

**Bank of England
Banking Act report
for 1987/88**



Banking Act 1987

Introduction	3
I Market developments	4
II Policy initiatives and developments	5
1. Domestic policy	5

Annual report under the Banking Act for 1987/88

Large exposures	6
Overseas asset control	7
Banking market clearance and funds	7
Letter to bank	7
Asset realisation	7

This report on the exercise of the Bank's functions under the Banking Act 1987 during the year to 29 February 1988 is presented to the Chancellor of the Exchequer, and by him to Parliament, pursuant to section 1(3) of the Act.

2. International policy	7
Committees and the Bank Supervision Committee	7
EC Directives and supervisory bodies	7
III Operational supervision	41
The legal framework	41
Supervision under the Act	41
Enforcement	41
Disposal orders	41

IV Organisation and staffing of Banking Supervision Division	52
--	----

Appendices	
1. Country debt provisioning ratios	54
2. Current supervisory workload	56
3. Current consultation papers	56
4. Banking Act 1987 orders and regulations	56
5. Banking Supervision Division organisation	56
6. Geographical representation of overseas institutions	56
7. Authorised institutions	57
List of those authorised	57
Changes in the authorised population	71
ANNEX	
List of banks authorised	72
List of banks supervised by the Bank of Banking Supervision	72

Banking Act 1987

Annual report under the Banking Act for 1987/88

This report on the exercise of the Bank's functions under the Banking Act 1987 during the year to 29 February 1988 is presented to the Chancellor of the Exchequer, and by him to Parliament, pursuant to section 1(1) of the Act.

© Bank of England 1988
ISSN 0308-5279

Printed in England by
Stephen Austin and Sons Ltd, Hertford

Contents

Introduction	5
I Market developments	6
II Policy initiatives and developments	16
1 – Domestic policy	
Capital adequacy	16
Country debt provisions: the Bank's matrix	18
Loan transfers and securitisation	20
Large exposures	22
Ownership and control	24
Building societies' conversion into banks	25
Liquidity stock	26
Audit committees	27
The Bank's relationship with auditors and reporting accountants	29
The Bank's relationship with securities and other supervisors	31
2 – International policy	
Convergence and the Basle Supervisors Committee	37
EC Directives and supervisory bodies	38
III Operational supervision	43
The legal framework	43
Supervision under the Act	45
Enforcement	51
Discount houses	53
IV Organisation and staffing of Banking Supervision Division	55
Appendices	
1 Country debt provisioning matrix	57
2 Current supervisory notices	60
3 Current consultative papers	61
4 Banking Act 1987: orders and regulations	62
5 Banking Supervision Division organogram	64
6 Geographical representation of overseas institutions	65
7 Authorised institutions	67
List of those authorised	67
Changes in the authorised population	71
Annex	
Annual Report by the Board of Banking Supervision	73

Annual report under the Banking Act for 1987/88

Introduction

The supervision of banks in the United Kingdom has been significantly strengthened in the past year by the coming into force of the new Banking Act, by the implementation of several major policy initiatives, and by the continued strengthening of the Bank's resources in this area. The 1987 Act removed the two-tier structure of recognised banks and licensed deposit-takers, and extended the range of statutory powers available to bank supervisors. Alongside these legal developments, a number of policy proposals were announced which aim to improve the way in which banks are supervised in today's increasingly competitive and integrated financial markets. A major part of these initiatives has been the international harmonisation of policy with respect to capital adequacy and the strengthening of the Bank's relationships with other supervisors.

The Board of Banking Supervision—which the Act placed on a statutory basis—has continued to offer valuable advice to the Bank on supervisory issues. The Board's own Annual Report appears on pages 73–74 as an Annex.

This year's Report offers a detailed review of the activities of Banking Supervision Division in 1987/88. Like last year's Report, it commences with a review of market developments over the year, highlighting issues of particular supervisory interest. Part II considers the major policy initiatives which have been undertaken at the national level and internationally. Part III reviews the current structure of operational supervision including the legal framework, the process of supervision under the Banking Act, and the Act's enforcement. Finally Part IV looks at changes in the organisation and staffing of the Division.

Part I

Market developments

Introduction

1987 has been a year of mixed fortunes for many British banks. Those with exposures to countries experiencing payment difficulties have had to reassess the value of their country debt. Margins on international business and on corporate lending have remained tight. Many banks, including those which diversified into the securities markets following Big Bang, have had to reappraise their strategy in the face of surplus capacity in these markets.

On a more positive note, the underlying profitability of most banks has continued to improve as financial controls are tightened. There has been a recognition of the need to focus on competitive strengths in core markets. Most UK banks have seen some improvement in domestic business volumes and non-interest income and this has provided the necessary funds to invest in people and technology in order to remain competitive.

Last year's review of market developments concentrated on trends in profitability and capital in the large British banks and the accepting houses. This year's review again looks at the performance of the large British banks⁽¹⁾ but starts with an overview of business trends for the UK banking sector as a whole. Rather than analysing the accepting houses as a group, the review this year looks at a broader range of UK institutions involved in merchant and investment banking.

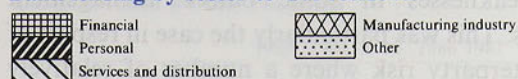
Business trends

Loan portfolios

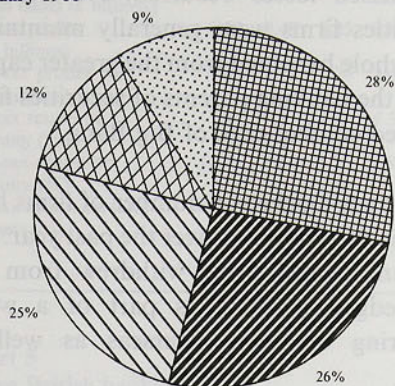
The level of bank lending overseas fell by 4% in 1987, largely as a result of the appreciation of sterling against the US dollar, in which the bulk of international lending is denominated. By contrast, lending to UK residents rose strongly. For example, lending to the financial and personal sectors grew by 19% and 31% respectively in the year to February 1988. Bank lending to business and other services (including property companies) increased by 32% but lending to manufacturing industry showed comparatively

(1) A glossary on pages 14-15 provides definitions of this and other terms used in Part I and identifies sources of information.

