



## ORIGINAL ARTICLE

# The politics of last resort lending and the Overend & Gurney crisis of 1866

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**Abstract**

News of the insolvency of Overend, Gurney, & Company on 10 May 1866 generated a scramble for funds in the City of London and urgent appeals to the Bank of England. The banking panic triggered by the collapse of the prominent British discount house became one of the Bank's most tumultuous modern crises. This article investigates the politics of the Bank's liquidity provision during the 1866 crisis, and in the ensuing months of financial stringency. By assessing the correspondence, speeches, and publications of Governors, City figures, and financial journalists, the article finds that the Bank's evolving approach to crisis lending was decisively shaped by its commercial objectives and a prolonged struggle to preserve its autonomy. When confronted with the 1866 crisis, the Bank adopted a pragmatic stance towards the market, which accommodated the credit needs of the City without sacrificing either its privileged legal status or its shareholders' interests. Its Governors' rhetorical pursuit of 'constructive ambiguity' during the post-crisis months succeeded in both limiting moral hazard and consolidating the Bank's discretionary powers.

**KEYWORDS**

Bank of England, central banking, financial crises, last resort lending, Overend & Gurney panic, Walter Bagehot

When asked in 1911 to survey the Bank of England's history, the economist H. S. Foxwell remarked that it resembled that of 'most really English institutions': it 'was case-made', owing 'its form and functions not to systematic planning, but to attempts to meet emergencies as they from time to

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time arose'.<sup>1</sup> Influenced by successive nineteenth-century crises, the Bank's governance gradually evolved out of a deep-seated conflict between its private business and its public alter ego as the country's last refuge of liquidity.<sup>2</sup> Its dual identity not only intricately shaped the Bank's crisis management; it also compelled its Governors 'to play a complex and uncertain political game'.<sup>3</sup> This article examines the Bank's emerging role as lender of last resort by investigating the politics of its crisis management during the Overend & Gurney panic of 1866. Widely regarded as a turning point in the Bank's evolution towards a modern central bank, the 1866 crisis saw liberal emergency lending to stabilize the capital market.<sup>4</sup> While the Governors came willingly to the rescue of the City, the Bank's high discount rate, which was maintained long after the crisis had peaked, elicited sharp public criticism. Political and journalistic scrutiny of the Bank's policy intensified in the post-crisis months and culminated in growing pressure—both from Parliament and from the City of London—to revise its statutory rights. In the aftermath of the crisis, the Bank embarked on a peculiar balancing act to forestall reforms to its charter that threatened to devolve discretionary powers away from the Bank towards the Treasury. The genesis of the Bank's role as lender of last resort was tied closely to this long-term erosion of its legal privileges, yet histories of the Bank have so far devoted only cursory attention to this process of attrition.<sup>5</sup> By exploring the Bank's many-layered rationale for credit assistance, this article enhances our understanding of the Bank's struggle to defend its profits and autonomy from political incursion.

The Bank of England's responses to the financial crises of 1847, 1857, and 1866 were guided by the legislative limitations placed on its autonomy by the Charter Act of 1844. Peel's Act had reinforced the Bank's idiosyncrasy as the custodian of the bankers' balances and a competitor for discounts in the open market.<sup>6</sup> Constructed along Currency School principles, the Charter Act separated the Bank's operations into an independent Issue Department and a commercially run Banking Department. Institutionally, the design of Peel's Act consolidated the Bank's monopoly over the central note issue, while restricting its control over the money supply.<sup>7</sup> Its crafters had envisaged the Charter Act as a panacea for financial instability, but within two decades the Treasury had twice resorted to suspending the law's provisions in order to allay panic and stabilize the payments system. By suspending the 1844 Act, the Chancellor permitted the Issue Department to extend the note supply beyond its legal limit, and thereby relieve pressure on the reserve of the Banking Department. If the Bank exceeded the fiduciary issue, however, any profits

<sup>1</sup> Foxwell, 'Introduction', p. 6.

<sup>2</sup> Goodhart, *Central bank and the financial system*, p. 209; Ziegler, *Central bank, peripheral industry*, p. 82; de Cecco, *Money and empire*, pp. 82–3.

<sup>3</sup> Calomiris, 'Banking crises', p. 109.

<sup>4</sup> Since the classic studies on central banking undertaken by Sayers, Hawtrey, and Fetter, it has become the broadly accepted view that the Overend & Gurney panic established the Bank's commitment to last resort lending; see Sayers, *Central banking after Bagehot*, p. 14; Hawtrey, *Art of central banking*, pp. 125–6; Fetter and Gregory, *Monetary and financial policy*, p. 25; Cottrell, *Investment banking*, vol. I, p. 399; Capie, 'Bank of England as a mature central bank', pp. 300, 307, 314–15; Capie and Wood, 'Financial crises', pp. 136–7; Eichengreen, *Globalizing capital*, p. 35; Flandreau and Ugolini, 'Overend-Gurney panic'; Bignon, Flandreau, and Ugolini, 'Bagehot for beginners'; Flandreau and Ugolini, 'Crisis of 1866'.

<sup>5</sup> Calomiris and Haber, *Fragile by design*, pp. 111–12, 120–2; Calomiris, 'Banking crises'; Calomiris, Flandreau, and Laeven, 'Political foundations'; Flandreau, 'Pillars of globalization', pp. 212–13, 218–35; Capie, Goodhart, and Schnadt, 'Development of central banking', pp. 126–31, 147–8; Kynaston, 'Bank of England and the government'.

<sup>6</sup> Goodhart, *Central bank and the financial system*, p. 209.

<sup>7</sup> Kynaston, 'Bank of England and the government', pp. 21–2; Deane, *State and the economic system*, pp. 83–4; Diatkine and de Boyer, 'British monetary orthodoxy'.



accrued through advances or discounts were formally due to the Treasury, consequently incentivizing the Bank to avert exercising the Chancellor's licence. Since the division of the Bank's business in 1844, its Governors had regularly invoked Peel's Act to insist that they adhered to the same profit-maximizing objectives as any joint-stock bank. Contemporary commentators such as Walter Bagehot and William Newmarch, however, considered the Bank's commercial ethos and the design of the Charter Act as a dual source of systemic instability. In the shadow of the 1866 panic, Bagehot launched a journalistic campaign that reproached the Bank for refusing to acknowledge its public role as the nation's guardian of financial stability. Stemming from his observations of mid-Victorian crises, Bagehot's editorials called on the Bank to disregard its profit motive in order to provide a financial lifeline to the national economy. It was during his time as editor of the *Economist* (1861–77) that Bagehot formulated his famous theory of crisis lending, later to be crystallized in *Lombard Street: a description of the money market* (1873).

Bagehot's formula for financial stability attributed to the Bank extensive regulatory and supervisory obligations. When facing a panic-induced drain of its specie reserve, the Bank's only safe course of action, Bagehot advocated, is to lend 'quickly, freely, and readily' in order to prevent collective runs on the country's credit institutions.<sup>8</sup> Bagehot further insisted that an effective lender of last resort must adhere to three distinct axioms. It should extend liquidity to solvent but temporarily illiquid institutions, charge higher interest rates than prevailed in the market, and secure its loans on what, in 'ordinary times', would rank as safe collateral.<sup>9</sup> Integral to Bagehot's scheme is a credible pre-commitment to crisis lending from which to cultivate public confidence in the credit system.<sup>10</sup> It is the quest for signs of such official 'commitment' that has become the historian's test for determining when the Bank of England assumed its duty as lender of last resort.

The stumbling block for establishing the Bank's commitment, however, is inherent in the difficulty of assessing the 'intellectual basis, and reasoning, of central bankers for providing such support, rather than the individual act of rescue itself'.<sup>11</sup> While liberal emergency lending in 1866 did not necessarily equate to a *pre-commitment* in future crises, the Bank's official silence on the matter has long been interpreted as a sign of tacit consent to Bagehot's principles. By investigating the correspondence, speeches, and publications of Governors, City figures, and financial journalists, this article finds that the Bank's evolving approach to crisis lending was fundamentally shaped by its commercial objectives and the quest to preserve its autonomy. When confronted with the 1866 panic, the Governors adopted a pragmatic stance towards the market, which accommodated the liquidity needs of the City without compromising its shareholders' interests. In the post-crisis months, the Bank crafted a coherent policy framework that neither fully adhered to Bagehot's theory of a pre-committed lender of last resort, nor surrendered its institutional independence. By employing the policy weapon of 'constructive ambiguity',<sup>12</sup> the Governors consolidated the Bank's discretionary powers, while putting its relationship with the capital market on a new footing.

