rigsdag that the 1850 Act had to be amended.

In only three paragraphs the 1861-Act introduced three fundamentally new concepts: First, it stipulated that a mortgage association could split its bond issues into any number of series, none of which had any connection to any of the others except for a common administration. The Act stated explicitly (§1) that the joint liability of the borrowers was limited to the particular series of bonds which financed mortgages in that particular group of loans. Each of these series of loans/bond issues would be open to new borrowers for only two or three years (unspecified in the law). In fact, each series of bonds/loans became a separate association. This had the triple advantage of limiting the joint liability of the borrowers, clarifying the ownership of the reserves, and making the redemption of the bonds more predictable for the prospective investors. Secondly, the 1861-Act provided for the establishment of reserve funds for each individual series of bonds and stated that borrowers could not escape their joint liability until the Ministry for the Interior had approved the annual accounts of each of these series. Third, new mortgage associations could only be formed by an act of law. The Rigsdag was not convinced of the need for more than the four associations existing at that time. Still, another 11 first priority and about ten second priority associations had been formed by law over the following sixty years, each catering for specific types of property and/or specific regions, but in some cases also overlapping each other, thereby creating a modest degree of competition.

An amendment Act of the 1896-act introduced some limitation on the maturities of the mortgage loans. Perpetual loans could be offered for a maximum of one third of the total, and the remaining two thirds could have a maximum maturity of 75 years.

Second priority mortgage associations ('hypotekforeninger') were – reluctantly – authorised by the one-paragraph 1897-Act with the usual privileges, on the condition that the bonds issued by second-mortgage institutions clearly stated their second mortgage rank[14]. They could offer mortgages up to 75 per cent of the property values, although this was not specified in the 1897-Act.

For 75 years after the MAUP collapse, no casualties were recorded among Danish mortgage associations, in spite of the turbulence wild gyrations experienced on the real estate markets in e.g. 1906-08, when several banks suffocated from exposures to speculative construction projects, and 1921-23, when approximately ten per cent of Denmark's ca. 225 banks collapsed due to real estate and other speculative business in a period of severe asset bubbles followed by collapse.

The depression of the 1930s did, however, have consequences. The farmers were hit particularly hard, and in 1931 one of the secondary mortgage associations catering particularly for agricultural property collapsed (Jydsk Landhypotekforening). Bondholders had to accept a postponement of interest and redemptions, and ended up with a loss of approx. 40 per cent. This was, so far, the last failure of a mortgage institution in Denmark. During the property boom-busts

of the 1970s, the late twentieth and the early twenty-first centuries, mortgage associations have survived entirely on their own.

A new mortgage institutions act was passed in 1936[15], but with only modest changes. The main purposes were to modernise the text and to bring the first priority and the second priority institutions under parallel legislation, and to shorten the maximum maturity of the loans to 60 years. In addition, reserve requirements were laid down directly in the law. Borrowers were required to supply a reserve fund contribution of 1.5 per cent of their loans, to be paid in during the first two years of the lifetime of their loan. In addition, current reserve fund contributions (1/20 of one per cent) had to be paid until the reserves reached an amount of five per cent of the circulating amount of bonds in each series, slightly increased compared to existing stipulations.

Since the 1870s, the mortgage bonds had been trading well on the stock exchange, and had also found a market outside Denmark. Substantial volumes of mortgage bonds were sold in Paris, Berlin, and Hamburg, and even in London. The First World War put an end to that, but it was not until 1931 that a ban on the export of bonds was introduced. In the late 1980s foreign investors were again allowed to buy Danish mortgage bonds.

Nothing much happened on the mortgage credit scene until 1959, when a handful of new institutions[16] were formed through initiatives mainly from the central bank but supported by the government and the private banks and savings banks. They broke new ground on four fundamental points: (1) They were formed not as associations of borrowers, but as ‘self-owned’ non-profit institutions, (2) there was no joint liability among their borrowers, (3) they were formed with an initially paid in capital (sub-ordinated loan capital paid in by the central bank, the commercial banks and the savings banks in various combinations), and (4), they provided mortgages up to 75 per cent of the property values as second priorities in competition with the existing second priority institutions, but they also offered third priority mortgages. The background was that the old mortgage institutions had feared a collapse of property prices in the post-war years, as had been seen in the early 1920s, and were, therefore, rather cautious in their property valuations. Therefore, the government had stepped in to play a major role in the financing of new residential construction. By the end of the 1950s, the immediate post-war problems had been overcome, and it was decided to replace the government’s role in property finance with new private or ‘self-owned’ institutions in partial competition with the existing institutions.

4. The 1970 Mini Reform

In 1969-72, an over-heated economy, including unsustainable residential construction and related galloping bond issues with upwards pressure on long - term interest rates caused the central bank – in co-operation with the government – to initiate a reform of the structure of the mortgage institutions sector, but not a fundamental break with its basic principles. The impression was that the many mortgage institutions competed too strongly on optimistic property valuations – their only possible competition parameter, since all other aspects of their activities were regulated by law – and that this had inflationary consequences and caused undesirable upwards pressures on interest rates.

Against this background a structural reform was forced through, during which the number of associations was substantially reduced over a few years, and the distinction between first and second priority institutions was eliminated.

Finally, the maximum maturity was reduced to 30 years, and restrictions were introduced on mortgage offers. Only mortgages on new construction could be offered, i.e. ‘topping on’ of existing mortgages as the values of the properties were perceived to increase was prohibited, since such additional mortgages were thought to be financing pure consumption purposes and thus detrimental to inflation and the vulnerable balance of payments.

5. The 1989 Reform: A Real Reform

In contrast to the 1970 Reform, the 1989 Reform was a real reform in the sense that it signified the end of most of the 140 year-old fundamental principles of the Danish mortgage associations. The background was the need to harmonise the Danish system with new EU regulations, which do not distinguish between 'commercial banks', 'traditional savings banks', 'mortgage banks' like e.g. the UK building societies, and 'mortgage associations'.

So, the non-profit untaxed mortgage associations were required to be capitalised as commercial banks, which eventually meant that they transformed themselves from associations of borrowers to profit maximising joint stock taxable companies, since the EU authorities would not recognise the joint liability among the borrowers as 'capital'.

This transformation was given some time to be implemented. It was completed in 2003 by a new Financial Institutions Act comprising all kinds of financial institutions, including insurance companies. In the process, further structural changes had taken place. Two mortgage institutions associations merged to form today's Nykredit A/S, and Danske Bank took over Realkredit Danmark, the oldest of the associations formed under the 1850-Act (Østifternes Kreditforening). The present scene, therefore, is a combination of two independent mortgage institutions (BRF Credit A/S and DLR Credit A/S), surviving from the 1960's creation of self-owned institutions, but now offering general mortgages, Total Kredit A/S (the result of a merger of the two bank sponsored institutions created in 1959 and now a subsidiary of Nykredit), Nykredit A/S (cfr. above), Nordea Realkredit A/S (a subsidiary of Nordea Bank, the largest bank in the Nordic region), and Realkredit Danmark, a partly-owned subsidiary of Danske Bank.

The important thing to notice is that long-term mortgage lending is, in principle, still taken care of primarily by separate legal entities, i.e. ring-fenced in separate legal entities at least to the extent that the mortgages are financed by bond issues, and that matched funding is still required in the bond-issuing mortgage institutions, whether they are bank owned or not. Approximately half of all new mortgages arranged for the last ten years have been made with interest rates adjusted once annually. These mortgages are financed with one year bonds, so even if the underlying mortgages have maturities of up to thirty years the cash flows from the underlying mortgages still match the cash flows on the corresponding bonds. When the one-year bonds have been sold, the borrowers are informed of the rate of interest they have to pay for the coming year.

II. Sweden

1. The Origins, and the First Eighty Years

Like in Denmark, the inspiration came from Prussia and was imported into Sweden by the count Frederik Bogislav v. Schwerin, a descendent of an ancient north German ducal family, a branch of which had settled in Sweden in the eighteenth century. He was concerned about the lack of capital following the collapse of the discount houses and the stringent lending policies pursued by the Riksbank[17]. In 1815 he published a report[18] proposing the creation of a mortgage association based on the principles known from the Prussian Landschaften. Nothing happened until the idea was taken up again in 1833 by Carl A. Agardh, a professor of botanics and economics, who proposed[19] the creation in Skåne, the southern province of Sweden, of a mortgage association based on the principles suggested by count Bogislav v. Schwerin.

Action was taken immediately by members of the Skåne nobility. Bylaws and management regulations were prepared and approved by the king, and in 1836 the Skånska Hypotheksförening ('Skånska Hyp') was formally established by 187 founders, each having signed up for an amount of their respective borrowing rights. Membership was open to all owners of rural

property in Skåne valued at minimum 3,000 kronor, i.e. minor farmers were avoided. Loans could initially be had for up to fifty per cent of the property values, later increased to two thirds.

Between 1845 and 1851, six other similar mortgage associations were set up in other Swedish provinces, differing from each other only in minor technical details. In contrast to Denmark, no general mortgage institutions act was passed. Each institution was approved individually by the government.

The mortgage bonds issued by these institutions were increasingly sold abroad, mostly in Hamburg. However, even in Hamburg, the appetite for the Swedish bonds had its limits, particularly after the 1857 crisis, and it became problematic that the mortgage associations could, or at least did not co-ordinate their foreign issues, or co-ordinate them with the issues of government bonds. Thus, the placing of the first railway loan was hampered by the more or less simultaneous 'flooding' of the Hamburg market with Swedish mortgage bonds. Therefore, the government decided to have the mortgage bond issues concentrated in a single government controlled institution, and thus the Sveriges Allmänna Hypoteksbank was formed in 1861 by royal decree[20].

The government injected a modest amount of capital, and any future profits were to be retained as reserves. The regional associations became 'members'. In return, the representatives of the Estates[21] decided that the Riksbank should discontinue its mortgage lending activities as from 1865.

The relationship between the regional mortgage associations and the Hypoteksbank was copied directly from the relationship between the ultimate borrowers and the regional associations. The regional associations were liable with all of their assets for the obligations of the Allmänna Hypoteksbank in proportion to their respective shares of its combined lendings. The Allmänna Hypoteksbank[22] only took care of the funding, and had no relations to the ultimate borrowers.

Thus, the idea of a centralised government regulated mechanism for bond issues grew up. The fast growing urbanisation during the last third of the nineteenth century gave rise to an equally fast growing need for financing of urban residential and commercial construction, and it was decided to copy the existing rural mortgage system. The rural associations would have nothing to do with urban properties, as these were seen to be far too risky, so new institutions had to be created. So, in 1865 the Allmänna Hypotekskassan för Sveriges städer ('Stadshypotekskassan')[23] was formed as a complete parallel to the rural Allmänna Hypoteksbank., i.e. as a central bond issuing institution funding a number of regional urban associations, which were jointly liable for the obligations of the central institution, and which arranged the mortgages for the ultimate and jointly liable borrowers. The Stadshypotekskassa started its operations in 1871, but the conditions for the local associations were too unclear, and the Stadshyp found it difficult to sell its bonds. So, early in the twentieth century only very few regional associations had been formed.

From the outset, the Swedish system differed from the Danish – and Prussian – systems on a number of points. Thus, loans generally had much shorter maturities (max. 40 years, but mostly much shorter), the bonds could be called after ten years, the interest rates were subject to a ceiling decided from time to time by the Estates/Riksdag, the bond issues were not split into separate series, and, probably most importantly, the practice increasingly grew up to disburse the loans in cash and not in bonds, which gave the associations a cash management problem absent from the Danish and Prussian associations and loosened the mirror-like matching of assets, liabilities and cash flows[24], which was the central feature of the Danish and Prussian systems. Neither in Prussia nor in Denmark was any central institution created to take care of the bond issues and funding of the local associations. In contrast to Denmark, a sharp distinction between rural and urban associations was

maintained until the second half of the twentieth century, and even today there are mortgage institutions specialising in agricultural and urban properties respectively.

2. The Twentieth Century

The lack of progress for the urban institutions persuaded the government that something had to be done, and after several debates in the Riksdag during 1908 and 1909, the king signed two decrees[25] that were to form the framework for the financing of urban property for the next 50-75 years.