Chart 1
Bank lending by sector to UK residents



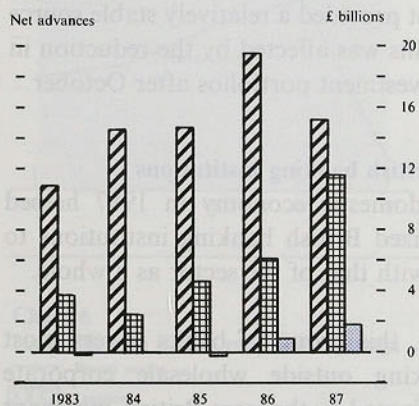
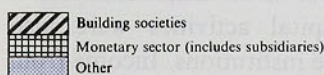
February 1988



little change over the year. The proportion of total bank lending to the personal sector rose from 24% in February 1987 to 26% a year later while that to manufacturing industry fell from 14% to 12%. The shares of different sectors at end-February 1988 are illustrated in Chart I opposite.

The buoyancy of bank lending to the financial sector represents heavy demand from a range of financial institutions. Lending to investment trusts and insurance companies grew rapidly, especially in the earlier part of 1987. A sharp rise in lending to securities dealers during the middle months of the year was partially unwound in the fourth quarter as the volume of trading declined and back office problems were resolved. Lending to leasing companies also increased, associated with the unexpectedly strong demand for leasing despite reduced tax advantages.

Chart 2
Loans for house purchase



The personal sector remains very important, both as a growth area and because of its profitability. In part such growth reflects a shift in consumer behaviour, as people increase their demand for credit, most notably for housing, and change their payment methods with a rise in the general use of credit cards.

As Chart 2 illustrates, the UK monetary sector's total advances (net of repayments) for house purchase approached that granted by the building societies in 1987. The chart also illustrates the growing competition from other lenders, notably special purpose mortgage vehicles which typically repackage mortgages for on-sale.

The significance of lending for house purchase for the large British banks is indicated in Table I. This shows the rapid increase in such lending in 1987, both in absolute terms and as a proportion of their total domestic business.

Table I
Large British banks: personal lending^(a)

£ billions, percentages in italics	1983	1984	1985	1986	1987
Total lending for house purchase	13.0	14.4	17.5	21.6	28.8
<i>As percentage of personal advances</i>	<i>52.7</i>	<i>51.0</i>	<i>51.9</i>	<i>53.8</i>	<i>56.8</i>
<i>As percentage of total sterling advances</i>	<i>19.7</i>	<i>19.6</i>	<i>20.3</i>	<i>21.7</i>	<i>23.8</i>
Other lending to persons	11.7	13.8	16.3	18.5	21.9
<i>As percentage of total sterling advances</i>	<i>17.7</i>	<i>18.8</i>	<i>18.9</i>	<i>18.6</i>	<i>18.1</i>

(a) Data are end-November for 1987, mid-November for preceding years.

Merchant and investment banking

In the first part of 1987, most investment businesses, including subsidiaries of the large British banks and a number of other specialised merchant banks, experienced a high level of profits. A significant part of these profits was, however, offset by the losses sustained as a result of the sharp adjustment in stock market prices last October.

As the stock markets fell, many banking groups suffered significant losses both on underwriting, in large part relating to the BP share offer, and on their trading activities

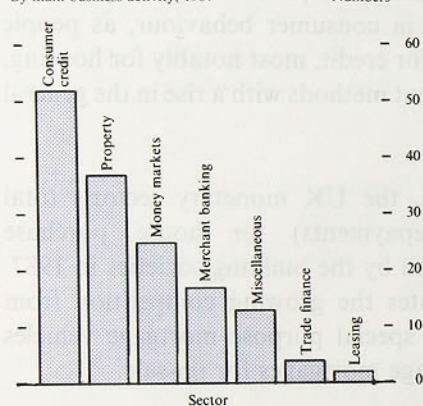
from holding long open positions in equities. Events highlighted weaknesses in some banks' management control systems. This was particularly the case in respect of client or counterparty risk where a number of relatively small but well-publicised losses occurred. Nevertheless, credit lines to securities firms were generally maintained and the market as a whole benefited from the greater capital backing provided by the banking parents of securities firms which was an intended consequence of Big Bang.

In fixed-interest securities markets, a number of firms have also encountered difficult conditions over the past year. For example, several bank-owned firms withdrew from the eurobond and gilt-edged markets as part of a wider corporate restructuring involving overseas as well as domestic operations.

However, income from corporate advisory work and other services held up well throughout the year and was probably the major source of income for most merchant banks. Profits from development capital activities were also significant for a number of these institutions. Income from investment management provided a relatively stable source of earnings, although this was affected by the reduction in the average value of investment portfolios after October.

Chart 3
Medium and smaller British banking institutions

By main business activity, 1987

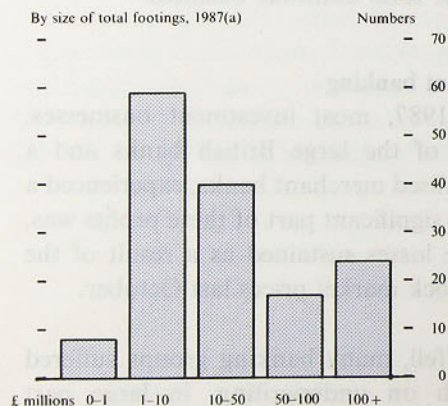


Medium and smaller British banking institutions

The strength of the domestic economy in 1987 helped medium and smaller-sized British banking institutions to record growth in line with that of the sector as a whole.

Chart 4
Medium and smaller British banking institutions

By size of total footings, 1987(a)



(a) December 1987 or January 1988 according to reporting schedule.