<sup>8</sup> Bagehot, *Lombard Street*, p. 173.

<sup>9</sup> *Ibid.*, pp. 197–8.

<sup>10</sup> *Ibid.*, p. 173; Humphrey, 'Lender of last resort', pp. 12–13.

<sup>11</sup> Capie et al., 'Development of central banking', p. 65.

<sup>12</sup> The concept of 'constructive ambiguity' originated in the field of international diplomacy and primarily referred to a negotiating stance. For a discussion of the concept and its use in evaluating central banks' approaches to crisis lending, see Freixas, Giannini, Hoggarth, and Soussa, 'Lender of last resort', pp. 40–1; Congdon, *Central banking*, p. 103.



## I

The downfall of Overend, Gurney, & Company, from its respectable Quaker origins to one of the most infamous trials for fraud in Victorian Britain, has become an epitome of financial hubris.<sup>13</sup> Its founding partners had capitalized on the growing diversification of the London money market in the early nineteenth century and zealously elevated the firm to national and European prominence.<sup>14</sup> On Samuel Gurney's death in 1856, Overend was said to be ranking 'next to the Bank of England', with annual profits totalling £200 000 and its yearly turnover of bills equalling half the National Debt.<sup>15</sup> Just seven years later, Overend had fatally over-burdened its sound discounting business with speculative undertakings and a host of dubious financing schemes. Early in 1861, the out-going Governor of the Bank of England, Bonamy Dobree, informed an alarmed correspondent of Overend's diminished City credit: 'The house referred to has made, it is said, heavy losses during the last 18 months—to the extent of [£300 000 to £400 000]—and is considered to have as much more locked up in inconvertible securities: it does a rather reckless business and is continually incurring losses'.<sup>16</sup> In City circles, Overend had for some years been suspected, as the *Economist* put it, of transacting 'business not at all in general of an illegitimate or unprofitable character, but still of a sort different from those conducted by bill-brokers "pure and simple"'.<sup>17</sup> Overend and its competitors in the bill brokerage business soaked up temporary floating balances from commercial banks and invested their capital in bills of exchange as 'a form of interbank currency'.<sup>18</sup> This aspect of the London money market presented a crucial consideration for bailouts of distressed companies: a large discount house could yield systemic risks for the entire British financial sector.<sup>19</sup>

One year before Overend's collapse, its directorate executed a belated reorganization scheme to convert the private discount house into a limited liability company, a step the *Economist* welcomed sceptically—at least its changed legal status would henceforth require its Board of Directors to publish the company's accounts, allowing scrutiny over its bill broking business.<sup>20</sup> Capital gains of £5 million from the company's flotation at the London Stock Exchange in August 1865 facilitated a last attempt to detoxicate Overend's securities portfolio by selling off stocks of high-risk 'accommodation' paper to other London banks and bill brokers.<sup>21</sup> But before the new directors' plan could be realized, the credit bubble tragically unravelled, with Overend at the centre of the storm. Public confidence in the soundness and integrity of Overend's brokerage operations experienced a first decisive blow in January 1866 after a railway contractor of the fatefully similar name—Watson, Overend & Co.—announced its liquidation.<sup>22</sup> Heavy withdrawals of deposits accompanied the disclosure that Overend, along with the Joint Stock Discount Co., held large

<sup>13</sup> On the trial of the company's directors, see Elliott, *Overend & Gurney*, pp. 190–221.

<sup>14</sup> Forbes, 'Overend, Gurney & Company', pp. 176–7.

<sup>15</sup> Bagehot, *Lombard Street*, p. 19; Batchelor, 'Banking crises', p. 45.

<sup>16</sup> Kynaston, *City of London*, pp. 235–6.

<sup>17</sup> *Economist*, 15 July 1865, p. 845.

<sup>18</sup> Michie, 'City of London', p. 17; King, *London discount market*, pp. 5–6, 30–4.

<sup>19</sup> Michie, *British banking*, pp. 115–16.

<sup>20</sup> King, *London discount market*, pp. 239, 251; *Economist*, 15 July 1865, pp. 845–6.

<sup>21</sup> Clapham, *Bank of England*, vol. II, p. 261; Kynaston, *City of London*, pp. 236–7.

<sup>22</sup> Scammell, *London discount market*, p. 170; King, *London discount market*, pp. 240–2.



stocks of the company's dubious railway securities.<sup>23</sup> The tip that eventually sent the discount house over the edge unfolded in early April: the break-up of the merchant house Pinto, Perez & Co., to which it had granted liberal advances in the past, coincided with drastic depreciations at the Stock Exchange and anxious short-selling of Overend's shares.<sup>24</sup>

Just as Overend's financial position was growing progressively more desperate, the City's credit supply further contracted in anticipation of war between Prussia and the Austro-Hungarian Empire. Bank Rate was raised from 6 per cent to 8 per cent at the start of May, which exerted an additional profit squeeze on London's discount houses.<sup>25</sup> While interest rates across Europe had risen markedly throughout the spring of 1866, commerce continued to be fuelled by the resurgence of trade following the cessation of the American Civil War in April 1865, along with an auxiliary surge in company promotions. Still, Britain's trade boom produced a gold drain at the Bank, which necessitated measures of monetary contraction in order to protect its reserve from 'being drawn upon for the war-chests of the [European] powers'.<sup>26</sup> Short-term capital flows from London to Paris in the run-up to the crisis created additional unease at Threadneedle Street.<sup>27</sup> With Overend's shares already trading at a heavy discount, two fatal revelations in early May combined to bring down the established discount house. Allegations of serious fraud against Pinto, Perez & Co. were accompanied by a disadvantageous court ruling, which compromised Overend's portfolio of railway securities.<sup>28</sup> On 9 May, Overend experienced a severe 'run' on its deposits, whereupon its directors set out to obtain emergency assistance of £400 000 from the Bank of England.<sup>29</sup> Kirkman Hodgson, a former Governor of the Bank (1863–5), as well as Robert Bevan and George Glyn scrutinized Overend's position, and came to the conclusion that 'the business was rotten beyond redemption'.<sup>30</sup> Overend's application to the Bank was decidedly rejected by the Governors, who publicly justified their refusal on the grounds 'that they could not help one "financing" business without being prepared to help all'.<sup>31</sup> While Overend's bailout was declined principally on the basis of its *insolvent* rather than merely *illiquid* position, the politics of the Bank towards its leading commercial rival in the City is a subject of particular notoriety.

During Overend's stellar ascent in the 1830s, the two institutions had fostered reciprocal and at times cooperative relations: under Samuel Gurney's watch the Bank of England regularly put money 'at call' with Overend which, in turn, occasionally repurchased discounted bills to relieve liquidity strains at the Bank.<sup>32</sup> Between 1857 and 1860, however, their relationship deteriorated rapidly: first turning from unanimity to frostiness in the aftermath of the panic of 1857, before

<sup>23</sup> King, *London discount market*, pp. 241–2.

<sup>24</sup> Ibid., p. 242.

<sup>25</sup> Batchelor, 'Banking crises', pp. 46–7.

<sup>26</sup> Clapham, *Bank of England*, vol. II, p. 262.

<sup>27</sup> Cottrell, *Investment banking*, vol. I, p. 398.

<sup>28</sup> King, *London discount market*, p. 242.

<sup>29</sup> Sowerbutts, Schneeberg, and Hubert, 'Demise of Overend Gurney', p. 94; Batchelor, 'Banking crises', p. 47; King, *London discount market*, pp. 242–3; Morgan, *Theory and practice*, p. 179.

<sup>30</sup> Neither testimonies nor references to this confidential assessment of Overend's books have survived in the Bank of England's archive. See Kynaston, *City of London*, p. 239; King, *London discount market*, pp. 242–3; Currie, *Recollections*, vol. I, p. 60; Sowerbutts et al., 'Demise of Overend Gurney', p. 99.

<sup>31</sup> *The Times*, 11 May 1866, p. 11.