The main points were the creation of a new Konungariket Sveriges stadshypotekskassa (the 'KSS'), which took over the assets, liabilities and activities of the existing Allmänna Stadshypotekskassa, which was wound down, and the creation of a set of regulations for the formation and operation of the regional urban associations. The KSS was a perfect example of the hybrid private/government type of institution that permeated the Swedish capital market since the foundation of Palmstruch's Bank in 1656 and the discount houses in the late eighteenth century. Formally a private institution, it was given a perpetual government 'loan', and in order to stimulate foreign demand for its bonds they were designed to look as much as possible as government bonds, although they were not government guaranteed.

After roughly 70 years of substantially unchanged structure, the world of Swedish mortgage institutions changed dramatically during the final three-four decades of the twentieth century. The background was the government policy since the late 1940s to carry through a forced and subsidised acceleration of residential construction, which entailed an acceleration of bond issues and the problem of getting those bonds sold in a world closed to cross-border capital movements. So, the commercial banks, savings banks, and insurance companies were ordered by the Riksbank to pick up specified amounts of the mortgage – and government – bonds at specified prices. In return, the financial institutions were allowed to include these long term bonds in their required liquidity reserves.

Banks and savings banks, therefore, decided to engage in the mortgage lending business themselves. If they had to invest in mortgage bonds anyway, better to invest in bonds issued by themselves than bonds issued by somebody else. So, in 1955 Svenska Handelsbanken started the process by taking over an old minor private mortgage company. In 1961 the savings banks formed their jointly owned SPINTAB Ab, the co-operative banks (the 'föreningsbanker') formed the FBkredit, and 12 regional banks formed the Svensk Fastighetskredit Ab. In 1997 Handelsbanken acquired the above-mentioned Stadshypotek[26]. SEB, exceptionally, offers mortgage loans through a department of the bank, not through a subsidiary.

SBAB ('Sveriges bostadsfinansieringsaktiebolag') was formed in 1985 to take care of the government's housing finance activities. It now offers a broad range of financial services, and the intention is to privatise it 'when the time is right'.

While the original principle of joint liability among the borrowers disappeared in the process of institutional changes during the twentieth century (like in Denmark), other regulatory principles remain in place, e.g. limitation on first priority loan-to-value mortgages, varied according to type of property, capital requirements, etc.

In Sweden, the mortgage institutions never reached a relative size comparable to that in Denmark. While in Denmark, the circulating volume of mortgage bonds matched or exceeded the combined volume of bank and savings bank loans since the 1930s, they never reached more than about half of that relative volume in Sweden[27].

Conclusions

In both Denmark and Sweden, the mortgage institutions of today look quite different from their original shapes of the late eighteenth and early nineteenth centuries. The main reason for their changes is not that the original model had proved inadequate in a modern world, or had otherwise failed to pass the test of time, but that it was required to conform to EU regulations reflecting different systems prevailing in other and larger countries. Still, some of the original features have remained, and there can be little doubt that these remaining principles of the original business model helped the Swedish mortgage institutions survive the property crisis of 1988-92, and also helped the Danish mortgage institutions through the finance and property crisis of 2007-11 without major problems. The business model forming the 'life boat' of Danish and Swedish mortgage institutions is mainly comprised of the following elements:

- Mortgages arranged in separate, specialised legal entities funding themselves (in Denmark fully, in Sweden mostly) with bond issues matching the underlying mortgages, therefore no (or few) liquidity problems;
- Abstention from anything like 'project' or 'development' financing, i.e. offering mortgages only on completed and fully (or almost fully) completed and utilised properties, therefore no 'project risks'.

To separate this type of financing activity from general commercial or retail banking seems to be a prudent principle with a stabilising effect on the financial markets, and could very well be introduced in other countries as well.

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References

[1] Based on Steffen E. Andersen: 'The Evolution of Nordic Finance', Palgrave Macmillan, Dec. 2010.

[2] For a description of these discount houses, see the Dec. 2010 issue of the Bulletin, p. 33.

[3] 'Die fünf Alten' were the Schlesische Landschaft (1770), das Kur- und Neumärkische Ritterschaftliche Kreditinstitut (1777), die Pommersche Landschaft, (1781), die Westpreussische Landschaft (1787), and die Ostpreussische Landschaft (1788). The description of these institutions given here (and in 'The Evolution of Nordic Finance') is based on the above mentioned 1839 report by A.F.Bergsøe, and on H. Mauer:: 'Das Landwirtschaftliche Kreditwesen Preussens', Strassburg, 1907.

[4] 'Adolph F. Bergsøe: 'Motiveret Udkast til en Creditforening for Danske Grundbesiddere', 1839.

[5] According to Bergsøe´s description, King Wilhelm II had paid in a capital sun of 200,000 Thaler at two per cent per cent interest to each of the Schlessige and Westpreussische Landschaften. This is not mentioned by Mauer.

[6] In my view a 'bank' is an institution which takes deposits from the general public for the purpose of re-lending the funds thus received to the general public, and which operates on a fractional reserve basis, and which makes payment transfers, and which may offer other financial services. According to this definition, 'investment banks', which only advise and arrange issues of bonds and shares,

and which trade such securities, are also not 'banks' and should consequently not be the subject of general banking regulations, and the modern term 'mortgage bank' should be applied only to British type building societies and, perhaps, to savings banks whose main activities is mortgage lending.

[7] Mauer, 'Das Landwirtschaftlische…' p.4.

[8] Mauer, p.4, fn.1.

[9] Bergsøe: 'Motiveret Udkast…', 1839, p. 48.

[10] My translation.

[11] E.g. the Swedish Banking Acts of 1846, 1886, and 1903 had 17, 43, and 85 paragraphs respectively, while the first Danish Banking Act of 1919 had only 23 relatively short paragraphs.

[12] Cfr. 'Kundgjørelse ang. Stadfæstelse paa et Tillæg til de under 6te December 1851, 14de Augusr 1852, 8de Februar 1853, etc sanctionerede Statuter for en Kreditforening af Grundejere i de danske Østifter' ('Østifternes Kreditforening'), 20.Sept, 1861, § 7.

[13] The first two of these were Østifternes Kreditforening, which arranged mortgages for both urban and agricultural properties and which became Denmark's largest mortgage association, now known as Realkredit Danmark (since the year 2000 a subsidiary of Danske Bank), and Kreditforeningen for Kjøbstadsgrundejere i Nørrejylland ('MAUP'), formed1851 and 1852 respectively. The latter had to stop operations in 1860 with heavy losses for its members, and bondholders had to accept a ten year suspension of redemptions. Finally dissolved 1880.

[14] The Ministry for the Interior had little faith in the second priority associations and would have nothing to do with them. The 1897-act was, therefore, passed through the Ministry of Finance, which became the supervising authority until 1936.

[15] Technically, there were two Acts, one for the 12 first priority and one for the five urban second priority associations, both dated 7 April, 1936, but the intention was to make them as identical as possible. They differed on a few technicalities.

[16] The five new institutions were dedicated to, respectively, countrywide residential properties, provincial properties, properties in the metropolitan area, industrial, and agricultural properties.

[17] On the role of the Riksbank in mortgage finance, see Steffen E. Andersen: 'The Evolution of Nordic Finance', Palgrave Macmillan, Dec. 2010.

[18] F.B. v. Schwerin: 'Om förlägenheten i allmänna rörelsen, orsakerne dertill och botemedlen deremot' ('On the difficulties of the general business conditions, their origins, and remedies against them'), Stockholm, 1815.

[19] C.A.Agardh: 'Om möjligheten af hypotheksinnrättningar för provinserne och synnerligen för Skåne', 1833.

[20] Fördning av 26. april, 1861.

[21] Since its foundation in 1668, the affairs of the Riksbank were the responsibility of the Representatives of the Estates (since 1866 the Riksdag ('Parliament')), not the government.

[22] The use of the term 'bank' is quite misleading. Sveriges Allmänna Hypoteksbank had none of the characteristics of a 'bank', cfr. footnote 6.

[23] The use of the word 'kassa' in the name may have been chosen to distinguish it from the Allmänna Hypoteksbank, but the use of the word ' bank' was, in any case, quite misleading, cfr. fn. 6 and 22.

[24] Between 1980 and 2006 the proportion of mortgage loans covered by bond issues gradually dropped from about 80 per cent. to about 70 per cent (in some years only 65 per cent), cfr. Steffen E. Andersen: 'The Evolution of Nordic Finance', Palgrave Macmillan, 2010, Table 10.5, p.263.

[25] Kungl. Maj:ts förordning angående Konungariket Sveriges stadshypotekskassa, and Kungl. Maj:ts förordning angående grunderna för stadshypoteksföreningernas bildande och verksamhet, both signed on June 5, 1909.

[26] The above mentioned Konungariket Sveriges Stadshypotekskassa had been transformed into Stadshypotek Ab in 1994.

[27] For figures regarding the growth and composition of the credit volumes in the Nordic countries, see Steffen E. Andersen: 'The Evolution of Nordic Financxe', Palgrave Macmillan, 2010.

“Under pressure”
The Central Banks and Neutral Scandinavia’s Politics of Supplying Belligerents with Credit during the First World War

The following working paper attempts to analyse the krone credits put at the belligerent’s disposal, de facto by the neutral countries’ governments, and the role played by the central banks in these affairs. The credits were important to the belligerents in upholding war time economies either in securing deliverances of foodstuffs as well as raw materials for the military industry, or as a part of the belligerents’ economic warfare. From the perspective of the neutral governments, the credits were a necessary means in upholding neutrality on one hand, and national business on the other. However, the credits probably were the single most important factor behind the great expansion in neutral Scandinavia’s money supply, and thus a major contribution to domestic inflation. The dramatic deflation policy and banking crisis that characterised the 1920s was a result of the events during the war, but historic focus on and criticism of the economic policy of the 1920s has nevertheless been labelled as “a writing of history that gives the impression that it is the washing up after the party that creates the accidents”. Thus, this working paper will focus entirely on events during the war, in which all of the three central banks’ direct or indirect participation in these credits has been an important basis for the criticism directed at war time monetary policy.

The paper will try to give an understanding of similar developments in the politics of these credits, and will shed light on where and why the policy differed among the three. The point of departure of this study will be from the perspective of the three central banks – the Danish Nationalbanken, the Swedish Riksbanken, and the Norwegian Norges Bank – and the main intention of this paper is to grasp and clarify the thinking of monetary policy inside the Scandinavian central banks via the case of belligerent credits. A most important aspect is the constraints under which the central banks conducted monetary policy, and the banks’ relationship to their respective governments will be in focus. Furthermore, it will be argued that whereas the governments in Denmark and Norway to a large extent forced Nationalbanken and Norges Bank to meet belligerent credit demands, Riksbanken seems somewhat paradoxically to have been safeguarded from this pressure by her institutional arrangements, and the private banks thus had to fill her role.

The extraordinary circumstances which the neutral countries where exposed to forced their governments to interfere to a greater extent in all parts of economic life. This was imperative to manage the delicate balance between safeguarding neutrality and upholding necessary imports and thus normal business activity. This game of balancing was never an easy task, and the Scandinavian countries each had their challenges during the course of war. Denmark probably had the most evident threat, sharing her only land border with Germany, which meant internal policy depended on a good relationship to the giant southern neighbour. The Swedish élites traditionally held their German relations in a sympathetic view, and Swedish trade was heavily exposed to the German market, as the country dominated the Swede’s import sector. Nevertheless, their export to a significant degree depended on the British market prior to World War I. The Norwegians, on the other hand, relied on British imports, while their exports were more diversified in that both England and Germany held a substantial share. The political consequences of considerations to uphold crucial imports, while at the same time hoping to keep export markets open, constituted a game of balancing, which all of the Scandinavian countries

where subjected to.
This meant that expanding government authority in the field of economic policy also had serious ramifications for the central banks. Their special status, including privilege of note issuing monopoly and as lenders of last resort, had the consequence that the different governments anticipated the central banks to play a key role in both financial and monetary political affairs as an instrument of the state. Inside the central banks, their special responsibility was understood, and they contributed in upholding national business and neutrality, at the expense of their primary objective in normal times of maintaining the value of money.