As Chart 3 illustrates, this group of banks covers most sectors of UK banking outside wholesale corporate business, which is dominated by the large British, merchant and foreign banks. The medium and smaller banks are particularly well represented in lending to the consumer and property sectors and there are a substantial number engaged in money-market business. Many of these institutions are small, with less than £10 million total assets, but a few are considerably larger, as Chart 4 shows. The diversity of this group makes it difficult to identify trends but some observations can be made.

The assets of this group grew by about 25% in 1987 and its profits by around 10%. Consumer credit was a successful area, particularly for those offering specialised products in which the larger institutions were unable, or unwilling, to compete. Notable examples are the market for second

Table II
Large British banks: earnings

	1983	1984	1985	1986	1987
Trading profits before bad debts (£ billions)	3.72	4.53	4.94	5.55	5.93
Pre-tax profits (£ billions)	2.23	2.48	3.25	3.80	0.62
Post-tax profits (£ billions)	1.42	1.11	1.76	2.45	0.01
Pre-tax return on equity (%)	17.2	19.3	24.3	24.5	3.4
Post-tax return on equity (%)	10.9	8.6	13.2	15.8	0.1
Pre-tax return on total assets (%)	0.88	0.85	1.09	1.19	0.18

Chart 5
Large British banks

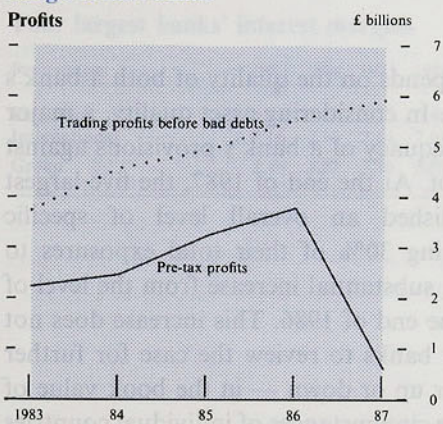
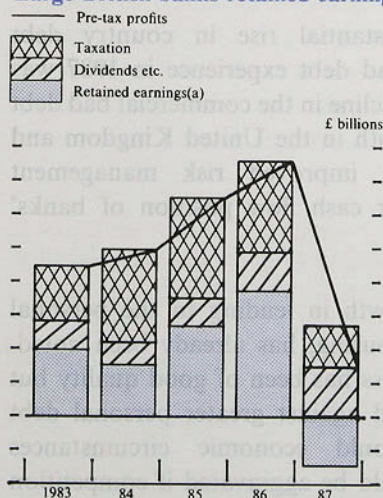


Chart 6
Large British banks retained earnings



(a) In 1987, retained earnings were -£0.72 billion, slightly less in value than dividends etc. of £0.73 billion.

mortgages and the funding of business expansion schemes.

Increasing competition from larger banks has, however, placed considerable pressure on the business activity and margins of the smallest companies. They also face the heaviest relative costs in satisfying the minimum criteria for authorisation. This has contributed to a record use of the Bank's formal powers of investigation and to a high incidence of surrenders and revocations in 1987 (see Part III).

Earnings and capital adequacy of large British banks

The profitability of the large British banks between 1983 and 1987 is shown in Table II. Trading profits before bad debts for these banks rose by about 7% in 1987. This improvement in underlying earnings reflects the continued profitability of UK retail banking operations.

However, the increased level of provisions against problem country debt resulted in a sharp fall in pre-tax profits and an equally sharp reduction in the pre-tax return on equity. The steady upward trend in underlying earnings and the dramatic fall in pre-tax profits are contrasted in Chart 5.

The impact of country debt provisions on profits fed through directly to retained earnings in 1987 given the policy of the large British banks of maintaining or increasing their dividends. The longer-term trend in retained earnings is illustrated in Chart 6.

The decline in retained earnings in 1987 meant that banks had to resort to other sources of new capital to support balance sheet growth. Access to the perpetual debt market was effectively closed in 1987 but, as Table III (overleaf) shows, the banks were able to raise substantial amounts through term subordinated debt and share issues. The major part of the share issues made in 1987 is attributable to the second call on TSB shareholders and to the rights issue made by Midland Bank.

Lower retained earnings combined with continued growth in weighted assets has halted the improving trend in the banks' capital ratios as Table IV shows. However, taking capital and the increase in provisions against country debt together, the large British banks have emerged from 1987 with stronger balance sheets. Overall, their capital ratios

Table III
Large British banks: sources of new capital^(a)

£ billions	1983	1984	1985	1986	1987
Retained earnings	0.99	0.77	1.35	1.87	-0.72
Perpetual debt	—	1.20	3.82	1.25	0.09
Term subordinated debt	0.68	1.29	0.05	-0.29	0.50
Share issues	0.25	0.28	0.70	1.42	1.98
	1.92	3.54	5.92	4.25	1.85

(a) Excludes certain items affecting reserves, such as surpluses on property revaluations.

Table IV
Large British banks: capital ratios

£ billions	1983	1984	1985	1986	1987
Total assets	271.1	315.7	303.1	334.7	345.2
Weighted assets	208.0	245.4	236.0	251.7	267.2
Adjusted capital base	16.9	18.6	23.0	26.5	26.3
Risk asset ratio (per cent)	8.1	7.6	9.7	10.5	9.8

Table V
Large British banks: capital constituents

£ billions	1983	1984	1985	1986	1987
Shareholders' funds	12.95	12.11	13.81	17.54	18.67
Preference shares	0.01	0.01	0.01	0.01	0.01
Primary perpetual debt	—	—	4.05	5.39	4.18
General provisions	1.27	1.79	1.76	1.34	1.29
Minority interests	1.08	0.78	0.40	0.45	0.44
Primary capital	15.31	14.69	20.04	24.73	24.58
Secondary capital	4.03	6.43	5.89	5.62	5.82
Total capital	19.34	21.12	25.93	30.35	30.40
<i>Memorandum item</i>					
<i>Tier 1 capital</i>					16.18
<i>Tier 2 capital</i>					12.77

remain at acceptable levels and are expected in most cases to meet from the outset the minimum standard agreed under the Basle convergence proposals.