<sup>32</sup> Batchelor, 'Banking crises', p. 45.



escalating in a hostile coup to destabilize the Banking Department in April 1860.<sup>33</sup> Overend's financial position after the collapse of the US railway boom in 1857 had come under significant pressure, as it tried to cover panic-induced demands on large stocks of call money.<sup>34</sup> To the Governors' consternation, Overend's new management approached the Bank for 'unlimited assistance', and thereafter sought ministerial approval from Downing Street for the suspension of the 1844 Act.<sup>35</sup> When the financial pressure had died down, the Governors announced in June 1858 that they would henceforth close the Bank's re-discounting facility to bill brokers and so curtail their access to advances for covering temporary shortfalls.<sup>36</sup> The rule restricted advances for discount houses to the ordinary quarterly 'shuttings' and precipitated a marked deterioration in the Bank's relation to the open market.<sup>37</sup>

Steeped in the moral rhetoric of 'sound finance', the so-called rule of 1858 satisfied a long-standing desire at the Bank to foster greater self-reliance among moneylenders as well as improve the quality of commercial paper.<sup>38</sup> Its primary intention was to reprimand the City's discount houses for the heavy burden which their agents, and Overend in particular, placed on its Banking Department during times of financial distress.<sup>39</sup> Overend's tactlessness in publicly demanding *carte blanche* may indeed have acted as the final straw. By restricting access to its re-discounting facilities, the Governors sought to pre-empt and simultaneously punish potential abuses from bill market over-trading, yet the policy's weakness of being malleable to suspension in emergencies seemed to undermine the 'remedy' for which it was intended.<sup>40</sup> With public criticism of the Governors' discount policy abounding, Overend orchestrated the withdrawal of £1.4 million notes from the Bank.<sup>41</sup> In a dramatic feat to gain attention, Overend's accomplices addressed an anonymous letter to the Governors on 17 April 1860, threatening collective action to dry up its central reserve.<sup>42</sup> When their attempt to intimidate the Bank failed to shake the Governors' confidence in their discount policy, Overend's young management realized that they had played too high.<sup>43</sup> Within a fortnight, all notes were repaid and the 'rule' stayed in place until its repeal in June 1890. It was then that Overend's standing in the City, as 'all that was wisest, safest and shrewdest in finance', took its first irreparable blow, an episode that undoubtedly left a lasting impression at the Bank.<sup>44</sup> Competitive advantages in the market for bill discounting, in which Overend was the Bank's largest rival, may certainly have constituted an important consideration against a future emergency loan.<sup>45</sup> The depth and breadth of financial intermediation offered in the Square Mile

<sup>33</sup> Collins, *Money and banking*, pp. 190–1.

<sup>34</sup> Kynaston, *City of London*, pp. 192–6.

<sup>35</sup> Ibid., pp. 192–4; Clapham, *Bank of England*, vol. II, pp. 228–30.

<sup>36</sup> Wood, *Theories of central banking*, p. 132.

<sup>37</sup> Clapham, *Bank of England*, vol. II, pp. 237–8; Cottrell, 'London's First "Big Bang"?', p. 73.

<sup>38</sup> Wood, *Theories of central banking*, pp. 132–4; Sayers, *Central banking after Bagehot*, p. 10; Calomiris and Haber, *Fragile by design*, p. 122.

<sup>39</sup> Turner, *Chronicles*, pp. 199–200; Grossman, *Unsettled account*, p. 96.

<sup>40</sup> King, *London discount market*, pp. 199–205; Francis, *History of the Bank of England*, p. 443.

<sup>41</sup> Sowerbutts et al., 'Demise of Overend Gurney', p. 97, record the share of notes withdrawn by Overend, Gurney & Co. as £0.8 million.

<sup>42</sup> Ibid., p. 97; Clapham, *Bank of England*, vol. II, pp. 242–6.

<sup>43</sup> Roberts, 'Bank of England and the City', pp. 158–9.

<sup>44</sup> Scammell, *London discount market*, p. 169.

<sup>45</sup> de Cecco, *Money and empire*, pp. 81–3; Grossman, *Unsettled account*, p. 97.





attracted a highly lucrative business of which the Bank was bound to take an enlarged share after Overend's collapse.

On Thursday, 10 May 1866, at c. 3.30pm, the 'Corner House'—Overend's headquarters located between Lombard Street and Birchin Lane—closed its doors and ceased payment.<sup>46</sup> Scenes of frenzied panic engulfed Lombard Street on this and the subsequent day.<sup>47</sup> On the City's second Black Friday, 11 May, *The Times* predicted that the news of Overend's stoppage would cause shock waves of such magnitude as to affect even 'the remotest corners of the kingdom'.<sup>48</sup> The Square Mile's anxious turmoil was swiftly transmitted over the telegraph, and within a few hours took hold of both country bankers and depositors. The *Bankers' Magazine* recorded how 'local bankers rushed to their agents, some to withdraw their balances, others to make arrangements to meet any undue pressure; and from the Bank of England, notes and coins were despatched into the country with frantic haste, in order to keep the financial machine going there'.<sup>49</sup> Such was the frightful atmosphere across the country that all Stock Exchange trading came to a standstill as jobbers temporarily stopped dealing in securities.<sup>50</sup> Within a day of Overend's insolvency—totalling £18 728 000 of liabilities—several London finance houses and Liverpool-based merchants suspended payments, or in the interim closed down, including among others the English Joint Stock Bank, Peto & Betts, and the Bank of London.<sup>51</sup> Come July 1866 around 200 joint-stock companies had been sent 'into Chancery'.<sup>52</sup>

While general confidence—both materially, in the security of deposits, and morally, in the efficacy of the banking profession—was all but shattered, public trust in the Bank of England as a last bastion of liquidity continued unimpaired. Overend's failure and the panic-stricken distrust that ensued at home and abroad doubly hit the Bank at a time when its specie reserve was only a meagre £5 727 000. The collapse of City credit thus added, to an existing external drain, a severe internal demand that acutely threatened the stability of Britain's financial system. At its morning meeting on 11 May the Court of Directors resolved an increase in the minimum rate of discount from 8 to 9 per cent, and adjourned until 3pm. When the directors reconvened, the minutes would remain silent on whether the Court settled on a distinct policy for emergency lending.<sup>53</sup> The day the panic broke, the Bank issued loans and discounts to the value of more than £4 million in order to stabilize the City's payments system.<sup>54</sup> For the close of business on 11 May, the Governors anticipated their banking reserve to be depleted to just over £3 million.<sup>55</sup> The total credit advanced during the initial five days amounted to £12 225 000, of which £2 874 000 were advances on government securities and £9 350 000 advances on bills and bills rediscounted.<sup>56</sup> The Bank's discount

<sup>46</sup> King, *London discount market*, p. 243.

<sup>47</sup> *Bankers' Magazine*, June 1866, p. 639.

<sup>48</sup> *The Times*, 11 May 1866, p. 11.

<sup>49</sup> *Bankers' Magazine*, June 1866, p. 639.

<sup>50</sup> King, *London discount market*, p. 243.

<sup>51</sup> *Bankers' Magazine*, June 1866, p. 640; Patterson, *Science of finance*, p. 689.

<sup>52</sup> Taylor, *Creating capitalism*, p. 177; Cottrell, 'London's first "Big Bang"?', p. 93.

<sup>53</sup> Bank of England Archive, London (hereafter BofEA), G4/89, *Court of Directors Minutes*, 11 May 1866, p. 26.

<sup>54</sup> BL, Add. MS 44,410, fos. 155–6, Gladstone Papers, courtesy of the British Library Board, Henry L. Holland and Thomas N. Hunt to William E. Gladstone, 11 May 1866. For the Bank's daily transaction data on advances and bills discounted, see the Bank of England dataset by Anson, Bholat, Kang, and Thomas, 'Bank of England as lender of last resort'.

<sup>55</sup> BL, Add. MS 44,410, fo. 155.