1. Setting the Stage: The three Central Banks and the Scandinavian Monetary Union

The institutional arrangements of the three central banks display some differences. The Swedish Riksbanken is regarded as the oldest central bank in the world, founded as early as 1668, and still enjoyed strong links with the Swedish parliament by the outbreak of WWI. Nevertheless, it was not until 1903 that Riksbanken gained a note issuing monopoly, according to the new bank law of 1897. All of the so called enskilda banks had the privilege of issuing Swedish banknotes until the turn of the century. The two other central banks were established at a quite later stage in history. After the Napoleonic wars, in the aftermaths of which Denmark lost its sovereignty over Norway to the Swedes, the Swedish “war booty” established Norges Bank in 1816. Nationalbanken in Denmark was finally established two years later. These two banks, however, differed significantly from Riksbanken, both with regards to political affiliation and note issuing rights. Both were privately owned banks and though some of the governors where appointed by the government and their business was controlled by parliament appointed councils, responsibility lay with the Board of Directors. Both banks also continued to hold the monopoly of note issuing throughout their history. Towards the end of the nineteenth century, the banks were established as central banks in so far as they had acted as lenders of last resort in connection with the credit crisis.
Since 1875, the three Scandinavian countries had been tied together in a monetary union, traditionally described as “the most successful of all European currency unions”. The Scandinavian Monetary Union initially consisted of a common currency based on the gold krone, in which gold coins and other coins circulated freely and were accepted as legal tender within the union. However, the union steadily extended its functions, and from 1885 the convention consisted of a clearing agreement in which the central banks could draw on each other at par and transfer drafts free of charge. At the same time, this benefitted big business as payments above 10000 kroner did not have to pay the normal fee when issuing or redeeming drafts on the central banks. From 1901, the convention included bank notes, as Denmark joined Sweden and Norway’s 1894 agreement of accepting each other’s paper money at par. Some setbacks to the convention followed but on the whole the union performed well as a part of the global gold standard regime. Although it is doubtful whether the union itself facilitated trade integration as such, it certainly facilitated the field of finance between the union partners, and acted as a “vehicle for promoting a special Scandinavian money market”. However, the outbreak of war changed everything. Monetary policy became one of several policy fields where Denmark, Sweden and Norway chose different paths. Thus by all practical standards, the Scandinavian Monetary Union lost its functioning during the war, and with the individual attempts to restore monetary policy during the economic turmoil of the 1920s, the prospects of a restoration was abandoned.
When the outbreak of war was a fact, almost all of the gold standard countries in early August 1914 suspended gold convertibility. The Scandinavian countries were no exception. Sweden and Denmark suspended convertibility on 2nd

Table 1: Banknotes in circulation, local currency, end of year, index (1913=100)					
Year	Norway	Sweden	Denmark	Netherlands	Switzerland
1913	100	100	100	100	100
1914	125	130	136	150	145
1915	151	140	145	176	148
1916	234	178	188	232	171
1917	303	244	223	273	224
1918	405	347	297	333	311

Table 1: Banknotes in circulation, local currency, end of year, index (1913=100)
Sources: Ekonomisk Tidskrift volumes 1913-1919 (Norway, Sweden and Denmark); "Financiële instellingen in Nederland 1900-1985: balansreeksen en naamlijst van handelsbanken", DNB Statistische Cahiers (number 2), DNB, 1987, s.24-25 (Netherlands); Balance sheets and income statements, Swiss National Bank 2007 (Switzerland)

August whilst Norway followed suit three days later. The two former countries' decision in this matter seems to have been motivated from within the central banks, while the latter is said to have been more of a political decision, on the initiative of Minister of Finance. Nevertheless, confidence in the notes was not lost with suspension of convertibility, as public demand grew considerably. All of the three countries thus experienced a remarkable growth in the amount of circulating notes for the remainder of the first year of war, a development that continued throughout the war years (see table 1). This development was shared not only with the belligerent countries, but with other neutral countries as well.

Even though the gold reserves of Nationalbanken, Riksbanken and Norges Bank eventually also started to rise (see table 2), it could not keep up with the growth in notes. However, the increase in gold reserves was also a common feature of the neutral countries.

With suspension of gold convertibility, the anchor of the international exchange rate regime was cut loose. This had the peculiar effect that within The Scandinavian Monetary Union, the three currencies bounded by law started fluctuating greatly. The broad picture for the duration of the war was that the Swedish krone appreciated to some extent to the Norwegian krone, and to a greater extent to the Danish krone. This notwithstanding, for a long time the main features of the monetary union were preserved, although the turmoil created serious tensions between the three central banks. However, the subject of the following main section deals less with the internal affairs of the functioning of the union, and more with those features shared by the three banks in governing monetary policy under the political pressure inflicted by war.

Table 2: Gold reserve, local currency, end of year, index (1913=100)					
Year	Norway	Sweden	Denmark	Netherlands	Switzerland
1913	100	100	100	100	100
1914	94	102	119	155	138
1915	178	122	140	307	158
1916	166	180	201	420	208
1917	157	240	219	499	215
1918	165	280	245	495	248

Table 2: Gold reserve, local currency, end of year, index (1913=100)
Sources: Ekonomisk Tidskrift volumes 1913-1919 (Norway, Sweden and Denmark); "Financiële instellingen in Nederland 1900-1985: balansreeksen en naamlijst van handelsbanken", DNB Statistische Cahiers (number 2), DNB, 1987, s.24-25 (Netherlands); Swiss National Bank, Balance sheets and income statements, Swiss National Bank 2007 (Switzerland)

2. Under Pressure – Supplying the Belligerents with Credit

The modi operandi of the three Scandinavian central banks during the course of war had to find its way through the pressure of the belligerents and own governments, manoeuvring their way through the conflicting aims and difficulties of the wartime situation. In many regards this internal political pressure was somewhat self-inflicted. The central banks recognised the fact that their special position and privileges entailed a duty to let their main objective – maintaining monetary value – be subjected to the good of the nation. This implied supporting the economic policy of the governments, but where the means of achieving this could conflict with their main objective.

A main reason behind the monetary expansion in all of the three Scandinavian countries can be found in the credits made available in kroner to the belligerents. The reasons for supplying these credits differed somewhat, but an ultimate driving force from the perspective of the governments naturally can be found in concern for domestic economic activity. Fearing the consequences in not accommodating the needs of powerful neighbours constituted another important incentive. The manner in which these credits were given also differed, Sweden following another path than her two Scandinavian counter parts.

2.1 The Paradoxical Independence? Riksbanken's Non-lending.

As already indicated, the Swedish Riksbanken's situation from the onset differs from both Norges Bank and Nationalbanken, as it was strongly affiliated with the Swedish parliament Riksdagen, being the parliament's own bank. However, this study so far has not indicated a strong political control in the dispositions of Riksbanken during the World War, but it can hardly be dismissed, not least because of this political submission to the parliament. This notwithstanding, in the case of credits, political affiliation seems to have entailed a somewhat greater independence.

Prior to the war Germany had been Sweden's most important source of imports, and Great Britain their biggest market of exports, but Germany soon gained the upper hand (see figure 1). As the Swedish export market was redirected from Great Britain to Germany in 1915, this development initially was facilitated by credit from exporting businesses. But in the spring of 1915 representatives of Deutsche Bank contacted Stockholms Enskilda Bank (SEB), with the intention of obtaining a bank credit of 40 million kroner, to start with. However, the terms were so unfavourable SEB-director Marcus Wallenberg hardly thought the proposal was meant seriously, leading to an abrupt halt in negotiations. Nevertheless, a couple of months later, a deal

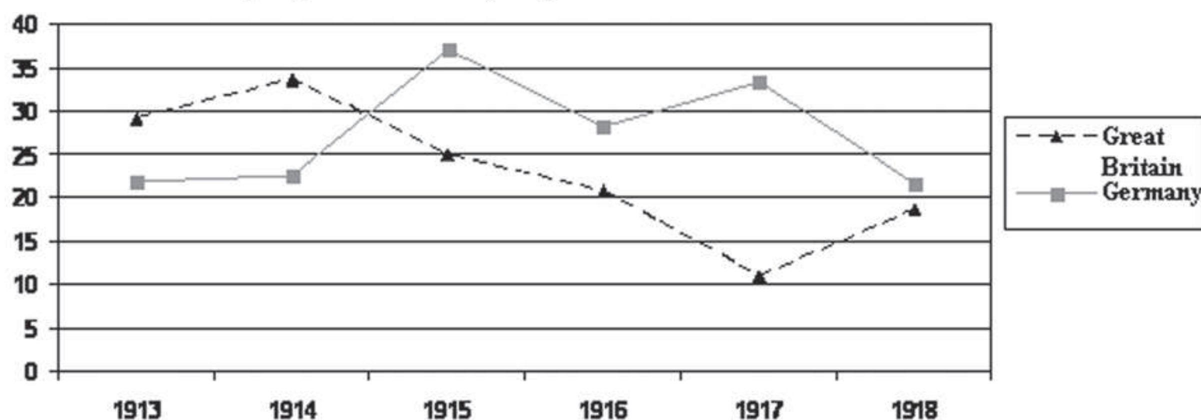


Figure 1: ***Per cent share of Sweden's total export value 1913-1918, source Historisk statistik för Sverige, del 3 Utrikeshandel 1732-1970*, Statistiska Centralbyrån, Stockholm 1972, computed from table 5.2.**

between Deutsche Bank and M. M. Warburg on the German side and four Swedish banks had been concluded. The agreement consisted of a credit totalling 40 million kroner put at disposal for German purchases in Sweden. This bank credit was the first of several credits from Swedish banks, to belligerent countries on both sides of hostilities.

Although it was formally concluded between private banks from the two countries, in reality the two governments were the real "perpetrators". From the perspective of the Swedish government an agreement between the two countries could facilitate a loosening of German export prohibitions. Furthermore, Riksbanken to some extent had been part of the proceedings. When the central bank had been acquainted with the ongoing negotiations, at this time between the private banks Centralbanken, Göteborgsbanken and Deutsche Bank, governor Victor Moll's point of view was that the credit agreement should preferably not be concluded. Moll believed that the right on behalf of the Swedish banks to rediscount in Riksbanken was not to facilitate credits to foreign countries. However, as proceedings by this time had come far, Moll's subsidiary wish was to include SEB as well as Handelsbanken and Skandinaviska Banken. The governor's request had the effect of making a reluctant director of Centralbanken invite the three banks into the affairs. SEB, however, withdrew from negotiations, on the bases of unfavourable economic conditions.

In the following years, several krone-credits, financing belligerent countries' import from Sweden, were concluded between private banks on both sides of hostilities. Although an effort was made by the Swedish government to balance this lending – e. g. like the 40 million krone credit to France – the bulk of Swedish credits, both through exporters and banks, were put at the disposal of Germany. There are a number of explanations for this, one being the effect of Swedish capitalist élites' traditional sympathy for Germany. Sweden's geographic position also played a role; Germany was only a short boat trip away, an important factor as warfare at sea intensified. Furthermore, as Germany got the upper hand of the economic warfare in Sweden, dominating her export sector at an early stage, an expanding credit directed towards this country came naturally. When, on the other hand, a credit to England was rejected in 1916, relationships between the two countries deteriorated.

Interestingly enough, with the exception of a German loan in July 1917, amounting to 15 million kroner, few if any of these credits seems to have been put forward by Riksbanken. This is all the more interesting when compared with developments in Norway and Denmark. With Riksbanken's political affiliation in mind, why this reluctant attitude? The answer is likely to be the direct effect of exactly this political affiliation. All of the Scandinavian countries were anxious to uphold neutrality, almost at all costs. Supplying one of the belligerents with credit from the parliament's own bank would send some very unfortunate signals to the counterpart. Where the other two private central banks were subjected to hard pressure from their governments, Riksbanken's position paradoxically seems to have safeguarded some sort of independence under the new political-economic situation. As governments and wartime policies in all three countries were often the subject of harsh criticism from parliamentary opposition, an attempt to challenge the parliament by imposing government policies on "their" institution probably would have seemed like a rather costly venture to engage in. Thus the Swedish government had to rely on other sources of credit in efforts both to accommodate belligerent countries and uphold the export industry, and from 1917 onwards to secure vital deliverances.