Under convergence, the constituents of a bank's capital base will alter, as explained in Part II. The constituents of capital as currently defined are shown in Table V. This also shows as a memorandum item the approximate allocation of capital between Tier 1 and Tier 2 elements as set out in the convergence proposals. In aggregate the large British banks are likely to have the capacity to raise further Tier 2 elements. However, a number will suffer a reduction in headroom arising from the proposed transfer to Tier 2 of perpetual debt, general reserves, hidden reserves and property revaluation reserves. The risk asset ratio of all banks will benefit from the non-deduction of plant and equipment.

Capital adequacy depends on the quality of both a bank's capital and its assets. In considering asset quality, a major uncertainty is the adequacy of a bank's provisions against problem country debt. At the end of 1987, the five largest British banks published an overall level of specific provisions approaching 30% of their total exposures to problem countries: a substantial increase from the level of just under 10% at the end of 1986. This increase does not remove the need for banks to review the case for further adjustments — either up or down — in the book value of their portfolios as the circumstances of individual countries change. The Bank expects that such reviews will continue to be made using the objective criteria set out in its matrix framework, which is described on pages 18–20.

In contrast to the substantial rise in country debt provisions, commercial bad debt experience in 1987 was better than in 1986. The decline in the commercial bad debt charge has taken place both in the United Kingdom and internationally, reflecting improved risk management controls and the stronger cash flow position of banks' corporate customers.

The continued rapid growth in lending to the personal sector, particularly for housing, has already been noted. Traditionally, such business has been of good quality but banks may need to guard against greater personal debt servicing difficulties should economic circumstances change. This problem could be aggravated if competition between banks and building societies leads to a relaxation of lending criteria.

Income and expenditure of large British banks

The four largest UK banks enjoyed a substantial rise in both net interest income and fee income in 1987.

Table VI
Four largest banks' sources of income

£ billions	1983	1984	1985	1986	1987
Net interest	6.54	7.51	7.82	8.34	8.78
Foreign exchange	0.24	0.26	0.28	0.41	0.36
Fees and commissions	2.49	2.98	2.99	3.30	3.80
Other	0.35	0.52	0.47	0.56	0.71
Total income	9.61	11.27	11.56	12.61	13.65

The steady growth in the importance of non-interest income, which increased its share of total income from 32% in 1985 to 36% in 1987, is illustrated in Table VI. This is partly a function of deliberate policy as bank managements have pursued fee income growth as a means of covering costs, in particular through diversification into such activities as insurance, asset management and estate agency.

Table VII
Four largest banks' interest margins

Percentages	1983	1984	1985	1986	1987
Domestic	5.43	5.50	5.56	5.48	5.42
International	2.16	2.16	2.14	2.01	1.79
Group	3.40	3.37	3.56	3.59	3.62

Net interest income grew more quickly than total assets in 1987, consistent with a slight improvement in group margins. However, as Table VII shows, margins on domestic and international business both fell to their lowest levels for some years. The explanation of this apparent paradox is that banks were able to engineer a shift into higher-yielding domestic assets.

The fall in domestic margins in 1987 was not accompanied by a squeeze on spreads. Spreads on sterling business were maintained as nominal interest rates fell, thereby reducing the cost of funding fixed-rate lending and enabling those banks with significant mortgage books to gain from the lag between changes in funding and lending rates. However, the fall in rates also had the effect of reducing the interest benefit derived from interest-free funds — the so-called endowment effect — which has traditionally been a substantial element of domestic margins.

During the year spreads in lending to large corporates remained tight, but lending to small businesses continued to earn a return reflecting the higher risks in this area. Personal business continued to attract relatively high spreads on a number of unsecured consumer credit products but this may change as building societies market unsecured lending more extensively to their customer base.

The pressure on margins and the increasing difficulty of generating more fee income have led many banks to re-examine their overheads. For the large British banks, costs grew faster than both income and the rate of inflation in 1987 and were equivalent to 66.9% of income last year compared with 66.3% in 1986. This increase is significant: 0.6% of the large British banks' income in 1987 represents approximately £100 million or roughly 3% of 1986 pre-tax profits.

Table VIII
Large British banks: costs

£ billions	1983	1984	1985	1986	1987
Staff	5.18	5.60	5.64	6.18	6.62
Premises and equipment	1.57	1.85	1.90	2.07	2.25
Other	1.65	1.92	1.90	2.10	2.44
Total operating costs	8.39	9.38	9.43	10.35	11.31

Part of this increase results from one-off costs stemming from their involvement in securities business. However, as Table VIII illustrates, bank costs have been rising for a variety of reasons, including the need to invest in branch modernisation and technology to provide a more cost-efficient service. The rapid growth in 'other' costs partly reflects the impact of higher marketing expenditure.

The problem of controlling overheads while investing for future growth is a particular dilemma for the largest banks. These banks are seeking to exploit technology in order to reduce branch costs while modernising management information systems so that they can use financial information directly for marketing and business development purposes.

The most visible way in which banks restrict costs is by reducing staff numbers. This has been particularly evident among institutions involved in merchant and investment banking. However, in seeking to control costs many institutions have also found it necessary to review their organisational structures and business strategies. With the full thrust of building society competition still to come, this willingness to re-examine key business strengths is clearly justified.

Conclusions

In 1987 many banks attempted to improve performance by strengthening financial controls and restructuring their organisations. A number of institutions were also engaged in a review of future business strategies, taking into account the challenge posed by stronger domestic competition and the opportunities created by the European Community's programme for an internal common market in financial services by 1992.

Competitive pressure is likely to remain a significant feature for the UK banking system in the foreseeable future. Domestic earnings may come under strain for a variety of reasons in addition to the difficulties so far encountered in the investment banking area. Overseas earnings will continue to be influenced by the international debt situation. However, the prospect of a further sharp increase in country debt provisions on the scale of 1987 has been reduced.