<sup>56</sup> *Hansard* (Commons), 3rd ser., CLXXXIII, 17 May 1866, col. 1051.



and customers' ledgers, which Flandreau and Ugolini have analysed for the crisis and pre-crisis months, revealed that the majority of Bank credit was channelled into the market through bill brokers, which acted as 'institutional buffers' between Threadneedle Street and the commercial banks.<sup>57</sup>

The panic temporarily relaxed in the afternoon of 11 May, on the heels of erroneous reports in the daily papers that the government had suspended the Bank Charter Act of 1844.<sup>58</sup> When the news transpired to be false, the Chancellor's office in Downing Street was swamped with agitated deputations of anxious joint-stock bankers and influential City names, 'urg[ing] with unanimity and with earnestness the necessity of some intervention on the part of the State'.<sup>59</sup> Among the City representatives waiting on the Chancellor that day were members of the Rothschilds, Glyns, Hoares, and other long-established private banks, as well as the managers of the London & Westminster, the London Joint Stock Bank, and the London & County Bank.<sup>60</sup> In the House of Commons the previous night, the Norwich banker Sir Robert Harvey had impressed on the Chancellor the need for decisive relief measures, and Gladstone indicated 'that if applied to on the following day by parties properly authorized, the Government would promptly take the state of the money market into consideration'.<sup>61</sup> While the Bank confidently maintained that its reserves were holding up to the demand for bank notes, the banking community urged the Chancellor to pass a Bill of Indemnity, which would allow the Bank to breach the legal ceiling of its note issue.<sup>62</sup> The 'bravado' of the Bank officials, as the journalist R. H. Patterson noted, provoked one joint-stock banker to intimate crudely that the City could dry up the Banking Department, if only one large London bank were to withdraw its deposits.<sup>63</sup> Writing a decade after the crisis, the general manager of Parr's Bank further lamented how the Governors kept the market in suspense, while 'drift[ing] towards the abyss of suspension with the happy consciousness that Government will interfere at the supreme moment'.<sup>64</sup>

As a 'stream of City magnates' called on the Chancellor, the Governors of the Bank could plausibly anticipate a timely suspension of the Act—and thus guaranteed reimbursement from the government for any losses incurred en route.<sup>65</sup> Gladstone's correspondence with the Bank further affirms that the impetus for the suspension of the Charter Act originated, as Kynaston has observed, not from an urgent application for self-protection by its Governors.<sup>66</sup> Rather, Gladstone wrestled with the weight of public responsibility that was brought to bear on the government, when he maintained that:

[T]he Reserve of the Bank of England has suffered a diminution without precedent relatively to the time in which it has been brought about; and, in view especially

<sup>57</sup> Flandreau and Ugolini, 'Crisis of 1866', pp. 82–3; Flandreau and Ugolini, 'Overend-Gurney panic', pp. 130–2; Goodhart, 'Comment', p. 224; Collins, 'Lender of last resort', pp. 146, 152.

<sup>58</sup> Patterson, *Science of finance*, p. 236.

<sup>59</sup> BofEA, G4/89, *Court of Directors Minutes*, 12 May 1866, p. 30; see also BL, Add. MS 44,410, fos. 150–1, notes on Gladstone's meeting with the Committee of Joint Stock Banks, 11 May 1866.

<sup>60</sup> BL, Add. MS 44,410, fos. 149–50.

<sup>61</sup> BL, Add. MS 44,410, fos. 147–8, Sir Robert Harvey to William E. Gladstone, 10 May 1866; Gassiot, *Monetary panics*, pp. 25–6.

<sup>62</sup> Patterson, *Science of finance*, pp. 236–7; Calomiris and Haber, *Fragile by design*, p. 119.

<sup>63</sup> Patterson, *Science of finance*, p. 237.

<sup>64</sup> Dun, *British banking statistics*, p. 127.

<sup>65</sup> Matthew, ed., *Gladstone diaries*, vol. VI, 11 May 1866, p. 436.

<sup>66</sup> BL, Add. MS 44,410, fos. 155–6; Kynaston, *City of London*, pp. 240–1.





of this circumstance, Her Majesty's Government cannot doubt that it is their duty to adopt without delay the measures which seem to them best calculated to compose the public mind, and to avert the calamities which may threaten trade and industry.<sup>67</sup>

Gladstone's announcement of the charter's suspension in the House of Commons that night served to quench nationwide panic with as good as immediate effect. The mere force of the 'psychological palliative', in the shape of the Chancellor's Letter, signalled a much-sought assurance to the money market that 'though money may be dear, still money is to be had'.<sup>68</sup> In line with the terms imposed in the letter, the Bank's minimum rate of discount was increased to 10 per cent on 12 May.<sup>69</sup>

Unlike in the crisis of 1857, however, Peel's Act was only suspended *de jure*, not *de facto*, as the Governors skilfully avoided an extension of the country's note issue above its legal limit.<sup>70</sup> Despite the rapid depletion of their note reserve, the Governors informed Gladstone on 11 May that they deemed an infraction of the Act unnecessary, for although '[w]e have not refused any legitimate application for assistance, and, unless the money taken from the Bank is entirely withdrawn from circulation, there is no reason to suppose that this Reserve [of £3 million or less] is insufficient'.<sup>71</sup> In the days after Overend's collapse, the Governors devised a well-coordinated plan to circumvent a breach of the Bank Charter Act, thereby allowing the Bank full 'advantage of the high rate of discount'.<sup>72</sup> The figures for the Bank's income in the months following the crisis bear out the Governors' profitable handling of the affair.<sup>73</sup> Justified as a 'premium' on moral hazard, the Bank's profits during the panic of 1866 and the months of high interest rates were £970 015 in August 1866, which amounts to a 37.7 per cent increase from the same six-month period in 1865 (table 1).<sup>74</sup> Its interest income from bills discounted increased even more starkly year-on-year by 222.5 per cent to £274 262 in August 1866.<sup>75</sup> In its London head office alone, the Bank's interest on advances nearly doubled from £74 120 for the year 1865 to £141 870 in 1866.<sup>76</sup> It should hardly surprise therefore that when the Bank's half-yearly dividend was declared in September 1866 at 6.5 per cent, it compared

<sup>67</sup> BofEA, G4/89, *Court of Directors Minutes*, 12 May 1866, pp. 30–1; Clapham, *Bank of England*, vol. II, pp. 265–6.

<sup>68</sup> Clapham, *Bank of England*, vol. II, p. 266; Bagehot, *Lombard Street*, pp. 64–5.

<sup>69</sup> The government's letter stated that 'No such discount or advance, however, should be granted at a rate of interest less than ten per cent: and Her Majesty's Government reserve it to themselves to recommend, if they should see fit, the imposition of a higher rate. After deduction by the Bank of whatever it may consider to be a fair charge for its risk, influence and trouble, the profits of these advances will accrue to the Public'. See BofEA, G4/89, *Court of Directors Minutes*, 12 May 1866, p. 31.

<sup>70</sup> Turner, *Banking in crisis*, pp. 150–1; Morgan, *Theory and practice*, p. 180; on the *de jure*, *de facto* distinction, see Bignon et al., 'Bagehot for beginners', p. 581.

<sup>71</sup> BofEA, G4/89, *Court of Directors Minutes*, 12 May 1866, p. 28.

<sup>72</sup> On the Bank's post-crisis months, see the nineteenth-century accounts of Gassiot, *Monetary panics*, pp. 31, 34; Patterson, *Science of finance*, pp. 238–51. See also Clapham, *Bank of England*, vol. II, pp. 268–9.

<sup>73</sup> Anson and Capie suggest that there is no indication that the Bank returned to the Treasury any profits that stemmed from the use of the Chancellor's Letter during crises; see Anson et al., 'Bank of England as lender of last resort', p. 50.

<sup>74</sup> Figures based on the Bank of England dataset and working paper by Anson et al., 'Bank of England as lender of last resort', p. 50 and 'Bank of England profits and interest income from bills discounted, 1845–1870'.

<sup>75</sup> *Ibid.*

<sup>76</sup> Calculated from Bank data on bills discounted from 1844 to 1919: Anson et al., 'Bank of England as lender of last resort'. For comparisons of the high dividends paid by the Bank of England and the Bank of France during nineteenth-century crises, see Flandreau, 'Pillars of globalization', pp. 228–9.



**TABLE 1** Bank of England profits, interest income from notes and bills, and half-yearly dividend on Bank stock, 1862–68

Financial year	Interest income from notes and bills discounted	Bank of England profits	Half-yearly dividend on Bank stock (%)
1862	44 654	604 041	4.25
1862/3	51 811	619 916	4.25
1863	78 786	669 209	4.50
1863/4	124 951	756 143	5.25
1864	183 389	850 814	5.75
1864/5	172 893	807 318	5.50
1865	85 032	704 270	5.00
1865/6	127 438	769 493	5.25
1866	274 262	970 015	6.50
1866/7	97 488	792 493	5.50
1867	42 943	629 073	4.50
1867/8	22 660	606 214	4.00
1868	29 046	584 369	4.00

*Sources:* Half-yearly dividends paid out in April and Oct., from Clapham, *Bank of England*, vol. II, p. 428. Figures for interest income and profits from Anson et al., ‘Bank of England as lender of last resort’, historical dataset, 1844–1919, with interest income and profits recorded in Feb. and Aug.

favourably to an average 4.85 per cent for 1860 to 1865.<sup>77</sup> This extraordinary windfall was owing to the ingenuity and single-minded resolve of the Bank Court not to make use of the Chancellor’s Letter.