I would suggest that another important explanation to Riksbanken's lack of contribution in supplying belligerent credits is to be found in the somewhat different banking structure in Sweden than in Denmark and Norway. These countries had a large and expanding number of small

banks, whereas the structure of Sweden's bank sector showed the opposite development prior to the war. In Sweden, a number of merges had created large banks with the capacity of supplying large credits. Riksbanken's contribution was basically not needed to the same extent. Finally, a possible result of few and large banks is political influence. This undoubtedly was the case in Sweden, where Knut A. Wallenberg, former CEO of family business SEB, had stepped down as Chairman of the Board in 1914 when he was appointed Minister of Foreign Affairs in Hammerskjöld's government. In 1915, during the negotiations of the first German loan, Wallenberg was clearly well informed of the proceedings. Although it is not believed that Wallenberg was himself an important factor in SEB's rejection of the German conditions, and the reasoning thus is said to have been based on purely economic considerations, it can not be ruled out that there was a mixture of political and economic considerations in what was in effect considered "state loans" negotiated at a later stage. In 1916, SEB ended up engaging in their first of several credits to Germany, with CEO Marcus Wallenberg, Knut's half brother, at the wheel. Thus, compared to the other Scandinavian countries, Riksbanken was abundant, for a limited number of large, powerful banks with political influence where required to play the same role. A different question is what the Swedish government would have preferred. The present situation seems to have safeguarded the use of Riksbanken and seemingly laid the final decision upon the private banks, but, on the other hand, it is not at all certain that the outcome would have been very different with more governmental exercise of power in these credit schemes.

2.2 Fear thy Neighbour – how Denmark's Geography Governed her Monetary Policy

As already indicated, Denmark's geographical position was crucial for the outcome of her foreign credit policies. There was a widespread anxiety in the Danish society that an invasion by Germany was a viable possibility. This fact affected Denmark's policies in many regards.

During the course of the war, Denmark facilitated credits to the belligerents to a total of 299 million kroner (see table 3) ; yet to arrive at the total Danish means of payment put at belligerent disposal, one must add another 97 million kroner, which was the sum of gold purchases by Denmark arranged in concurrence with the facilitating of credits. Of the 299 million, the major private banks contributed approximately two thirds, whilst Nationalbanken's credits totalled 97.8 million. The bulk of the credit was directed to Germany and the Central powers. Austrian banks borrowed almost 10 million kroner in December 1917 and March 1918, Hungarian banks a little more than 4 million kroner in the same two months. Germany obtained credits totalling 195 out of the 299 million kroner between December 1915 and July 1918. In addition to these credits, German banks were the sole sellers of the above mentioned gold; in fact they sold gold in conjunction with all nine credit arrangements but one. Furthermore, Nationalbanken supplied credits of approximately 37 per cent of the total German loans, compared to only 25 and 27 per cent of the three loans to French and British banks.

These statistics show a clear preference for the Central powers in the Danish crediting of the belligerents. It is also obvious that Nationalbanken was a major contributor in these credits, and as far as statistics are concerned, Nationalbanken's contributions also seemed to show a distinct preference for lending to German banks. The reasons are several, of course. This interpretation of the statistics could easily be exaggerated, as the so called preference on behalf of Central Powers can also be explained by the fact that the credits were needed to a greater extent by these countries. To put it another way, the fact that British banks are not represented in the statistics as borrowers after a loan of 30 million kroner in November 1917 – after which German, Austrian and Hungarian banks borrowed nearly 65 million out of their total 209 million – could also be

Table 3. Nationalbanken's credits to the belligerents (in DKK). Source: table 2.14, "Banklån under krigen 1914-18", in Olsen & Hoffmeyer, *Dansk Pengehistorie 1914-1960*, p. 55.

Lender	Amount	Date
Germany	30 mill	December, 1915
Germany	10 mill	June 1916
England	10 mill	July 1916
France	7.5 mill	August 1916
Germany	5 mill	December 1916
Germany	7.5 mill	February 1917
Germany	8 mill	September 1917
Germany	0.9 mill	October 1917
England	6 mill	November 1917
Germany	4.5 mill	December 1917
Austria	1.3 mill	December1917
Hungary	0.5 mill	December 1917
Germany	3.5 mill	March 1918
Austria	0.7 mill	March 1918
Hungary	0.3 mill	March 1918
Germany	2.1 mill	July 1918
Total	**97.8 mill**	

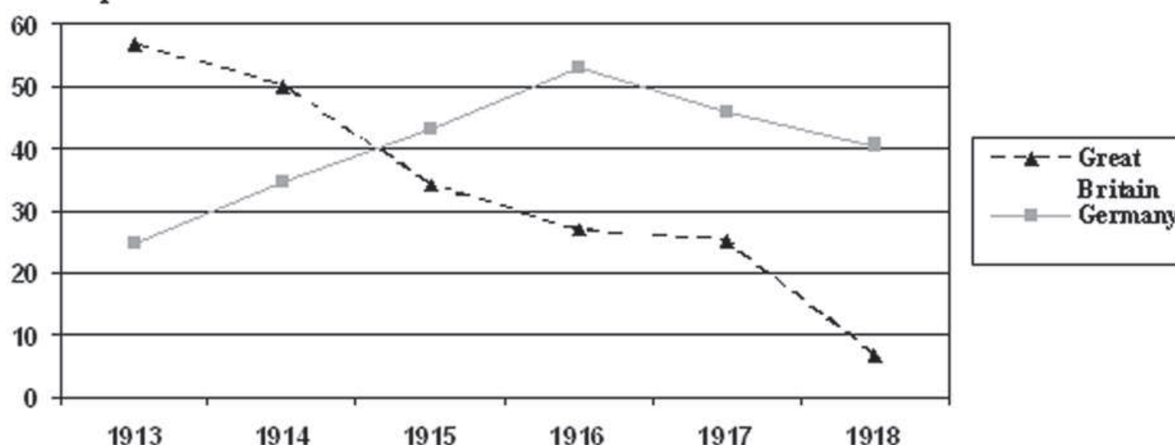
The table has been modified somewhat for sake of the argument and comparison. The original table specifies that the lenders are banks (e.g. "German banks", "English banks") and also contains information of the total credit supplied and amount covered by the private banks in each of the credit agreements, in addition of mentioning the amount of gold paid in each of the incidents.

explained partly by the results of the battlefields and the fact that USA had joined forces with the Entente. At this stage the British were probably dependent on neutral credits to a lesser degree in upholding their economy, in comparison with their enemies. Nationalbanken's preference for German lending could likewise be interpreted as the opposite: Danish private banks' preference for and confidence in supplying credits to the Entente, whilst Nationalbanken thus was forced to supply the Central powers.

The credit statistics must, all the same, be interpreted in light of trade statistics. Great Britain's pre war dominance over the Danish export sector fell rapidly from almost 60 per cent share in 1913, to less than half this share in 1916 (see figure 2). The Germans simultaneously saw their share of exports rise from a quarter to more than 50 per cent in the same period of time. In this occurrence Danish bank credits were both cause and effect. The reduction in British imports facilitated a reduction in credits, leading to a further reduction in imports, whilst the German example saw the development of exactly the opposite trade and credit spiral.

One reason behind this development was the before mentioned anxiety over a German invasion. Concluding the first German loan in 1915, Nationalbanken gave three reasons for the engagement in their protocol. One was purely out of business concerns, as Nationalbanken felt that the gold they bought as part of the agreement was needed, and furthermore the bank obtained a much wanted current account in the Reichsbank. Another line of reasoning behind the credits was the politics of trade: Denmark was far from self-sufficient in goods other than livestock and thus needed the products for which Germany was now the most obvious supplier. Because of Germany's war, Denmark had to concede export products to obtain these necessary goods. Normal credit arrangements were no longer sufficient for countries at war; but the Danish exporters had been losing interest in the German market, as the rate of the German Mark had experienced a steep drop, which meant they

Figure 2. *Per cent share of Denmark's total export value 1913-1918* **, source Henriksen and Ølgaard,** *Danmarks udenrigshandel* **, Studier fra Københavns Universitets Økonomiske Institut, nr. 2, G. E. C. Gads forlag, København 1960, computed from table 2.**



received small amounts of kroner for their Marks. As the lending of krone by Nationalbanken to Germany spurred the Mark to appreciate, exporters regained interest in the German market. Finally, the most important line of reasoning behind the German loan was political pressure coupled with anxiety over what would be the likely outcome of refusing. Although it is not highlighted as the main reason in the protocol, Riksbanken began her reasoning with the following words: "the motive for nationalbanken [sic] to concur in the agreement is in addition to the Ministry of Foreign Affairs' wish (…)", whereupon mentioning some more economic considerations. The foreign political motivation was however the most important, explained quite clearly in Dansk Pengehistorie: "One should not upset big, strong powers, being a small country eager to uphold its neutrality." Legal director Carl Ussing describes in his post war book of Nationalbanken how this anxiety in many instances became vital to the banks actions, as it was "a most serious matter to deny. Denmark could not risk becoming enemies with her southern neighbour." Having negotiated with the Ministry of Foreign Affairs, Nationalbanken had to take full responsibility to avoid any risk that the Danish government would be suspected of supporting one of the belligerents. Ussing reveals the considerations made by the Board of Directors, as maintaining monetary value lost its importance: "up against the concern for the country's safety, upholding its neutrality and the preservations of business, other concerns had to let go".

In addition to maintaining the value of money, private economic considerations were Nationalbanken's first casualty of war, and politics of trade and foreign policy gained prominence. Negotiating a new government initiated loan in February 1916, the protocol of the central bank states explicitly that the loan is in the wish of the Minister of Foreign Affairs Scavenius, for the benefit of Danish exports. Furthermore, a draft letter to the same minister states quite clearly that neither Nationalbanken nor the private banks in question had any real interest in the agreement: "it was agreed upon to bring to your attention, that the banks on their behalf have no wish to conclude the considered business agreement, but on the other hand are willing to, when the Ministry of Foreign Affairs consider it necessary or also for the benefit of the nation."

In letters between members of the Board of Directors in July 1917, the awareness of the loss of both business concerns and Nationalbanken's primary objectives are most evident: "I agree that we must accept the proposal, as this is not the time for a 'rational' bank policy". An answer the

following day states that Nationalbanken must do whatever it deems necessary and responsible if possible to "give our contribution to rescuing Denmark from the big settling of accounts taking place".

By the end of 1917, the pressure from the Danish government, without willingness to take a political or economic responsibility, was becoming unbearable for Nationalbanken. During the negotiations of yet another government initiated loan in November, the central bank tried to get the Danish government to take their share of responsibility if proceedings were to be upheld, but it was initially a futile attempt. However, in February the following year, concluding another German loan, the efforts succeeded. The conclusion of a credit agreement was of the utmost importance for the Danish government. However, as the representatives of Nationalbanken stated that the bank would not contribute to any agreement without a state guarantee, and the four private banks in question were not interested in further proceedings without Nationalbanken, the government gave in. State guarantees were given, Nationalbanken obtained economic safety, but most importantly, the political responsibility was put in its rightful place. The efforts of Nationalbanken vis a vis the Danish government was to find its parallel in Norges Banks efforts the same year.

2.3 Fishy Business – Norwegian Concerns in Upholding one of her Industries

Norway differed from her two Scandinavian counterparts, in that the most imminent threat was not Germany, but Great Britain. British imports were crucial to Norwegian business and were to play a decisive role in the broader economic policy, ultimately effecting monetary policy. As has been stated, the Norwegian case has more in common with the Danish than the Swedish case. However, the role of Norges Bank in accommodating the belligerents seems to have been even greater than in the case of Nationalbanken. Whether the reasons lay more with a nervous, yet powerful government than with a subservient central bank, the research has not yet concluded. But there is no doubt that the government lay great pressure on Norges Bank, and the central bank Board of Directors guided much of their policy with strong regard to whatever was beneficial for the nation.