Against this background, banks have been willing to examine individual parts of their business and develop new products or services in such activities as insurance, estate agency and personal investment management. This has often been accompanied by the adoption of more segmented organisational structures with stronger distinctions between retail and corporate business. Other changes have been conditioned by external events, such as the decision on polarisation, which has obliged banks to choose in their retail networks between selling in-house products and acting as independent brokers of life assurance and unit trusts.

Regulatory factors have also had a wider impact on bank strategy. The development of the convergence proposals for the common measurement and standards of capital places a premium on share capital and retained earnings. In this instance, regulatory change is likely to reinforce the competitive pressures towards more active asset management and rationalisation of unprofitable business.

The next part of this Report describes the major policy initiatives taken by the Bank in 1987.

Glossary of terms for Part I

<i>Sources of data:</i>	<p><i>Audited financial statements for the large British banks, with the exception of the tables on capital ratios and mortgage lending. Bank of England statistical returns for medium and smaller British banking institutions. The tables relating to loan portfolios adopt the sectoral classifications used in the Bank of England Quarterly Bulletin and in the Central Statistical Office's Financial Statistics.</i></p> <p><i>In some instances, previous year's figures have been restated in the light of more recent information and changes in accounting policy. Not all the columns in the tables balance, on account of rounding.</i></p>
<i>Large British banks</i>	<p>Barclays, Lloyds, Midland, National Westminster and Standard Chartered (the five largest banks) together with Bank of Scotland, The Royal Bank of Scotland and the TSBs. All data for these banks are consolidated. Calendar year-end information except for Bank of Scotland, The Royal Bank of Scotland and the TSBs.</p>
<i>Trading profits before bad debts</i>	<p>Profit before taxation adding back bad debt provisions (including the exceptional problem country charges in 1987).</p>
<i>Pre-tax profits</i>	<p>Profit after bad debt provisions but before taxation.</p>
<i>Post-tax profits</i>	<p>Profit after taxation and before extraordinary items; includes amounts attributable to minority shareholders in subsidiary operations.</p>
<i>Return on equity</i>	<p>Percentage ratio of pre/post-tax profits to average shareholders' funds plus minority interests. Shareholders' funds defined as paid-up share capital and reserves.</p>
<i>Return on total assets</i>	<p>Percentage ratio of pre-tax profits to average total assets.</p>
<i>Retained earnings</i>	<p>Current year's post-tax profits after extraordinary items and distributions.</p>
<i>Term subordinated debt</i>	<p>Subordinated debt with a fixed maturity and satisfying the Bank of England's conditions for secondary capital.</p>
<i>Perpetual debt</i>	<p>Undated subordinated debt, satisfying the Bank of England's conditions for primary or secondary capital.</p>
<i>Primary perpetual debt</i>	<p>Perpetual debt eligible for inclusion as primary capital under Bank of England rules. Qualifying criteria require that the debt can only be converted into primary capital instruments, is available at all times to absorb losses, and provides for the deferment of interest payments in certain circumstances.</p>
<i>Total assets</i>	<p>Balance sheet footings.</p>
<i>Weighted assets</i>	<p>Total assets adjusted in accordance with the risk weightings as set out in the supervisory notice, <i>Measurement of capital</i> (as amended).</p>
<i>Adjusted capital base</i>	<p>Total capital (see below)—less: goodwill, equipment, connected lending of a capital nature, investments in subsidiaries and associates, and holdings of bank paper in excess of concession.</p>

<i>Risk asset ratio</i>	Percentage ratio of adjusted capital base to weighted assets.
<i>Primary capital</i>	The total of shareholders' funds, minority interests, general provisions and primary perpetual subordinated debt.
<i>Secondary capital</i>	Perpetual debt not included in primary capital together with term subordinated debt.
<i>Total capital</i>	The sum of primary capital and secondary capital.
<i>Tier 1 and Tier 2 capital</i>	As defined under the proposals for international convergence of capital measurement and capital standards (see pages 37-38 in Part II).
<i>Net interest income</i>	Gross interest income less interest paid on borrowings.
<i>Other income</i>	Includes investment income.
<i>Interest margin</i>	Net interest income/average interest-earning assets.
<i>Interest spread</i>	The difference between average interest rate earned on interest-earning assets and average interest rate paid on interest-bearing funds.
<i>Endowment effect</i>	The benefit received by the retail banks from deploying the 'free' funds generated by their non-interest-bearing current accounts and other net interest-free funds.

Part II

Policy initiatives and developments

II.1 Domestic policy

Capital adequacy

The maintenance of adequate capital is the cornerstone of sound banking. Under the present approach to the assessment of capital adequacy, authorised institutions are required to hold capital against the many different types of risks carried on balance sheet.⁽¹⁾ The recent convergence proposals⁽²⁾ will in due course ensure that the credit risks on off-balance-sheet activities are included on a comprehensive basis.

The Basle convergence proposals, taken together with the EC Second Banking Co-ordination, Own Funds and Solvency Directives, will have significant implications for the way in which capital adequacy is assessed in the United Kingdom. Part II.2 below outlines the progress achieved in both Basle and Brussels over the past year, and describes how the EC Directives have been designed so as to ensure consistency with the Basle convergence proposals.

The capital adequacy framework which has emerged from the discussions in Basle and Brussels is broadly similar to that presently applied in the United Kingdom. There are, however, a number of key differences concerning the structure of the capital base, the eligibility of certain elements of capital, and the scope and levels of risk weights applied. All these factors will affect the capital position of UK banks, although they will not all work in the same direction.

The Basle proposals leave limited discretion to national supervisors in their application of the framework. In a paper published in January,⁽³⁾ the Bank explained how it intended to exercise that discretion, and gave some additional information on how it intended to implement the

(1) The various types of risk which the Bank considers in assessing capital adequacy are set out in paragraph 2.10 of the *Statement of principles*.

(2) *Proposals for the International Convergence of Capital Measurement and Capital Standards*, December 1987.