Several largely forgotten accounts—one the proceedings of the Political Economy Club and the other a testimony of a former director of the London and Westminster Bank—elucidate the means by which Threadneedle Street accomplished its aim. The economist Henry Higgs recorded that a former or current ‘Governor of the Bank of England’ had been ‘pluming himself’ at a gathering of the Political Economy Club ‘on the way in which the Bank had passed through the crisis of 1866 without infringing the Act of 1844’.<sup>78</sup> The then-editor of the *Economist*, Robert Inglis Palgrave, promptly enquired how the Bank had braced the crisis, given that a certain amount of its note reserve was not even at the Bank’s disposal in London, but was held instead in the ‘tills at their various country branches at Manchester, Birmingham, Liverpool’.<sup>79</sup> It was common knowledge that the Bank’s cash reserve of notes and coins had shrunk at an alarming rate, from £5 811 745 on the day before Overend’s closure to a mere £1 202 810 a week later (table 2). The statistician William Newmarch ‘settled the question’ by confidently announcing to the assembled dinner party:

You did not break the Act, and I’ll tell you ’ow you did it. You sent the ’at round Lombard Street every night, and we all paid in all the Bank Notes that we had, and we drew them out again the next morning.<sup>80</sup>

<sup>77</sup> Calculated from figures in Clapham, *Bank of England*, vol. II, p. 428.

<sup>78</sup> Political Economy Club, *Minutes*, p. 350; see also Clapham, *Bank of England*, vol. II, p. 269.

<sup>79</sup> Political Economy Club, *Minutes*, pp. 350–1.

<sup>80</sup> *Ibid.*, p. 351.



**TABLE 2** Notes and coins in the Banking Department of the Bank of England, 10 May to 23 August 1866

Date of Bank Return	Notes (£)	Gold and silver coin (£)
10 May 1866	4 950 325	861 420
17 May 1866	730 830	471 980
24 May 1866	830 865	557 351
31 May 1866	415 410	444 570
7 June 1866	2 167 405	658 636
14 June 1866	2 729 330	786 220
21 June 1866	4 067 320	677 010
28 June 1866	4 346 545	871 864
5 July 1866	3 335 800	729 280
12 July 1866	3 094 685	705 955
19 July 1866	2 498 455	726 140
26 July 1866	2 630 035	823 704
2 Aug. 1866	2 412 390	861 000
9 Aug. 1866	2 733 060	847 169
16 Aug. 1866	3 611 505	999 361
23 Aug. 1866	4 508 520	1 081 585

Source: Weekly Bank Return, *London Gazette*, nos. 23115, 23117, 23119, 23122, 23124, 23127, 23129, 23132, 23134, 23137, 23141, 23145, 23147, 23149, 23152, 23154 (May–Aug. 1866).

When the panic swept Lombard Street, Newmarch was managing the accounts of the private bank Glyn, Mills, Currie & Co.<sup>81</sup> In an anonymous article published in *Fraser's Magazine* in August 1866, he explained further that 'the letter of the law was only saved by the London bankers responding to an appeal from the Bank Court to pay every night to the Banking department *all* the notes which, under ordinary circumstances, would have remained in the tills of the bankers themselves.'<sup>82</sup>

This practice of paying 'surplus notes into the Bank of England every night' is corroborated by two of Newmarch's contemporaries.<sup>83</sup> Sir Edward Watkin, the railway magnate and Liberal MP, alluded in the House of Commons to the directors' resourceful efforts to 'prevent their infringing the Act', not least by sending 'round and borrow[ing] bank notes from their customers'.<sup>84</sup> Ten years later, John Peter Gassiot, who had recently resigned as director of the London and Westminster Bank, informed the bank's shareholders that on Black Friday 1866 an emergency application for £500 000 had been made to the Bank of England.<sup>85</sup> The loan was granted at a rate of 10 per cent and against a deposit of upwards of £1 million in bills.<sup>86</sup> The terms affixed to the Bank's liquidity injection stipulated that the advance be repaid before 6 June.<sup>87</sup> Soon afterwards, however, the

<sup>81</sup> Deane, 'Newmarch', pp. 664–5.

<sup>82</sup> 'The financial pressure and ten per cent', *Fraser's Magazine*, Aug. 1866, p. 239.

<sup>83</sup> Gregory, *Westminster Bank*, p. 276; Clapham, *Bank of England*, vol. II, p. 269.

<sup>84</sup> Hansard (Commons), 3rd ser., CLXXXIV, 31 July 1866, col. 1721.

<sup>85</sup> The London & Westminster Bank received the second-largest advance granted by the Bank of England in May 1866. See Flandreau and Ugolini, 'Overend-Gurney panic', p. 137.

<sup>86</sup> Gassiot, *London and Westminster Bank*, quoted in Gregory, *Westminster Bank*, pp. 271–4.

<sup>87</sup> Gregory, *Westminster Bank*, p. 273.



London and Westminster was called on to assist the Bank of England in unconventional ways. In Gassiot's privately published memories of the panic, he recounts how:

On Tuesday, 15th of May, shortly after four o'clock, the Manager of the London and Westminster Bank was somewhat surprised to receive a request from the Bank of England for the loan of such bank notes as it could spare, with a promise that they should be returned in the morning. £140 000 of notes were sent. The system of borrowing was continued day by day until the 6th June.<sup>88</sup>

From 15 May until 6 June, the Bank arranged for the London and Westminster on request 'to pay in at the close of the day as many bank-notes as it could spare [ranging from £80 000 to £200 000] irrespective of the usual payments'.<sup>89</sup> That same day, 15 May, the Governor of the Bank had reported back to Gladstone that he was 'exceedingly glad to be able to say that we are still within our legal bounds' and 'cannot help hoping that we may continue to improve our position day by day'.<sup>90</sup> While it is not clear how many City banks obliged the Bank in this way, it cannot be doubted that, without their cooperation, the Governors would have been forced to transfer notes from the Issue Department and forego the profits incurred on its discounts and advances.<sup>91</sup> Its Governors trod a dangerously narrow path, knowing that if an unchecked run had been staged on the Bank, its reserve would have been swiftly exhausted. For as the *Economist* observed in May, 'if one or two large bankers had drawn their balances, all the rest would have followed like sheep, and the banking department of the Bank of England *must* have been left bare'.<sup>92</sup> In the event, the Bank successfully balanced its need for self-preservation with the guiding commercial principles of its charter. By calling in favours to ensure the provision of banknotes under the 1844 Act, the Governors employed an analogous measure to the well-established 'gold devices', to which the Bank at times took recourse in order to uphold gold convertibility.<sup>93</sup> The Bank's crisis lending in 1866, when considered in light of its commercial gains, therefore stands out as a unique combination of window-dressing and *quid pro quo* with the City's banking community.<sup>94</sup>

## II

That a financial crisis of such unparalleled scale and severity should receive little in the way of parliamentary scrutiny is undoubtedly astonishing.<sup>95</sup> The continued tension in the money market during the summer of 1866 coincided with the defeat of the Second Reform Bill at the hands of Adullamites and Tories and the subsequent downfall of the last Russell Ministry.<sup>96</sup> In the ensuing

<sup>88</sup> Gassiot, *Monetary panic of 1866*, p. 11.

<sup>89</sup> Ibid., p. 11; Gregory, *Westminster Bank*, p. 274.

<sup>90</sup> BL, Add. MS 44,410, fos. 172–3, Henry L. Holland to William E. Gladstone, 15 May 1866.

<sup>91</sup> Gassiot, *Monetary panics*, p. 37.

<sup>92</sup> *Economist*, 19 May 1866, p. 582.

<sup>93</sup> Eichengreen and Flandreau, 'Editors' introduction', pp. 10–11.

<sup>94</sup> On the nineteenth-century practice of financial window-dressing, see Capie and Webber, *Monetary history*, vol. I, pp. 266–7. With thanks to the article's referees for discussion on the Bank's operational flexibility in its monetary and banking policies.

<sup>95</sup> King, *London discount market*, p. 244.