Even though the thorough statistics from the Danish credit facilitation are lacking in the Norwegian case, the statistics available reveal much of the differences mentioned (see table 3). The total credits put at disposal for the belligerents amounted to almost 350 million kroner, a sum substantially greater than total Danish crediting, although comparable. The major difference, however, stems from credits' direction and central bank participation.

Norges Bank supplied the belligerents with more than 200 million of the 346 million kroner, i.e. nearly 60 per cent of the credits, whereas Nationalbanken, from her side, supplied one third of Danish total belligerent credits. Furthermore, the direction of the credits is obviously in favour of the Entente, as 255 million of the total Norwegian credits, or nearly 75 per cent, were put at the Entente's disposal. The private banks were obviously reluctant to support the Germans with their credits as only one loan was directed towards Germany. This loan amounted to less than 20% of total private bank crediting, and was conditioned by the participation of Norges Bank. The Norwegian central bank likewise contributed more to Great Britain than Germany, which were the only two countries to whom Norges Bank offered credits, though Germany was offered less than a third of the central bank's total crediting. Nevertheless, four of the five loans were directed towards Germany.

The story behind these credits is, however, more interesting than the bare numbers. The German loans of Norges Bank, like the French and other Entente loans from the Swedish private banks, in general seem more than anything to be loans negotiated with the intention of balancing loans to the borrowers' enemies. All of these German

Table 4. Norges Bank's credits to the belligerents (in NOK). Source Rygg, *Norges Banks historie II*, pp. 507-508.		
Lender	**Amount**	**Date**
England	140 mill	September, 1916
Germany	6 mill	August, 1916
Germany	40 mill	December, 1916
Germany	15 mill	May, 1917
Germany	3 mill	October, 1918
Total	**204 mill**	

loans most likely were an outcome of the large and much criticised British credit agreement concluded on the 5th August 1916, an agreement which shall be dealt with in greater detail later. The first Norges Bank loan to German banks consisted of symbolic "pocket money", at a total of 6 million kroner, a sum that could never be considered harmful for the central bank. But as it was concluded in the same month as the top secret British loan of 140 million, it is likely it was seen somewhat as a pay-off. The Germans' reaction to both this secrecy and a Norwegian-British trade and credit agreement that seemed to push the limits of neutrality was a freeze in diplomatic relations. The second German loan from Norges Bank was thus concluded at the end of 1916 after great diplomatic and political turmoil; the central bank this time felt obliged to put 40 million kroner at the Germans disposal. When again a new credit of 15 million was negotiated in May the following year, Norges Bank was put under pressure by the Norwegian government, which most likely felt obliged to accommodate the German threat, after months of submarine warfare. Finally, at the time of the last central bank credit directed towards Germany in October 1918, pressure from the government was even more intense. Norges Bank only contributed with 3 million out of a credit of 30 million kroner, but the negotiations were conducted simultaneously alongside government negotiations of a trade agreement and letters of safe conduct. The central bank struggled in vain to obtain a state guarantee for their contribution. What Norges Bank obtained, however, was a secret promise from the Minister of Trade and acting Minister of Finance Friis-Petersen and Minister of Foreign Affairs Ihlen. Under the precondition of Norges Bank guaranteeing the potential risks of the participating private banks, the government, on their part, would give their recommendation to the parliament that the state was to take responsibility of potential losses.

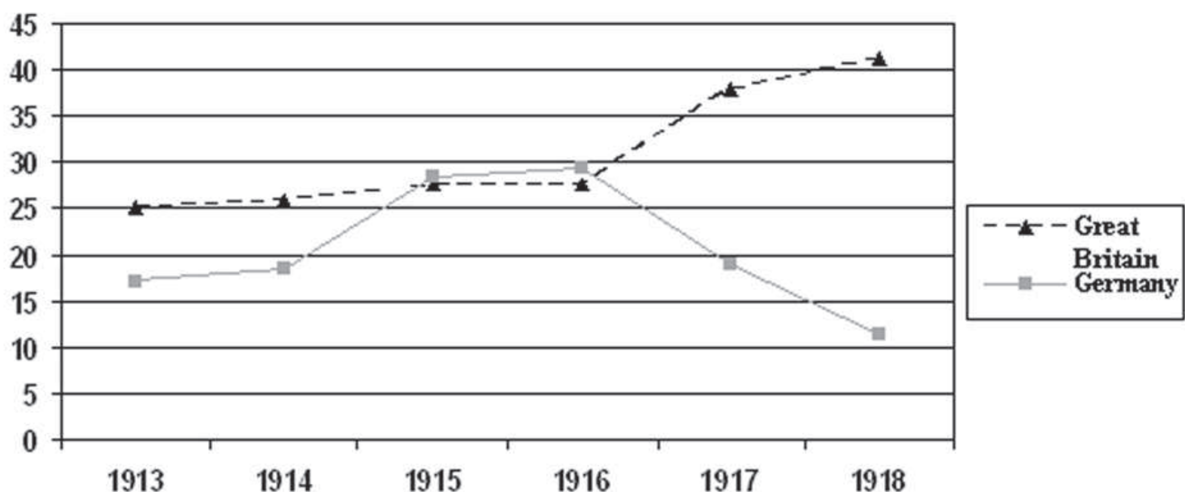
In the course of this last incident, Norges Bank, like Nationalbanken the same year, finally succeeded in gaining both economic and political security of their reluctant contribution to what was above all else governments' efforts to stay neutral. Norway, the "neutral ally", had, however, decided where her lay in the ongoing conflict. In the summer of 1916, she by all practical standards started a de facto cooperation, the so called fish agreement with Great Britain was negotiated. The background to this cooperation is to be found in Norwegian reliance and dependence on British imports, which for the massive Norwegian fishing industry was a necessary condition in upholding business. Furthermore, the motives are to be found in a liberal government with strong reformatory ambitions, and faithful believers in the political control of the economy during the crisis. Finally, the Norwegian politicians and public in general were also in favour of cordial relations with the British, the opposite of Swedish élites' position.

The fish agreement was the outcome of Germany and Great Britain's economic warfare on Norwegian soil. In 1915 Germany via agents had conducted massive purchases of fish in the open market, attempting to secure herself with necessary supplies. The results are easily traced in the trade statistics, as the value of German

exports rose by more than 150 per cent from the previous year (see table 3).
The sharp rise in export values also was an effect of the rise in prices, which was an obvious result of the open market fish purchases. This development was far from pleasing in the eyes of the British, especially as London was fully aware that necessary equipments and goods in upholding the Norwegian fishing industry were by and large imported from England. In the winter fish season of 1915-16 Great Britain, after secret negotiations with the Director of the Norwegian fisheries acting on behalf of the Norwegian government, chose to initiate a campaign to counter and block the German purchases. The strategy was chosen instead of another discussed option: effectively shutting down the Norwegian fish industry – and thus making 100,000 men unemployed – by bringing a halt to this industry's imports. Norwegian fishermen in response had to concede declarations that the necessities imported were not to be used in supplying enemies of the Entente. The British campaign was conducted with British means of payments, where nearly 150 million kroner were spent, of which a substantial portion by shipment of gold to Norges Bank in the spring of 1916.

With these gold shipments, the Norwegian central bank's role in the later fish agreement was initiated. Although England acted in conclusion with self-interest, she by no means had need for the Norwegian fish. On the British side, it was felt that choosing the path of blockade purchases and thus maintaining a Norwegian fish industry was in many respects doing Norway a favour. The Norwegian government did not share this point of view, and felt British demands and new control measurements over substantial parts of the Norwegian economy as increasingly meddling in Norway's affairs. However, with the threat of cutting off supplies, the British government held the upper hand. The Norwegian government succeeded in gaining Norges Bank's support in the scheme, as the bank agreed to lower its commissions buying British gold – the commissions of which increased due to the increased preference to gold shipments by belligerents as means of payment as currencies fluctuated greatly. Nevertheless, Norges Bank's price demands of subsequent gold shipments from England contributed to the bank's termination of negotiations in May-June of yet another deal. The demanded provisions of 5 per cent were among several incidents to upset the British negotiators.

Figure 3. ***Per cent share of Norwegian exports 1913-1918*****, source *Norges Offisielle Statistikk XII 245*, Historisk Statistikk 1968, Statistisk Sentralbyrå 1969, computed from table 165**



Thus, in the final attempts of negotiating another deal in July 1916, which subsequently led to the fish agreement, the Norwegian government probably had powerful means of pressure in obtaining the contribution of the central bank. The government, especially the acts of Prime Minister Gunnar Knudsen, and the work of the commission of supplies, is said to have been the principal reasons behind the halt in the May-June negotiations. Nevertheless, in Norges Bank the risk of yet again contributing to another halt in negotiations, and thus bringing the fish industry to its ruin, resulting in massive unemployment, probably contributed to the decision taken by the Board of Directors. It was swiftly decided that Norges Bank was to take a decisive part in the two governments' agreement by supplying England with the entire credit of 140 million kroner. The research so far does not indicate strong resistance to this scheme by Norges Bank's Board of Directors, or that there were any attempts on behalf of the central bank to pass the supplying of credit over to the private banks, but here work remains to be done. The Government all the same put substantial pressure on Norges Bank, as it was clearly understood that a deal had to be made, and that the bank's contribution was vital.

The Norwegian central bank on the other hand repeatedly made forceful efforts to ensure that British promises to deliver specific vital goods were a part of the agreement, and thus a necessary condition for credits. These deliverances were not to be confined to the fish fleet, as Norges Bank also wanted to make the agreement contain promises of delivering supplies to Norway's broader industry, and households in general. In fact, in their negotiations with agents on behalf of the British government, Norges Bank succeeded in obtaining a clause in the separate credit agreement where such a condition was specified. However, the Norwegian government in the main negotiations with the British representatives was not capable of securing the same promise, and the clause was removed. Norges Bank thus never came closer to its initial conditions than a declaration from the Norwegian government, that the agreement with regards to imports was concluded "in a manner satisfying to the government". This notwithstanding, Norges Bank repeatedly claimed her initial conditions both in letters to the Norwegian government and to her business partners in England, and thus is said to have contributed to British deliverances of necessities.

3. Concluding Remarks

The constraints under which the Scandinavian central banks conducted monetary policy during First World War were truly burdensome. The banks were expected to contribute to their governments' economic policy, and though the banks made some resistance, it was understood that their special position entailed some sort of subordination to what the governments believed to be in the nation's best interest. However, this was not necessarily in conflict with traditional central bank policy, as one of the main targets of policy was looking out for national business. This notwithstanding, the political subordination thus meant that the main objective of monetary policy, maintaining monetary value, became one of many objectives. From this perspective, much of the criticism directed at the central banks for leading an inflationary policy both during and after First World War, probably should have been directed towards the Scandinavian governments. Nevertheless, the governments likewise were under hard pressure from the belligerents on one side and the potential "meltdown" of national business on the other. If it at all was completely understood, sacrificing the main objective of traditional monetary policy must have been of minor importance to the governments during the course of war, and thus an easy decision to make.

The Swedish case displayed some key differences from the two other countries, as Riksbanken did not contribute directly to the belligerent credits – at least not to any great extent – and

it was suggested this paradoxically stemmed from her initial political subordination to the parliament. In concurrence with this, the Swedish banking structure was different form her neighbours. However, the consequences of the credits seems to have been the same in all three countries, as Riksbanken was obliged to rediscount papers from the enskilda banks. The objections from Governor Moll fell short of the Swedish government's interest. This is where Nationalbanken and Norges Bank's private ownership gave them opportunity to at least make some demands as a necessary condition for contributing to the credits. The research so far does indicate that they to some extent were successful.

The pattern of Scandinavia's pre war foreign trade differed significantly from the development during the course of war. This was only natural as the countries' geographical position made them more disposed to both economic warfare and warfare at sea. Belligerent crediting was both cause and effect in a trade-and-credit-spiral, in which Sweden and Denmark supplied credit and traded with Germany, whereas Norway thus strengthened her British ties. However, Sweden's traditional exports and the size and structure of her economy, meant that her economic performance during the war outshone that of Norway and Denmark.