(3) *Explanatory paper on the Proposals for International Convergence of Capital Measurement and Capital Standards*.

proposals in the United Kingdom. For the most part, where there is national discretion within the Basle framework, the Bank will seek to maintain its existing policies. Other countries may opt for a slightly different treatment. The proposals have been structured, however, so that any differences should be small. Differences in the way in which banks measure their capital will certainly be much less under the convergence proposals—and the overall international standard of capital adequacy higher—than if individual countries were to continue with their existing national systems.

The proposed risk weights for balance-sheet assets differ in a number of respects from those currently applied by the Bank, notably in the greater recognition given to the risk-reducing effect of collateral and guarantees⁽¹⁾ and the lower weights proposed for residential mortgages and land and premises. The benefit of these changes is likely to be offset for some banks by the capture, for the first time, of the credit risk on the full range of off-balance-sheet business. It is not yet possible to be precise about the size of the overall change in aggregate weighted risk assets resulting from these proposals.

The other major difference from the current system is the requirement that all international banks achieve a published minimum capital ratio. The minimum proposed in the consultative paper is 8%, of which the core capital element must be at least 4% (transitional arrangements will, however, apply up until end-1992). The Bank will require all UK banks to meet these minimum standards, and will continue to set individual 'trigger' and 'target' risk asset ratios⁽²⁾ for each authorised institution in the United Kingdom, which in nearly all cases will be above the 8% minimum.

The Bank is currently moving towards the conclusion of its consultations with banking associations and other interested parties on the convergence proposals. Those discussions have uncovered a number of important points of detail on which clarification has been sought from the Basle Secretariat.

-
- (1) In this context the Bank needs to be assured that collateral and set-off arrangements are legally effective. The Bank is therefore reviewing the legal position before reaching a decision on how to implement this aspect of the Basle proposals. The review will also look at the effectiveness of netting arrangements, such as those commonly used in the swaps and foreign exchange markets.
 - (2) These terms are explained in paragraph 2.12 of the *Statement of principles*.

National authorities have clearly tried to avoid proposing fundamental modifications which would risk undermining the overall framework of the proposals. If the co-ordination of national suggestions continues to proceed smoothly it is hoped that the proposals will be confirmed by the Basle Supervisors Committee at the end of June and by G10 Governors shortly after. Once the consultation process is complete, and definitive proposals agreed, the Bank will seek to move forward promptly with the application of the new capital adequacy framework to UK banks.

Country debt provisions: the Bank's matrix

In the course of the past year the large British banks significantly increased their provisions to around 25%–35% of their exposures to problem countries. The extent of this increase, and the impact on the end-year results, is described in Part I above.

The exceptional size of the increase in British banks' country debt provisions in 1987 in part reflects the limited progress achieved in raising provisions in previous years. At the start of the year, the average level of provisions against the most heavily indebted countries made by the large British banks was around 8%–12%, having risen from around 5%–10% at the end of 1985.

The prospects of fully recovering the value of banks' claims on a number of heavily indebted countries became more uncertain in 1987. In considering the adequacy of their provisions, banks had to take into account both Citicorp's public announcement in May of sharply increased loan loss reserves and the publication of the Bank's matrix framework for assessing the adequacy of provisions against particular problem countries.

The matrix framework can be traced back to an initiative taken by the Bank in April 1987 to require banks to attain an agreed level of specific provisions—a decision fully supported by the Board of Banking Supervision. Further discussions on the nature of such requirements underlined the importance of securing a common assessment of trends in the risk characteristics of lending to problem countries. The matrix was designed to assist banks in making a more objective assessment of significant economic and financial developments in problem countries. There are, of course, many ways of doing this but the particular virtue of the matrix is that it provides common parameters from which

to form an assessment. The matrix has thus provided a valuable basis for discussion between banks, their auditors, the Inland Revenue and the Bank itself.

The matrix identifies a range of factors which point to the likelihood of partial or total failure to repay.⁽¹⁾ A country is scored against a total of fifteen different criteria, weighted according to their relative seriousness, and divided into 3 main categories: 'A' factors evidencing a borrower's inability or unwillingness to meet its debt service obligations; 'B' factors evidencing a borrower's current debt service problems; and 'C' factors covering a range of economic and other indicators of future performance (one of which is the secondary market price for that country's debt). The scores for each item are summed to provide an overall country score which is then translated into an appropriate provisions range.

The matrix scores have guided the Bank's attitude to the substantially-increased provisions charged by UK-incorporated banks. In consultations with individual banks, the Bank has sought to ensure that all significant problem country exposures attracted at least the minimum level of provisions implied by the matrix scores, and several banks have in fact attained provisioning levels towards the top of the range indicated by the matrix.

By working within the matrix guidelines, the five largest British banks have significantly increased their provisions to an average level of around 30% of problem country exposures. Even so, they have, in some cases, provided less than the level of discount implied by secondary market prices, and less than some of their counterparts in other G10 countries.

A degree of caution is, however, necessary in making such comparisons. Secondary market prices for loans to a number of countries have fallen sharply over the past year, often influenced more by the increase in banks' provisions, and hence by the supply of loans into the market, than by deterioration in the underlying country risk.

International comparisons in provisioning levels are frequently not based on consistent definitions of exposure or provisions and these differences in definition are further complicated by significant national variations in

(1) A copy of the matrix with explanatory notes is reproduced at Appendix 1.

accounting, taxation and legal environments. Taken together, these differences constrain the ability of international banks to reach a common level in their provisions. Moreover, the Bank believes that banks should resist the temptation to engage in competitive provisioning where this has more to do with gaining a short-term publicity advantage than with the longer-term interests of shareholders.

In the uncertain environment of international lending, it would perhaps be surprising if all banks were able to reach a consensus view of the appropriate level of provisions. The matrix provides UK banks with a reasonably objective and standard measure of changes in risk over time, but it does not pretend to provide a uniquely correct view of the precise level of provisions required to cover losses at any one point in time.