<sup>96</sup> The Adullamite rebellion of Liberal backbench MPs against the Second Reform Bill overshadowed the parliamentary session and precipitated the establishment of a Conservative minority government in late June 1866.



interregnum, between Lord Russell's resignation in late June and the accession of Lord Derby's Conservative government, criticism of the Bank's discount policy started to mount. Downing Street thereafter became again the scene of commercial deputations, supported in their demands by contributors to the *Bankers' Magazine* and memorials from the Chambers of Commerce of Birmingham, Bristol, and Glasgow.<sup>97</sup> In the Commons, Sir Edward Watkin requested that the government institute an inquiry into the proceedings of the Bank directors 'in order to ascertain whether they really comprehended the gravity of the crisis; or, comprehending it, whether they took any ... steps to alleviate it before the Government letter appeared'.<sup>98</sup> On three separate occasions between July and August 1866, Watkin called for a Royal Commission on the causes of the crisis as well as the conduct and principles underpinning the management of the currency.<sup>99</sup> Watkin's motion not merely inquired into the Bank's use of the Chancellor's Letter, and the effects of its discount policy, but implicitly questioned the legal foundations of the Bank's governance.

Neither the Liberals nor the Conservatives, however, showed any political appetite for reviewing the contested principles underlying Peel's 1844 Act. Russell's Ministry avoided re-opening the dreaded subject and the proposed wider remit for the commission lacked cross-party backing. Gladstone's verdict was to object to the appointment of a commission on the grounds that 'we ought never to ask a Government to undertake a function which it is impossible for them to perform with any approach to satisfaction'.<sup>100</sup> He cautioned that a parliamentary inquiry 'so far as it related to causes and principles' would merely spawn another row between Currency and Banking School theorists.<sup>101</sup> The newly appointed President of the Board of Trade, Sir Stafford Northcote, likewise took the view that, given the divided recommendations of previous commissions, it would be 'hopeless ... to investigate practical questions tending to legislation unless you have made up your mind on which of the two theories you intend to proceed'.<sup>102</sup> Within a fortnight of assuming office, Disraeli, who had succeeded Gladstone as Chancellor, similarly expressed his reluctance towards a Royal Commission:

What I think we are suffering from is not so much a want of currency as a want of capital. I do not think there is any banking arrangement that could relieve us from the embarrassments we are now daily experiencing.<sup>103</sup>

With the parliamentary session drawing to a close in mid-August, the Conservative government consented to review the matter further over the recess.<sup>104</sup> No legislative proposals on the subject, however, were put forward on the state opening of Parliament in February 1867, and with the battle to secure the Second Reform Act taking up most of Disraeli's energies, the case against a commission was once and for all sealed.

<sup>97</sup> *Bankers' Magazine*, Sept. 1866, pp. 1045–8; *Economist*, 20 Oct. 1866, pp. 1224–5; *The Times*, 19 July 1866, p. 5.

<sup>98</sup> *Bankers' Magazine*, Aug. 1866, p. 917; *Hansard* (Commons), 3rd ser., CLXXXIV, 31 July 1866, cols. 1706–27.

<sup>99</sup> *Hodgkins, Watkin*, pp. 278, 284–7; *Hansard* (Commons), 3rd ser., CLXXXIV, 20 July 1866, col. 1258; 31 July 1866, cols. 1706–27; 6 Aug. 1866, cols. 2124–5.

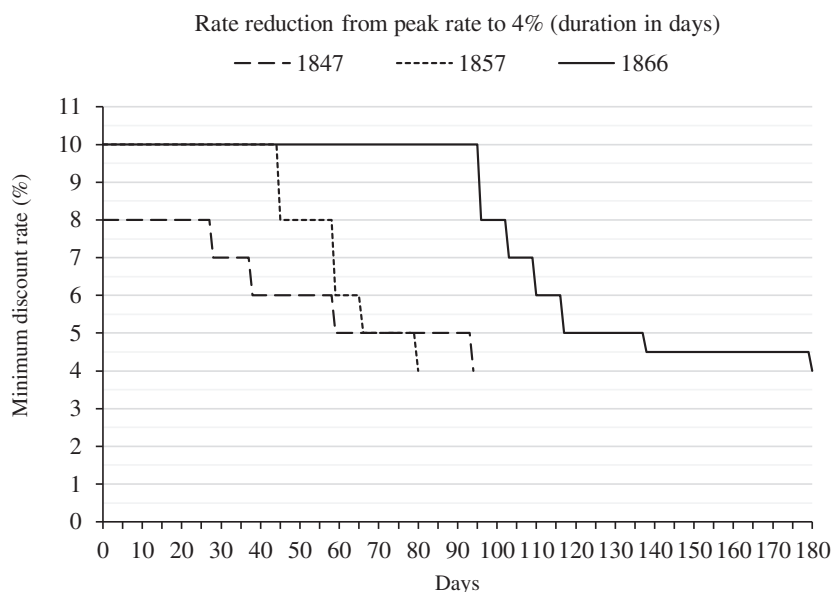
<sup>100</sup> *Hansard* (Commons), 3rd ser., CLXXXIV, 31 July 1866, col. 1754.

<sup>101</sup> *Ibid.*, 31 July 1866, col. 1755.

<sup>102</sup> *Ibid.*, 31 July 1866, col. 1739.

<sup>103</sup> *Bucks Herald*, 21 July 1866, p. 3.

<sup>104</sup> *Hodgkins, Watkin*, p. 285; *Bankers' Magazine*, Sept. 1866, p. 1043.



**FIGURE 1** Bank of England minimum rate of discount during the financial crises of 1847, 1857, and 1866.

Source: Clapham, *Bank of England*, vol. II, pp. 429–30

There is reason to believe that had a lengthy parliamentary inquiry taken place—as was the case after the crises of 1837, 1847, and 1857—the Governors of the Bank would have been asked to explain their rationale for keeping Bank Rate at 10 per cent for 95 days. The three months of ‘dear money’ that followed Overend’s collapse contrasted markedly with the Bank’s discount policy in 1847 and 1857 (figure 1). During the crisis of 1847 the ‘penal rate’ set by Downing Street had been 8 per cent, and was maintained at this level for 27 days; similarly, in 1857 the minimum discount rate of 10 per cent at the start of the crisis gradually declined to 4 per cent in the course of a quarter.<sup>105</sup>

Even though the Bank averted a parliamentary inquiry into its handling of the crisis, its position *vis-à-vis* the market formed the source of prolonged scrutiny in the national press. Criticism of the Governors’ policy was mounting from July 1866, with the dearness in the money market featuring frequently in the news reporting of the post-crisis months. The editor of the *Globe*, R. H. Patterson, denounced the Bank’s discount policy for imposing an ‘artificial restriction upon the supply of banking-currency’ which, in the general atmosphere of panic and suspicion, had the consequence of forcing even solvent houses to their knees.<sup>106</sup> Writing after ten weeks of high Bank Rate, Bagehot’s editorials in the *Economist* condemned the Bank’s management of the crisis for needlessly casting doubt and uncertainty over the credit of many English merchants. While ‘[t]he failure of Overends made our foreign creditors sceptical and inquisitive’, Bagehot noted in July, ‘the long prevalence of 10 per cent has made them incurably distrustful and suspicious’.<sup>107</sup> Not only did the 10 per cent keep the City in a state of alarm, the mistrust it engendered abroad in the stability of London’s financial institutions also failed to attract a large influx of gold from

<sup>105</sup> Hansard (Commons), 3rd ser., CLXXXIV, 31 July 1866, col. 1715.

<sup>106</sup> Patterson, *Science of finance*, pp. 238–9.