This point will be developed further in this working paper, as differences in economic performance made the three currencies fluctuate greatly in these years when the Scandinavian Monetary Union still was in effect. This constituted an internal economic pressure on the three Scandinavian central banks that guided their actions, and must be added to the political pressure they were exposed to. A third line of pressure will also be dealt with at a later stage, namely the continuous contemporary public attacks directed at the central banks from national economists. The attacks, led by prominent economists like Gustav Cassel and Knut Wicksell, were harsh, and the attackers did not at all share the view of the central banks, that monetary policy had to be conducted with an eye to more than maintaining the value of money.

Gjermund Forfang Rongved

Gjermund Forfang Rongved is currently a PhD research fellow at Institute for Archaeology, Conservation and History; University of Oslo. His working paper: "Under Pressure: The central banks and neutral Scandinavia's politics of supplying belligerents with credit during the First World War" is the revised version of a paper he presented on last year's EABH Young Scholar Workshop in Rotterdam.

The Sixth Annual Conference of the South Eastern European Monetary History Network (SEEMHN)

Bucharest, 17-18 March 2011

The National Bank of Romania hosted the sixth annual conference of the South Eastern European Monetary History Network (SEEMHN) in Bucharest during 17-18 March 2011. The SEEMHN is a community of historians and economists that was established in April 2006 at the initiative of the Bulgarian National Bank and the Bank of Greece. Its objective is to disseminate knowledge on the monetary and political history of the region in the context of European experience. A conference focusing on topics related to south-east Europe is held on an annual basis and is hosted by the central banks in the region. Discussions draw on the historical experience in terms of the lessons to be learnt that could help explain current developments and forecast future ones. Both the initiators and the supporters of this project share the belief that understanding past experiences helps economic policymakers not only in tracing the roots of the ongoing global crisis, but also in identifying the necessary steps towards implementing a prudential supervision framework that would prove effective in fending off crises in the future.

Day one of the conference, i.e. 17 March, saw the 8th meeting of the SEEMHN Data Collection Task Force (DCTF). Given that research in the history of economics implies the use of statistical data capable of conveying key information on economic developments over the medium and long term, the SEEMHN DCTF meeting marked yet another occasion to step up efforts towards obtaining top-notch data series by scientific standards. Participants presented and discussed the progress achieved so far, with a special fo-

cus on the structure of tables encompassing the collected data as well as on the actual indicator content. In order to minimise any errors likely to emerge during data collection and processing, participants agreed on the need to perform crosschecks among group members, so as to ensure the highest degree of consistency of collected data.

Day two of the SEEMHN meeting in Bucharest, i.e. 18 March 2011, was devoted to presentations delivered at the conference "Monetary Policies and Banking Institutions in South-Eastern Europe between National Objectives and European Patterns – a Historical and Comparative Perspective". Since SEE countries enjoy a vast experience in taking over and customising economic development patterns put forth by the Western world, the conference focused on the importance of choosing the most suitable development model and its effective implementation with a view to bridging the gap in terms of economic development and not only. Thus, the topic was a good opportunity to examine, based on comparative economic history, the paths pursued by countries in the area when adopting development patterns that had proved successful in Western economies, as well as their efforts towards tailoring the relevant rules to local realities and possibilities.

Researchers in the field of comparative economic history – members of the academia or central bank officials – took this opportunity to speak about the recent outcome of their work. Bogdan Olteanu, Deputy Governor of the National Bank of Romania, delivered a warm welcome address to the participants. Daniel Dăianu, a former Minister of Finance in Romania, shared, in his capacity as keynote speaker, his opinions on the ongoing crisis and its similarities and dissimilarities vis-à-vis other such events in the past.
Later, the conference featured the papers submitted in the first session dedicated to the evolution of monetary policies and banking institutions. In this section, Yüksel Görmez and Serkan Yiğit (Central Bank of Turkey) gave an insight of the changes to monetary policies and banking institutions in Turkey. Matthias Morys (University of York), referring to the "classical gold standard"

and the key question whether the countries follow the so-called "rule of the game", deemed that the peripheral countries follow different rules than core countries in Europe, in terms of discount rate. Martin Ivanov (Bulgarian Academy of Sciences) investigated the influence of universal banks in Bulgaria on the economic growth from the 1890s to the 1940s.

The second session that took place in the morning focused on research in the field of European economic thinking. Nikolay Nenovsky (University of National and World Economy, Bulgaria; University of Orleans, France) expressed his thoughts on Bulgarian economists' views regarding the developments stemming from the Great Depression as an example for the economic thinking exhibited by peripheral European countries. Dominique Torre (University of Nice Sophia-Antipolis, France) looked at the monetary views of Paul Einzing, an economic journalist and analyst who was born in Braşov, Transylvania. Closing the second session was Ivo Maes (National Bank of Belgium) who highlighted Alexandre Lamfalussy's works on the international and European monetary system.

The two sessions that took place in the afternoon analysed a number of issues relating to finance and economic development. Eric Girardin (Université de la Méditerranée, France) presented his comparative research on the long-run relationship between the silver stock, output and prices in the core and periphery of Southern Europe during the sixteenth-eighteenth centuries. Dragana Gnjatović (Megatrend University, Belgrade) spoke about the experience of introducing European institutions in the financing of agriculture in Serbia, most notably Raiffeisen-type farming credit cooperatives from 1894 to 1913. George Virgil Stoenescu, Adriana Aloman, Elisabeta Blejan, Brînduşa Costache (National Bank of Romania) presented the Romanian experience with regard to the introduction of the gold standard and its adjustment to the local economy at the end of the nineteenth century. Wrapping up the session was Martin Pontzen (Bundesbank) who talked about the developments in the German bond market throughout the twentieth century.

In the final session, Kim Oosterlinck (Université Libre de Bruxelles, Belgium) and Loredana Ureche-Rangau (Université de Picardie Jules Verne, France) provided an overview of the factors that impacted Romania's sovereign bond prices on the Paris Stock Exchange in the interwar period. Olga Christodoulaki, Haeran Cho and Piotr Fryzlewicz (London School of Economics and Political Science, United Kingdom) examined the historical events' influences on expectations of the sovereign risk of Greece in the period 1914-1929. Kiril Kossev (Nuffield College, University of Oxford) gave a description of the structure of the financial sector in two Balkan countries in the period 1919-1941 and its impact on the real sector. Finally, Milan Sojić and Branko Hinić (National Bank of Serbia) discussed the measures taken by the Federal Republic of Yugoslavia to curb inflation in 1994.

The papers submitted at the Bucharest conference will be published shortly in a book to be edited under the auspices of the National Bank of Romania.

The next SEEMHN Data Collection Task Force meeting will take place during 29-30 September 2011 and will be hosted by the Deutsche Bundesbank.

The 7th SEEMHN annual conference will take place in 2012. The date and the host country will be announced by the participating central banks on their websites (e.g. the link to SEEMHN annual conferences can be accessed on the website of the Bank of Greece http://www.bankofgreece.gr/Pages/en/Publications/Studies/seemhn.aspx).

Islamic Finance in Europe
Tools for Development of a Plural Financial System

From 30 June to 1 July 2011 Dr. Valentino Cattelan, Università degli Studi di Roma Tor Vergata, in cooperation with CEIS (Centre for Economic and International Studies) and the Jean Monnet Centre of Excellence – University of Rome Tor Vergata, organised a two-day Summer School in order to pursue a better understanding of the emerging Islamic finance market, from the Muslim region to Europe. The school is part of the broader academic project: "The European Module on Integrating Islamic finance in the EU market", granted by the European Commission – Lifelong Learning Programme (2011-2013).

"The growth of Islamic Finance in recent years is one aspect of the increased role being played in the global financial system by a number of emerging economies. This is of course a welcome development… (but) as the recent crisis has taught us, growing complexity calls for enhancing international cooperation by policy-makers and regulators" (Mario Draghi, Banca d´Itlaia, 2009)

Currently, Islamic financial institutions´ assets amount to over 2 trillion USD and as such it is an attractive area of investment for European bankers. In addition it is an interesting research topic and is broadly discussed as an alternative technique for financial intermediation and tool for economic development. But where does Islamic finance come from? What are its roots? What makes it different from conventional finance? How did IF develop in the course of history, especially in Europe? Why does it matter for us? How could historical experience be used as a tool for development? How do financial assets comply with the Islamic law that prohibits charg-

ing or paying of interest? Which tools are used to implement compliant assets?

The Summer School addressed financial practitioners as well as students and researchers in the field and offered a comprehensive approach to Islamic economics and law related to the financial sector, particular attention to the emergence of an economic and legal pluralism in Europe. A multidisciplinary approach was used to provide participants with proper tools to understand the present evolution of Islamic finance in relation to the EU market. In this context, the hybridisation of economic and legal structures, as a result of the meeting between foreign cultures and the West is an important factor as cultural requirements and ethical demands play an important role when it comes to financial transactions.

In the aftermath of the recent democratic revolutions, of course, the conference started by shedding some light on recent developments in the region, with specific regard to Egypt; Prof. Adel A. Beshai from the American University of Cairo gave an introduction to the cultural and political peculiarities of the region and presented the "Future Economic Reform of Arab Countries after the Call for Democracy". Dr. Salman Syed Ali (Islamic Research and Training Institute - Islamic Development Bank) introduced the participants to the topic of "Financial Stability and Economic Reform from an Islamic Perspective". Syed Ali provided a broad perspective to Islamic economic theory from the lack of speculation to the contribution of investments in real economy to the global financial stability.

Dr. Ridha Saadallah (University FSEG Sfax) explored a definition of the specific context of Islamic Finance recalling the Sharî´, a principle that underlies the system with the aim to extract the operating principles for Islamic Finance Transactions. In the afternoon the Summer School analysed two topics of strong interest, from an economic as well a social point of view.

Prof. Laurent Weill (EM Strasbourg Business School, University of Strasbourg) analysed the economic consequences of the expansion of Islamic finance in the EU. He mostly focused on the role of IF on economic development; its quantitative and qualitative role.

Dr. Deborah Scolart (School of Law, University of Rome Tor Vergata) discussed the role of women in social and economic development in Muslim countries, as well as presenting effective instruments to achieve women empowerment. Prof. Claudio Porzio (University of Naples, Parthenope) held a presentation on "Islamic Banking Risk Profile and Prudential Regulation". As a subject matter expert presented the peculiar risk profile of Islamic financial transactions, comparing them with conventional contracts, and consequently showed appropriate innovations to be introduced in order to achieve better integration of Islamic and conventional finance tools. The day was brought to a close by Valentina Costa (University of Rome Tor Vergata), who introduced her fieldwork in Egypt on Islamic Microfinance and its positive effects on women social empowerment to the audience.

Day two started with an analysis of how Islamic tradition differs, both in the conceptualisation of norm creation and the allocation of legal economic entitlements, from the common Western idea of justice. Prof. Werner F. Menski (School of Oriental and African Studies, University of London) analysed "Law as Kite: Managing Legal Pluralism in the Context of Islamic Finance". Prof. Menski applied global legal theory to the practice of Islamic finance and argues that per definitionem the practice of Islamic finance anywhere requires the plurality-conscious management of different and competing concepts of law that we all seem to struggle with. Dr. Valentino Cattelan (School of Economics, University of Rome Tor Vergata) presented a lecture on the topic "From the Idea of Haqq to Islamic Contract

Law". He interpreted the fundamental prohibitions of Islamic contract laws within the cultural background of Muslim tradition.

Sessions focused on the policies by European governments to manage Islamic finance followed. Dr. Jonathan G. Ercanbrack (School of Oriental and African Studies, University of London) examined the United Kingdom as the most advanced jurisdiction in Europe in the management of Islamic finance. In particular Dr. Ercanbrack presented the FSA approach to regulating IF and highlighted the risks of this approach and its effects on the provision of Islamic financial products in the UK market. Ibrahim Zeyyad Cekici (University of Strasbourg) presented France as a newcomer in the market, with a speech on "Managing Islamic Fiance Vis à Vis Laïcité: The Case of France". His text exposes two groups of texts, giving a legal and tax framework for Islamic financial and banking products.