The extent of the increase in specific provisions in 1987 created a problem for some banks that did not have sufficient current or prior year taxable profits against which to offset their resulting tax losses. In these cases, banks have created deferred tax assets to recognise the carry forward of losses for tax purposes which are available to relieve future profits from tax. The Bank has considered whether shareholders' funds represented by deferred tax assets should be allowed to stand as capital for supervisory purposes. This is distinct from actual provisions arising from the matrix calculations which will continue to be excluded from a bank's capital base.

The Bank recognises that the arguments for inclusion in capital are not clear cut. On the one hand, by allowing capital represented by a deferred tax asset to be included in the capital base, the Bank is effectively including an item which is contingent upon a future event (continued and sufficient taxable profits). On the other hand, by excluding it, it might appear that the Bank was taking too critical a view of the probability of an institution earning profits in the foreseeable future. The Bank is currently considering its response to this question.

Loan transfers and securitisation

Banks in the United Kingdom have shown a growing interest in recent years in developing schemes for transferring some or all of the risks associated with a particular asset or pool of assets. These range from the sale of individual loans to the packaging, securitising and sale of

a portfolio of residential mortgages. They also include sub-participations, which aim to achieve the economic effect of a transfer without its legal form.

In the second half of 1987, the Bank undertook detailed research into the legal mechanisms by which transfers can be effected and studied recent trends in market practice, both in the United Kingdom and abroad. Bringing together the results of this research, the Bank published a consultative paper in December 1987 entitled *Loan transfers and securitisation*.⁽¹⁾ This set out proposals for the supervisory treatment of all types of loan transfer and invited comments from the banks and other interested bodies.

In developing its policy towards loan transfers, the Bank is concerned to see:

- that loan sales and packaging are successfully executed;
- that all parties involved fully understand the responsibilities and risks they have assumed or retained; and
- that any material risks to buyers or sellers are adequately captured by the supervisory system, in particular in the assessment of capital adequacy.

The Bank believes that the method used can have a significant bearing on whether risk is successfully transferred or not. The paper describes the three most common forms of transfer—novation, assignment and sub-participation—and analyses the legal position underlying each and their effectiveness for both buyer and seller in achieving a clean transfer of risk.

The paper deals with both single loan transfers and the packaging, securitising and sale of pools of loans, and sets out a number of general principles for determining the risk asset ratio treatment in each case. The transfer of a portfolio of assets, however, raises some additional issues, stemming principally from the risk that a bank which originates or services the portfolio may continue to be

(1) A full list of current policy notices and consultative papers issued by Banking Supervision Division can be found in Appendices 2 and 3.

identified with it such that a completely clean risk transfer is not achieved. This risk may be very difficult to quantify, but is no less real for that. In order to limit the risk, the Bank has proposed a number of conditions designed to ensure a clean transfer of risk from the originating or servicing bank (often the same institution) in respect of the portfolio of assets being sold or otherwise transferred.

The Bank has received a number of responses to the paper. Most appear to accept that the transfer of assets raises legitimate prudential concerns, but there is some disagreement with the detail of the Bank's proposed policy. On loan transfers, the principal concerns are:

- that the whole of a loan must be sold before it is excluded from the seller's risk asset ratio;
- that the selling bank should give a commitment that it will not repurchase the loan; and
- that a partial risk weighting may be applied to the selling bank in a sub-participation to reflect its continuing operational risk.

A number of reservations have also been expressed about the Bank's proposed restrictions on a bank's relationship with a vehicle whose assets it originates and services. The principal objections concern the Bank's requirements that the originator-servicer provides no liquidity support to the vehicle, bears no interest rate risk associated with the assets, and retains no options to repurchase assets from the vehicle. All these comments are being reviewed.

Large exposures

The 1987 Banking Act introduced for the first time a legal requirement for the notification of large exposures. This requirement was brought into effect on 1 April 1988, some months after the rest of the Act, in order to allow banks to develop the necessary reporting systems. Authorised institutions whose principal place of business is in the United Kingdom are now legally required to report to the Bank exposures of over 10% of capital and to give prior notice of proposed transactions putting them at risk for 25% or more of capital.

The Bank's general policy⁽¹⁾ towards large exposures is that no exposure to a single counterparty should normally exceed 10% of a bank's capital base without thorough justification, and that no such exposure should exceed 25% of the capital base other than in the most exceptional circumstances. The main exceptions to the 25% rule are: exposures to other banks with a maturity of up to one year; exposures to overseas central governments; exposures of up to one year to group financial companies;⁽²⁾ exposures secured by cash or British government stocks; and, in the case of bank subsidiaries, exposures guaranteed by the parent bank.

The definition of exposure adopted by the Bank is very wide and generally includes all claims on a counterparty including, for example, undrawn facilities, contingent liabilities, other counterparty risks and equity holdings. Most forms of exposure are measured by their face value in a bank's book. However, this is clearly not appropriate for underwriting commitments and interest and exchange rate related contracts, where the bank is in practice at risk for only a proportion of the nominal value of the commitment.

For example, the likelihood of a bank experiencing a loss from an underwriting commitment is related to the risk of actually having to take up the security, possibly leading to a subsequent forced sale. Although there is an element of credit risk, this is generally low. The principal risk is position or market risk. The measurement of underwriting exposures adopted by the Bank involves calculating a credit equivalent amount, based on the capital requirements for underwriting positions published by UK securities regulators.⁽³⁾

The large exposures notification requirements in the Banking Act only apply to banks whose principal place of business is in the United Kingdom. However, the principles adopted by the Bank will as far as possible be applied to UK branches of overseas banks, who are now required to report their 20 largest exposures.

(1) As set out in BSD/1987/1.

(2) As defined in paragraph 44 of the above notice.

(3) This analysis is summarised in a technical note *Large underwriting exposures* published as BSD/1987/1.1.

Ownership and control of banks

Over the past year, control of a number of UK banks has changed hands. Notable takeovers include the TSB's acquisition of Hill Samuel, National Australia Bank's purchase of Clydesdale Bank and the Northern Banks, and Equiticorp's purchase of a majority shareholding in the Guinness Peat Group including Guinness Mahon. There has also been the acquisition of a 14.9% stake in Midland Bank by The HongKong and Shanghai Banking Corporation.