<sup>107</sup> *Economist*, 21 July 1866, p. 846.





the Continent.<sup>108</sup> Bagehot also remained highly critical of the Bank for failing to provide emergency assistance ‘on any distinct principle’; instead, he claimed, ‘they naturally do it hesitatingly, reluctantly, and with misgiving’.<sup>109</sup> His journalistic campaign for an unrestricted lender-of-last-resort facility sparked a well-publicized controversy with Thomson Hankey, a West India merchant, director and former Governor of the Bank.<sup>110</sup> During the autumn of 1866, his *Economist* editorials repeatedly called on the Bank to acknowledge the duty that flowed from its holding the ‘ultimate cash reserve’ of Britain’s banks.<sup>111</sup> In the eyes of Hankey, Bagehot advocated ‘the most mischievous doctrine’ according to which the Bank should ‘keep money available at all times to supply the demands of Bankers who have rendered their own assets unavailable’.<sup>112</sup> Supported in his views by two former Governors, George Warde Norman and John Hubbard, Hankey commissioned the publication of *Principles of banking, utility, and economy*, originally a lecture given to his constituents at Peterborough in 1858.<sup>113</sup>

Hankey’s *Principles* defended the Bank’s conduct in past financial crises and maintained that its behaviour conformed to the outlook of any other commercial bank.<sup>114</sup> Its primary concern during a panic should be ‘to bear its full share of a drain on its resources’, without assuming ultimate responsibility for the capital market.<sup>115</sup> Bagehot’s ‘doctrine’, so Hankey believed, would have subjected the Bank to the unpredictable outgrowths of moral hazard. If it could be relied upon that the Bank stood always ready to lend freely to whoever applied for assistance, financial institutions would be incentivized to take on greater risks and hold less adequate reserves.<sup>116</sup> From this observation he concluded that:

I should be sorry to see any interference to prevent persons overtrading or speculating. Let every one invest his own money as he pleases; let every one trade on what capital he pleases, borrow money at what rate and on what security he pleases; *but* the trading community must be taught at some time or other that no such establishment as the Bank of England can provide ready money beyond a certain clearly-established limit, and that limit is the money left in their hands by their depositors.<sup>117</sup>

Beyond its implications for the professional ethics of Victorian banking, last resort lending was fundamentally objectionable to Hankey on political-economic grounds. It presupposed a paternalist attitude on the part of the Bank towards the banking community, while assigning its Governors a public duty to intervene in the market.

<sup>108</sup> On 1866 as a twin banking and currency crisis, see Flandreau and Ugolini, ‘Crisis of 1866’, pp. 89–91; Andreadès, *Bank of England*, p. 360.

<sup>109</sup> Bagehot, *Lombard Street*, p. 64.

<sup>110</sup> *Economist*, 22 Sept. 1866, pp. 1105–6; 8 Dec. 1866, pp. 1418–9. For discussions of the Bagehot–Hankey controversy, see Fetter, *British monetary orthodoxy*, pp. 268–83; Dowd, *Laissez-faire banking*, pp. 237–40.

<sup>111</sup> Fetter, *British monetary orthodoxy*, pp. 273–4; Bagehot, *Lombard Street*, pp. 315–19.

<sup>112</sup> Hankey, *Principles of banking*, p. 25.

<sup>113</sup> *Ibid.*, pp. 1, 39; George Warde Norman in *Economist*, 22 Dec. 1866, p. 1488.

<sup>114</sup> Hankey, *Principles of banking*, p. 26.

<sup>115</sup> *Ibid.*, p. 26; Dowd, *Laissez-faire banking*, pp. 237–8.

<sup>116</sup> Hankey, *Principles of banking*, pp. 19–21.

<sup>117</sup> *Ibid.*, pp. 21–2.



The Bank's chief spokesman in Parliament, the former Governor John Hubbard, equally contested Bagehot's claim that, as the holder of the bankers' balances, the Bank had a duty to come to the rescue of the market. In July 1866 he asserted in the Commons that 'in no case should encouragement be given to the banking world to assume that, in any emergency, they had a right to ask the Government to supply them at any price with a reserve which they should in common prudence have secured for themselves'.<sup>118</sup> In his view, the Banking Department's autonomy safeguarded to a certain degree against financial excesses and moral hazard by fostering self-reliance among the financial community. Hubbard instead supported proposals to increase the Treasury's discretionary powers over the central note issue, so as to prevent further infringements on the Bank's commercial operations. In a series of letters to *The Times*, he advocated the authorization of Exchequer bills as 'subsidiary currency' in future crises to eliminate any necessity to breach the 1844 Act.<sup>119</sup>

Even though a Royal Commission was off the table, the Bank Charter Act was due for renewal in 1870. Continued agitation in the Commons to reform the Bank's statutes threatened a potential devolvement of powers away from Threadneedle Street to the Treasury. While the suspension of the legal limit on the Bank's note issue had exposed yet again the shortcomings of Peel's Act, the City itself was challenging the Bank's privileged status. The private banker, politician, and scientist Sir John Lubbock had long criticized the Bank's reserve as inadequate in the event of a crisis. His 1860 treatise laid out the case in favour of a confederation of clearing banks, organized under a multi-reserve system, and after Overend's collapse Bagehot revived the discussion in the *Economist's* columns.<sup>120</sup> Bagehot's editorials promoted an 'oligarchical' system of multiple banking reserves as a more 'natural' option to the status quo.<sup>121</sup> Both the City's internal rumblings and Bagehot's journalistic crusade strove to strip the Bank of its legal privileges. The Bank's battle to protect its commercial autonomy ultimately culminated in Richard Lowe's failed Bank Notes Bill of 1873, and the 1875 Select Committee on Banks of Issue. Seminal works on central banking have examined in detail the legislative remedies proposed on these occasions and in a flurry of nineteenth-century pamphlets.<sup>122</sup> What they illustrate is that the Bank's status was under severe scrutiny and pressure to adapt—both from Whitehall and from the banking community.

While the Bank had lent liberally at the outbreak of the panic, the crucial point of contention centred on 'why the authority' granted 'by the Government letter ha[d] not been exercised'.<sup>123</sup> In pursuit of profit, the Bank had refrained from adding to the note circulation, as licensed in the Chancellor's Letter, and so economized on the bank notes available for commercial needs. The Bank's approach to crisis lending thus continued to be rooted in its private status and strong concern for its own solvency and institutional independence. Its response on Black Friday displayed both the Governors' commercial acumen and an aspiration for the Bank to take up a position of moral leadership in the market.

Governor Holland's management combined a pragmatic approach to crisis assistance with a critically neglected moralist agenda that closely resembles the Currency School's cathartic

<sup>118</sup> *Hansard* (Commons), 3rd ser., CLXXXIV, 31 July 1866, col. 1754.

<sup>119</sup> John Hubbard, *The Times*, 14 May 1866, p. 7; 17 April 1873, p. 7.

<sup>120</sup> Lubbock, *London bankers*; *Economist*, 29 Sept. 1860, pp. 1062–3; Fetter, *British monetary orthodoxy*, pp. 269–71.

<sup>121</sup> *Economist*, 25 Aug. 1866, pp. 995–6; 1 Sept. 1866, pp. 1025–6.

<sup>122</sup> See Mints, *Banking theory*, ch. 10; Wood, *Theories of central banking*, ch. 15; Fetter, *British monetary orthodoxy*, chs. 7–9.

<sup>123</sup> *Bankers' Magazine*, Aug. 1866, p. 917.



rationale of 'letting a crisis burn out'.<sup>124</sup> That insolvent finance houses which had committed grave misjudgements should shoulder the consequences of their errors, rather than being rescued from liquidation, held strong currency among City authorities. In a paper given to the Royal Statistical Society of London in 1872, Hammond Chubb, Secretary to the Bank of England from 1864 to 1894, enunciated this doctrine, which—though unacknowledged as a policy directive—serves to justify Overend's fate as due punishment for its discredited practices. Chubb insisted that:

[T]he speculative trader is always anxious to individualise himself, and yet to be of the nation. 'Give me,' he says, 'the means I want. I have nothing to do with these national crises.' But he cannot separate himself thus. He has been swelling the volume of fictitious capital; he has been doing his utmost to force into circulation an unreal currency; ... and with the break-down of these, he must suffer with the rest.<sup>125</sup>

Speculation on debts not only signified a severe character failing; on the macro-level it also embodied a systemic danger to the entire financial community. Consequently, Overend's business practices and its dramatic collapse quickly turned into a cautionary tale. Governor Holland purposefully used his long-awaited speech at the next shareholders' meeting to denounce Overend's practice of 'financing' in the clearest terms.<sup>126</sup> The sheer size of an establishment's financial operations, such was the implied warning, was no guarantee for future assistance.