After these theoretical considerations, Alberto Brugnoni (ASSAIF Milan), a former director of Merrill Lynch Bank, spoke about "Europe and Sovereign Bonds: the Opportunities of the Sukûk Market". The presentation focused on the current state of the debate in those European countries that have declared their interest in the issuance of a sovereign sukûk. Governments' reasons for such an issuance are diversification of the budget, attraction of foreign investments, funding of infrastructure and the provision of an investment outlet for local Islamic banks to park their capital. A discussion on "Structuring Sharîah Compliant Legal Transactions: The experience of Norton Rose, a Leading International Legal Practice" led by Farmida Bi, Federica Periale and Francesa Staffieri (Norton Rose LLP) ended the event, providing all participants with lots of insights from the daily legal practice of the recognised market leader in Islamic finance. They did groundbreaking work with the first Islamic retail bank to open in the West, which is now advising the UK government on Islamic financing.

EABH Members interested in one or more topics of the Summer School are kindly invited to contact Dr. Valentino Cattelan for a copy of the speakers´ presentations delivered in Rome. Prof. Cattelan will edit a book under the title Islamic Finance in Europe – towards a plural financial system (to be published by Edwar Elgar in 2012). The EABH will inform you as soon as the edition has been launched.

Dr. Valentino Cattelan

Dr. Valentino Cattelan is currently Post Doctoral Research Fellow at the School of Economics, University of Rome Tor Vergata. He is qualified as a lawyer in the EU, and he actively contributes to seminars, workshops and conferences in Islamic law and finance. His major fields of research are comparative law, methodology, Islamic law of contracts and its application in the Islamic financial market. As coordinator of the European Module "Integrating Islamic finance in the EU market", he promoted the Summer School outlined in these pages.

EABH is currently working on the enlargement of the Association's thematical scope and therefore preliminary considerations on Islamic principles and methods in the European financial system are in progress. A workshop on the topic is planned in the near future.

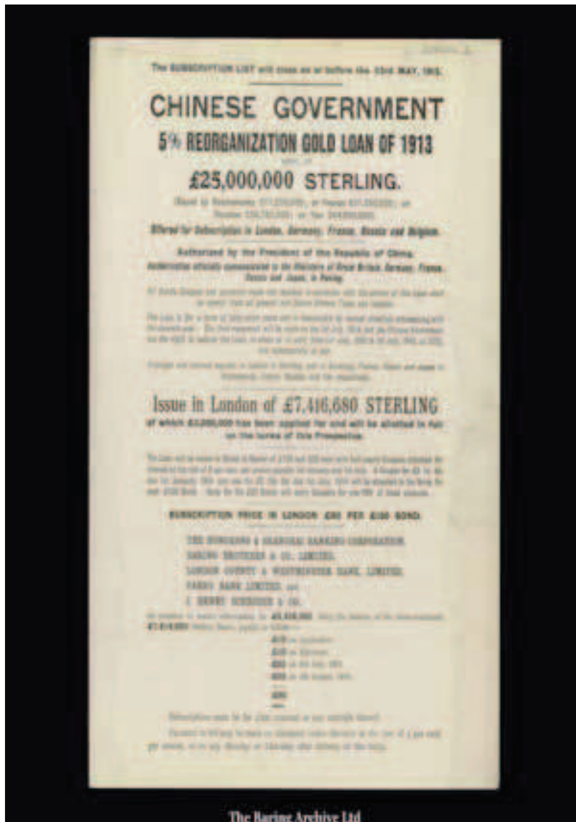
The Baring Archive's Collection of Prospectuses

The Baring Archive's collection of prospectuses has now been digitised and is available to search and view online. The collection documents over 300 transactions involving Barings and spans more than 100 years of the firm's history.

From the mid-nineteenth century, the business of issuing securities for governments and companies greatly increased. As one of London's leading houses, Barings was involved in some of the most significant transactions of the day. Domestic clients included a number of companies who remain household names - Guinness, Goodyear, Whitbread and W H Smith, to name but a few. Sovereign issuers included Argentina, Canada and Japan, all of whom demanded funds for public works. During the 1800s, the booming railway industry provided Barings with the majority of its overseas corporate clients. Major feats of engineering, including the Canadian Pacific Railway and the Trans-Caucasian Railroad received capital from Barings transactions.

The Baring prospectuses provide a remarkably comprehensive record of the securities transactions handled by the firm between 1850 and 1966. Issues of securities were generally preceded by the publication of a prospectus. With a view to attracting investment, prospectuses would advertise the size and price of a transaction and often, publicise the issuer's purpose in raising new funds (a railway company, for example, would sometimes enclose a map of their proposed route). Certain facts regarding the issuer would also be stated; usually, the company's registered address and a list of its directors. As a result, these documents offer a wealth of information regarding leading British and foreign firms, together with the activities of the banking houses that helped them to flourish.

http://www.baringarchive.org.uk/features_exhibitions/digital_resources/bond_issues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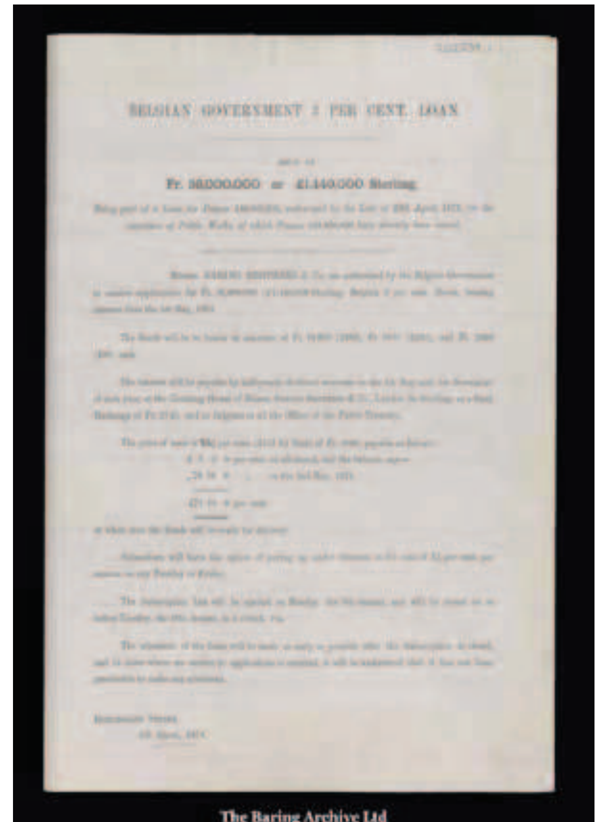
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The Currency of Art

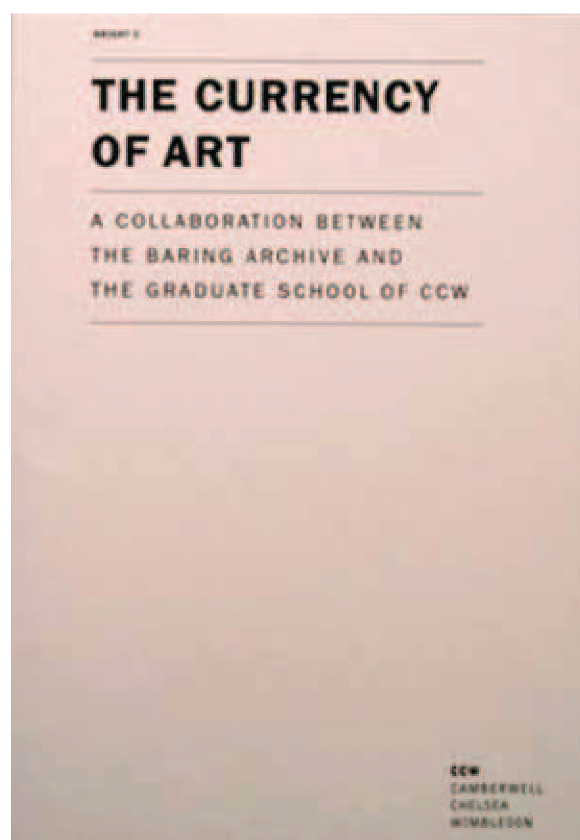
A new publication entitled 'The Currency of Art' has arisen from a collaborative project undertaken by The Baring Archive and the Graduate School of CCW (Camberwell College of Arts, Chelsea College of Art and Design and Wimbledon College of Art - three constituent colleges of the University of the Arts London).

A collection of national and international importance, The Baring Archive tells the story of the development of international finance and of Barings' role in it. The publication is the result of a project which enabled artists and researchers across a number of disciplines and institutions to select artefacts in The Baring Archive and to create a new piece of work in response. The new work was then displayed alongside the archival documents which inspired them at an exhibition entitled 're:SEARCHING: playing in the archive', which opened at The Baring Archive in May 2010.

The group's investigations have led to illuminating juxtapositions between newly created works and the original collection. Sculpture, paintings, book art, prints and performance art have been inspired by nineteenth century correspondence from Italy, the firm’s first ledger, Nathaniel Hawthorne’s account, the designs of Argentinean bearer bonds, and bearer bonds for the City of Moscow loan of 1908. By uncovering hidden narratives embedded in the artefacts, new avenues of interpretation have opened up, directly relating to the activities of Barings over its long and fascinating history.

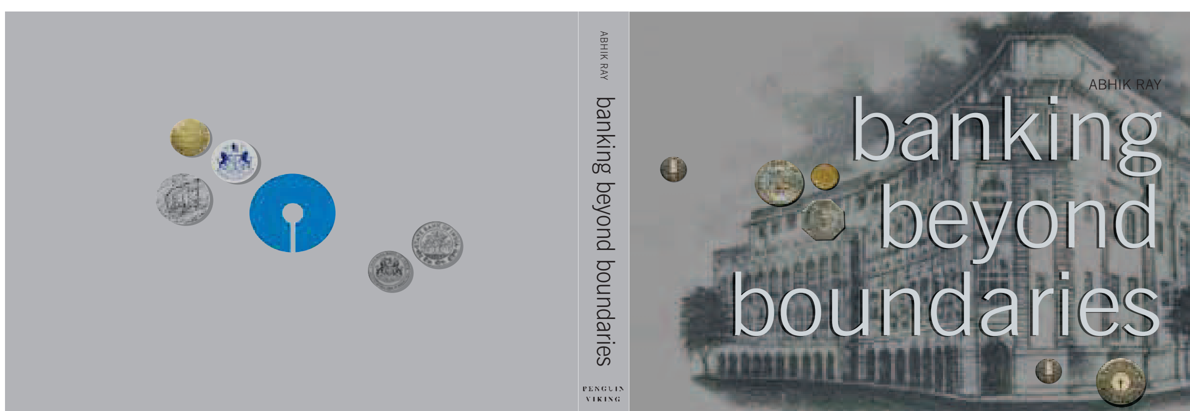
'The Currency of Art' celebrates the current phase of this exciting collaboration and looks towards its developments. As Professor Eileen Hogan writes in her introduction, ‘It should be seen as a catalyst to provoke debate across the arts, curatorial practice, finance and banking about the values underpinning these relationships as they were formed in the past, and as an invitation to speculate about their possible shape in the future.’

If you would like to receive a copy of The Currency of Art please contact The Baring Archive (baring.archive@uk.ing.com).
For more information on The Baring Archive please visit http://www.baringarchive.org.uk/.
For more information on CCW Graduate School visit http://www.camberwell.arts.ac.uk/ccwgraduateschool/.



An Arresting History

Few banks in the world can perhaps equal the long and remarkable history of State Bank of India. For well over two centuries, the Bank has pioneered modern banking in the Indian subcontinent, demonstrating remarkable resilience in adapting to the challenges of changing times. As a key instrument of public policy throughout, it first played a crucial role in the commercialisation of the subcontinent and then, in the post Independence era, performed a pivotal role in powering the growth of the Indian economy.
Banking beyond boundaries is the story of the State Bank and its predecessors - the presidency banks and the all-India Imperial Bank of India through two centuries. It was these predecessor institutions which brought modern banking to the subcontinent in an era when unregulated banks were springing up and collapsing all around. They emerged as islands of stability and dependability, and built up a formidable reputation for upholding the highest standards of banking in all their dealings. So keen were they to uphold them that even the high and mighty like Governor General William Bentinck was not spared. The bank dared return a cheque of Bentinck because his account was short by a measly sum. Special efforts were made at a time when infrastructural facilities were practically non-existent for extending banking to the important ports and trade centres in the subcontinent. Key central banking functions too were discharged before the arrival in 1935 of the central bank of the country - Reserve Bank of India.
Vested with public responsibilities after its nationalisation in 1955, the State Bank broke away from the colonial legacy to become an essential constituent of India's plans for modernisation in an age of economic planning. Now thanks to technology the bank is able to reach out to people in the remotest villages who have never seen beyond a rural moneylender. And the high standards and traditions inherited from its predecessors are also unremittingly being carried forward.
The strong fundamentals of the State Bank have enabled it to periodically restructure and reorient itself to take on the most daunting challenges and to adapt quickly to changing environments. Today the Bank is a financial supermarket with an unparalleled reach offering all conceivable financial services. It is vibrant and remains focused on staying ahead of competition.
Banking beyond boundaries covers all this and more – offering an engaging pictorial history of the development of banking in India since ancient times. Its richly illustrated pages are a visual treat and the absorbing text, fascinating anecdotes and analyses provides a complete view of how the State Bank of India, the foremost bank in India, was propelled into the big league as the only Indian bank among the top 100 banks in the world.



New from Edward Elgar Publishing

Islamic Capitalism and Finance

Origins, Evolution and the Future

Murat Çizakça, INCEIF, Kuala Lumpur, Malaysia

"It was a humbling experience to read the product of such a remarkable feat of scholarship. It is all at once an exploration in analytic history and a complete text of Islamic finance theory and application. It is also one of the most succinct renditions of evolution of Islamic finance embedded in comprehensive account of particularities of economies as diverse as Malaysia and Turkey. This is a unique contribution to Islamic finance and Islamic economic history. It has been a rewarding learning experience. It is truly a breathtaking effort."

– Prof. Dr. Abbas Mirakhor, former IMF Executive Director and the recipient of the Islamic Development Bank Prize in Islamic Economics (2003).

This illuminating and thought-provoking book questions whether classical Islamic capitalism, which has served Muslims so well for centuries, can provide a viable alternative world economic system. In the current recession – the worst since 1929 – this is surely a provocative question. But if Islamic capitalism is to emerge as a viable alternative, its nature and systems must be well understood. Murat Çizakça explores key issues within Islamic capitalism and finance, shedding light on whether the Islamic system can indeed be called 'capitalist', the principles on which the system was built, the institutions that were consequently developed, how they function and have evolved, and, perhaps, most importantly, whether they can be modernized to meet today's needs. With the latest breathtaking developments in the Middle East and the disappearance of dictators, this book gives a solid background to the economic systems that will emerge in the world of Islam.

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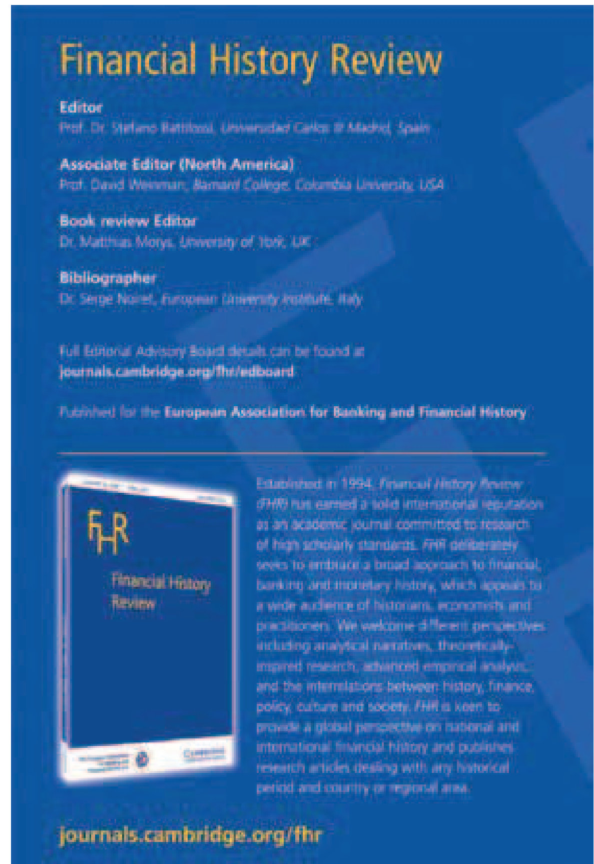

Editorial Initiatives

The Past Mirror

Financial History Review, through its section "The Past Mirror", assiduously advocates the relevance of history for a proper understanding of present financial and monetary developments, and no less importantly for informed and educated policy responses to them. *FHR* has published several influential and thought-provoking 'Past Mirror' papers so far, including:

- Banking crises yesterday and today
  Charles W. Calomiris
- The Great Depression analogy
  Michael Bordo and Harold James
- Banking crises and the international monetary system in the Great Depression and now
  Richhild Moessner and William A. Allen
- The joint production of confidence: lessons from nineteenth-century US commercial banks for twenty-first-century euro area governments
  Adalbert Winkler

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Save the Date

Public Policies & the Direction of Financial Flows

7-9 June 2012
Bucharest, Romania

Dear Members and Friends,

The *European Association for Banking and Financial History (EABH) e.V.* is delighted to announce this conference with the title **Public Policies & the Direction of Financial Flows**. The conference will be held at the headquarters of the *National Bank of Romania* in Bucharest.
The focus of our discussion will be on: Why and how did non-market forces (states, local authorities, international authorities, technical bodies) manage to direct financial flows so as to achieve specific goals, mainly related to economic development?
For further information visit: www.eabh.info or contact us: info@bankinghistory.de

We are looking forward to next year's conference and would be delighted to welcome you there.

With best regards,

Manfred Pohl

The European Association
for Banking and
Financial History e.V.

3rd EABH Workshop for Young Scholars

Public Policies & the Direction of Financial Flows

Regional Development– Transition to Market Economies–integration into Processes of Economic Development

The European Association for Banking and Financial History (EABH) e.V.
& GRETHA Research Centre University of Bordeaux

15/16 March 2012, Bordeaux

Call for Papers

Many times in history, public authorities have decided to pursue economic policies (mainly development policies) by directing the financial flows of the economy. The central idea of the workshop is to study this phenomenon using a comparative approach. The basic question to be addressed is therefore: Why and how did non-market forces (states, local authorities, international authorities, technical bodies) manage to direct financial flows so as to achieve specific goals, mainly related to economic development?

The motivations for adopting such policies need investigation: insufficiency of market forces, weakness of the financial institutions, a special macroeconomic context and the urgency to achieve certain goals are just some of the most common motivations to be studied, while considering the ideology of the policymakers. Communist countries, capitalist countries, middle-of-the-road countries, war economies: all share, to some degree, devices to direct financial flows. The scope of the inquiry will include banks, which extend credit, insurance companies, which invest their reserves, as well as financial markets (via authorisations to issue shares, for example, or even via forced lending to the state) and intergovernmental bodies dedicated to development.

Such management of financial flows may be achieved with a great variety of instruments, from laws to plans to regulations to government decisions to moral suasion. Most often, these devices coexist with other forms of economic regulation (on prices, investments, foreign trade, etc.), yet the focus of the papers should be on financial flows and possibly on how the management of those interacted with other forms of regulation.

The following questions are to be considered:

- *How were the authorities in charge of the direction of financial flows organised and how did they collect the relevant information?*
- *Did these authorities actually attain their aims (through: assessments of the results of these policies including drawbacks, unwanted effects, interferences with other policies?*
- *Which bodies produced the documents and the statistics that cover the subject? Why were they preserved or destroyed?*
- *How to identify and follow the policies concerning the direction of financial flows?*
- *How to determine the mindset and portfolio of skills of the people who devised and managed them?*

The transition of command economies to market economies in Eastern and Central Europe, in the Black Sea area or in Central Asia is part of this subject matter:

- *How did the 'Transition Period' since the fall of the Berlin Wall favour such trends to orient financial and capital flows towards this area?*
- *How did the European Community set up and oversee such flows?*
- *(Papers considering the role played by the Bank of Economic and Regional Development (BERD) or by the Black Sea Trade & Development Bank (BSTDB), for instance, would be very much appreciated.)*
- *How did small and medium sized enterprises benefit from such earmarked financial flows?*
- *How did modern forms of insurance take shape in these areas?*

Comparative approaches to the subject matter are encouraged, also by means of co-authorship. All papers of sufficient quality and relevance to the key issues will be presented at the EABH Conference in Bucharest in July 2012 and will be published in an academic publication under the copyright of EABH.

Please submit papers by Monday 30 January 2012
to: info@bankinghistory.de

The EABH mourns the loss of

Hubertus Heemskerk, †22 March 2011

Tommaso Padoa Schioppa, †18 December 2010

Willem F. Vanthoor, †28 August 2011

They all have been valuable contributors to the EABH over the years and will be greatly missed.

Antique Staplers & Other Paper Fasteners

Expansion in the volume of papers generated and stored in offices during the second half of the nineteenth century created a demand for efficient ways to fasten papers together. As part of our research at the Museum, we have investigated the development of early staplers and other mechanical devices that were sold to meet this demand between the 1850s and early 1940s. The old paper fastening machines discussed here were used not only to insert and clinch staples but also to insert other types of paper fasteners, such as eyelets, and to attach papers together without t he use of fasteners by cutting and folding or crimping the paper itself.

Until circa 1860, and indeed for some time thereafter, the types of documents that today are stapled together were fastened in a number of ways that did not require the use of mechanical devices. Some documents were held together by stitches made with needles and threads. Others were secured by strings, tapes or ribbons that were inserted through holes made with a sharp instrument or though parallel incisions made with a penknife. The strings, tapes or ribbons were then tied and sometimes secured with sealing wax. Still other papers were held together with straight pins or glue, and strings or ribbons were tied around groups of papers. We have found a 1787 reference to "a parcel tied with red tape, in imitation of law-papers" and a 1783 reference to "a small bundle of papers, fastened by a piece of red tape." The term "red tape" was used in its current figurative sense by 1894: "They [libraries] are frequented by some untrustworthy persons whose dishonesty or recklessness subject all honest men to a system of detectives and of red tape, which is annoying, mortifying, and the occasion of some loss of time."

Charles Slack states that the British firm Perry & Co. introduced the rubber band in 1844, and that a licensee of Goodyear made rubber bands around the same time in the US. We found references to India rubber bands published in 1854, 1856, 1857, 1867, 1868, and 1876. Waterlow & Sons, London, advertised pins, elastic bands, and red tape in 1855. Geo. N. Davis & Brother, Boston, MA, advertised rubber stationers' bands in 1856. John W. Clothier, Philadelphia, PA, advertised patent India rubber bands, red tape, and mucilage c.1858. Henry G. Norton & Co, New York, NY, advertised rubber elastic bands in 1867. The Rubber Clothing Co., New York, NY, advertised elastic bands in 1868. In 1876, Henry Bainbridge & Co., New York, NY, advertised Congress rubber bands.

F. M. Butler of New York, NY, exhibited sealing wax at the Exhibition of the Massachusetts Charitable Mechanic Association, Boston, in 1837. Grigg & Elliot, Philadelphia, PA, advertised sealing wax c.1850-60 (Hagley Museum and Library), Waterlow & Sons, London, did so in 1855, Richard B. Dovell's Son & Co., New York, NY, did so in 1867, and Thaddeus Davids & Co., New York, NY, did so in 1876. Of course, sealing wax was introduced centuries earlier.

Letter clips, which were similar mechanically although not in appearance to modern clothes pins with springs, were patented at least as early as 1843, were advertised by Waterlow & Sons, London, in 1855 and by Wm. Staehlen, New York, NY, in the late 1860s, and were marketed widely after 1876. These letter clips were also known as paper clips, but they should not be confused with what are now known as paper clips. Small bent-wire paper clips were patented as early as 1867 but were not widely marketed until the late 1890s.

Text and pictures taken over from www.officemuseum.com

The photo above shows Pyramid Pins of the type sold for use in offices as well as homes by the New England Pin Co., Winsted, CT

Morgan's Mucilage, 1881
Mucilage, a water-soluble glue made from plants. A number of sellers exhibited mucilage along with other office supplies at the 1876 International Exhibition.