Seized upon by the *Economist* as a policy-defining speech, Holland's address to the General Court in September 1866 stands out as a diplomatic yet double-edged episode from his otherwise unassuming career at the Bank.<sup>127</sup> In praising the Bank's management of the panic, Holland maintained that:

This house exerted itself to the utmost—and exerted itself most successfully—to meet the crisis. We did not flinch from our post. When the storm came upon us, on the morning on which it became known that the house of Overend and Co. had failed, we were in as sound and healthy a position as any banking establishment could hold; and on that day and throughout the succeeding week, we made advances which would hardly be credited ... we would not flinch from the duty which we conceived was imposed upon us of supporting the banking community, and I am not aware that any legitimate application for assistance made to this house was refused.<sup>128</sup>

The Governor's address has since repeatedly been interpreted as an outright admission of the Bank's willingness to assume the role of a fully-fledged lender of last resort. Instead, Holland accomplished a skilful balancing act aimed at diffusing public scrutiny of the Bank's conduct on Black Friday and its subsequent discount policy. If the emerging trend towards tighter regulation of the Bank's interaction with the market and the 'squeezing out' of its established privileges was to be pre-empted, the Bank was well advised to show greater sensitivity to the long-run health of the financial sector. By doing so, the Governors pursued a chiefly conservative agenda: to retain

<sup>124</sup> Kindleberger, *Manias, panics, and crashes*, pp. 126–9.

<sup>125</sup> Chubb, 'Bank Act', p. 177.

<sup>126</sup> *Bankers' Magazine*, Oct. 1866, p. 1196.

<sup>127</sup> *Economist*, 22 Sept. 1866, pp. 1105–6.

<sup>128</sup> *Bankers' Magazine*, Oct. 1866, pp. 1193–4.



the status quo of the Bank's commercial operations and to forestall criticism that the Bank had acted too late and lent too little. In return, the Governors conceded the institution's adoption of a supervisory (though not yet regulatory) role over the nation's financial system. While this new role was imbued with a sense of moral supremacy, the Bank still retained a strategic degree of uncertainty with regard to its future conduct towards the market. Both within and outside the Bank Parlour, Holland's speech was heavily contested for its dissenting representation of the Bank's established relationship with Lombard Street.<sup>129</sup> Condemned as a misguided doctrine, the Governor's rhetorical masterstroke lastingly shaped Threadneedle Street's policy towards crisis assistance. Whilst the Bank had extended 'unconditional' support to the City during the onset of the panic, the Governors had simultaneously preserved the Bank's discretionary right to refuse securities presented to it on the basis of whether or not they were considered good collateral.

Not only had the Governors prevented a breakdown of the credit system, but they had also enhanced the Bank's discretionary power and influence over the London money market by employing the policy weapon of 'constructive ambiguity'. Constructive ambiguity could effectively limit moral hazard, if utilized both *ex ante* and *ex post* financial crises.<sup>130</sup> In practice, the Governors made no commitment to save any individual institution and maintained that each crisis ought to be judged on a case-by-case basis depending on the domestic and international financial environment. Such a stance received added credibility from the fact that the Governors were answerable neither to the government nor to the electorate, but solely to the company's proprietors. This strategy was maintained during the subsequent nineteenth-century crises in 1878 and 1890, during which the Bank closely monitored the risk of financial contagion, while preserving its room for manoeuvre within the confines of the Charter Act. Even as late as 1893, George Clare noted that the Bank's existing arrangements and any delays in obtaining a Chancellor's Letter at the onset of a panic tend to heighten the sense of alarm and distrust in the money market. When a crisis approaches, he wrote, '[i]t is uncertain whether the Directors will take action in time, ... uncertain whether the Reserve will hold out until relief is given, and so on, and it is this leaven of uncertainty that does all the mischief'.<sup>131</sup> Far from a pre-commitment to crisis lending, the Bank's stance in 1866 sought to preserve its autonomy, while fostering prudence and self-reliance in the money market.

From Holland's speech at the annual shareholder meeting and its fiercely contested reception, it is evident that the post-crisis period had far from reconciled the tensions arising from the Bank's dual identity, which de Cecco has termed 'the most serious internal contradiction in the British financial system'.<sup>132</sup> Guaranteeing the stability of the credit system without sacrificing the Bank's privileged status, as the Governors gradually became aware, was only attainable through re-discounting and the development of efficient instruments to monitor market discipline. Its evolving supervisory function, as Dimsdale, Hotson, Flandreau, Bignon, and Ugolini have observed, involved customized screening methods and prophylactic measures for raising the quality of bills in the market and consequently of the collateral presented for advances.<sup>133</sup> Beyond erecting barriers against moral hazard, such measures guaranteed that potential losses from

<sup>129</sup> *The Times*, 26 Dec. 1866, pp. 4–5.

<sup>130</sup> Freixas et al., 'Lender of last resort', pp. 40–1; Congdon, *Central banking*, p. 103.

<sup>131</sup> Clare, *Money-market primer*, p. 62.

<sup>132</sup> de Cecco, *Money and empire*, pp. 82–3.

<sup>133</sup> Dimsdale and Hotson, 'Financial crises', pp. 41–9; Bignon et al., 'Bagehot for beginners', pp. 583, 600–1; Flandreau and Ugolini, 'Overend-Gurney panic', pp. 151–2.



emergency liquidity operations were reduced in the long term.<sup>134</sup> What the Governors' unwillingness to rescue Overend had demonstrated was that the Bank could not be relied on to extend bailouts or special treatment to insolvent institutions, irrespective of their fortune or eminence in the City. The Bank thereby cautioned that even systemically important businesses did not labour under a 'too-big-to-fail' guarantee, thus eliminating the moral hazard problem from the policy equation.<sup>135</sup> The path chosen by the Governors in 1866 effectively circumvented the moral hazard problem since the Bank's intervention in the wholesale market through the discount houses ensured both that the payments system was stabilized and that systemic risks from contagion effects were rendered manageable.<sup>136</sup> Figuring prominently in the Bank's calculations was the belief that long-term benefits derived from refusing to rescue insolvent institutions may outweigh the temporary fruits of cooperation.<sup>137</sup>

Central banking statesmanship gradually grew out of this Victorian crisis of confidence, which galvanized criticism of the Bank's governance and its stance on last resort lending. The Governors' liberal yet profitable handling of the Overend & Gurney panic strengthened political and external pressures on the Bank to acknowledge its 'equivocal position of having to serve two masters—the public, who cry for reserves; the shareholders, who call for dividends'.<sup>138</sup> Whereas the existing literature assumes a limited set of policy choices, confined either to credit rationing or to last resort lending, the Bank's intervention in 1866 demonstrates that multiple facets of crisis lending co-existed beyond these polar opposites. The Overend & Gurney panic thus highlights that the trade-offs faced by the Bank between financial stability and cooperation on the one hand, and profits and competition on the other, were often mutually compatible in this period. Separating the Bank's emergency operations from its long-run policy further unmasks two existing misconceptions: firstly, concerning its approach to credit assistance and, secondly, about its attitude towards moral hazard. While the actual strength of the demands on its reserve could not be anticipated, Overend's collapse hardly came as a shock to the Bank, which in the months leading up to the crisis had gathered sufficient intelligence to assess its competitor's financial situation. The Bank's decision to assist the capital market therefore appears neither ad hoc, nor at the expense of its private profits: the heavily criticized 10 per cent clause, set out in the Chancellor's Letter, assured as much. With an Exchequer letter always within arm's reach, the Bank preserved a loophole that would allow it to surpass its statute, if necessary, whilst protecting its discretionary powers. During the prolonged period of financial stringency from May to July 1866, the Governors compensated for their liberal advances by shrewdly avoiding exercise of the Chancellor's licence—and in so doing representing a *de jure* but not *de facto* suspension of Peel's Act.

Without infringing the Bank's charter, the Governors' crisis lending offered emergency liquidity through the discount market while adopting a supervisory authority to punish those guilty of professional malpractice. Swayed by external pressures to justify its conduct after the crisis, the Bank instituted a policy of 'constructive ambiguity' that both defended its political independence and satisfied its duties towards its shareholders. In combining commercial acumen and moral suasion, the Governors' strategy of holding the market in suspense as to its conduct in future crises effectively limited the risks of moral hazard. Under close public scrutiny, the Bank's governance

<sup>134</sup> Flandreau and Ugolini, 'Crisis of 1866', pp. 77, 88–9.

<sup>135</sup> Capie, 'Bank of England as a mature central bank', p. 307; Scammell, *London discount market*, p. 169.

<sup>136</sup> Michie, 'Too big to fail', p. 15.

<sup>137</sup> Capie, 'Bank of England as a mature central bank', pp. 306–7.

<sup>138</sup> Dun, *British banking statistics*, p. 128.



and approach to last resort lending gradually evolved into its twentieth-century mould. Between 1866 and 1890, the Bank strategically refined its control mechanisms, so as to safeguard the capital market without sacrificing either its privileged legal status or its private business concerns.

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