Such takeovers and mergers are a normal feature of a competitive market place and are generally to be welcomed as a means of strengthening capital resources and injecting new and more vigorous management skills. However, the Bank needs to assess the motives and situation of potential controllers of banks. In order to operate effectively, banks must retain the full faith and confidence of their depositors and all banks remain vulnerable to a sudden reversal of this confidence. Such a reversal might be triggered by protracted uncertainty over future ownership arising from a contested bid.

The Governor, in his speech to the Northern Ireland Chamber of Commerce in October 1987,⁽¹⁾ noted that the Bank would not look favourably on acquisitions designed to put banks 'into play' or to break up banking groups in ways which appeared to be detrimental to depositors' interests. The Governor also expressed concern about an industrial or commercial company acquiring control of a bank at the heart of the financial system where this created a possible conflict of interest in the conduct of a bank's business or exposed the bank (and thus the wider financial system) to the risk of contagion.

It is the Bank's presumption that there will remain a strong and continuing British presence in the banking system of the United Kingdom. However, the strength of London as a major international financial centre rests in part on the ability of foreign companies to relocate here and, on occasion, to take a controlling interest in UK financial institutions. With the move towards the completion of the European internal market by 1992, overseas participation in the UK banking sector might be expected to increase, just as British banks are likely to increase their interests in continental European markets.

(1) Printed in the November 1987 *Bank of England Quarterly Bulletin*.

The 1987 Banking Act gives the Bank wide powers to object, in the interests of depositors, to prospective and existing controllers of UK-incorporated authorised institutions. The Bank's interpretation of the fit and proper person criterion as it relates to such controllers is set out in the *Statement of principles* which is described on page 45 below.

Building societies' conversion into banks

The Building Societies Act 1986 permits building societies to convert from their present mutual status into public limited companies. On conversion, a building society will cease to be a mutual institution supervised by the Building Societies Commission. It will instead be registered under the Companies Act 1985 and will require authorisation under the Banking Act 1987.

The Bank was a member of a working party set up in April 1987 by the Commission to advise on certain aspects of the process of building society conversion to public limited company status and on the provisions of statutory transfer regulations. In July 1987 the Commission published a consultation paper (*Building Societies: Conversion to Public Limited Company*) on the transfer regulations it proposed to make. Subsequently, the Bank has continued to liaise closely with the Commission on this subject.

A building society contemplating conversion will be treated in the same way as any other applicant for authorisation under the Act. An important part of the application process will be the preparation of a detailed business plan covering the period from the time of its submission to about three years after the anticipated date of authorisation. A society's plan should include: reasons for wishing to convert and consequent application for authorisation under the Banking Act; plans for developing its old business and for introducing new business; and plans for personnel, including its staff recruitment and training policies, with special regard to new business areas identified in the plan. Particular attention will be paid to the proposed successor company's liquidity position and capital adequacy.

In view of the likely complexities involved, the Bank has encouraged any building society considering conversion to have preparatory discussions with the Bank and with the Commission well before any formal application for authorisation under the Banking Act. In conducting these

discussions, the Bank has maintained close contact with the Building Societies Commission.

Liquidity stock

During 1987 the Bank engaged in extensive discussions with representatives of the UK banking community on the introduction of a high quality stock requirement as part of the overall measurement of liquidity. These discussions followed on from the Bank's earlier consultative papers on sterling primary liquidity (described in last year's Report) and have recently borne fruit in the publication of a new set of proposals for a stock of high quality liquidity, which are currently the subject of consultation with banks.⁽¹⁾

The Bank's purpose in introducing a stock requirement is to ensure that banks maintain a prudent mix of different sources of liquidity. The 1982 *Measurement of liquidity* paper provides an overall framework for measuring liquidity in terms of expected cash flows arising from the maturity structure of a bank's assets and liabilities. This analysis remains valid, but it was considered desirable to build a stock requirement more centrally into this framework.

The purpose of a stock requirement is complementary to, but distinct from, that of a mismatch framework: while the latter is concerned with the expected cash flow position in normal trading conditions, the stock measure includes within its definition of liquidity only those high quality assets whose liquidity is unquestioned even in difficult circumstances. A stock of high quality liquid assets is particularly important, for example, in the event of a 'hiccup' in expected cash flows. This may occur where an individual bank or a group of similar banks faces cash flow pressures arising from arrears or from an unexpected rate of deposit withdrawals.

The latest paper differs from the earlier proposals in three important respects: first, the proposed stock requirement applies to liabilities in both sterling and other currencies; second, no single across-the-board norm is proposed; and third, no distinction is drawn in principle between core institutions and other banks. These changes have been introduced in the light of comments received from banks on the Bank's earlier consultative papers, and were guided by

(1) Consultative paper (2/88).

discussions on this subject in the Board of Banking Supervision. The Bank proposes to set Tier 1 and Tier 2 liquid assets against a bank's gross liabilities measured at sight up to 8 days. This produces a relatively straightforward basis of measurement to which all banks will be required to adhere. However, individual stock ratio requirements are to be set flexibly on a bank by bank basis at a point within a range, reflecting *inter alia* the perceived strength of an institution's cash flow and the 'stickiness' of its deposits. The range proposed by the Bank is 10%–20% of gross liabilities at sight up to 8 days.

The rationale of a stock policy requires that liquid assets are defined as high quality in the sense of being low credit risk and readily realisable. To ensure that only high quality assets are included within the stock measure, the paper proposes a two-tier definition of liquid assets, with primary quality Tier 1 assets included without limit, and a second tier of assets, which either do not have the backing of the central bank or which are less price certain, included within a limit.

The application of liquidity requirements to currency liabilities is a novel element in the Bank's liquidity proposals, and the proposal for a high quality stock of currency assets in particular has implications which go beyond the UK banking and financial system. In developing its proposals the Bank has therefore consulted with overseas monetary and supervisory authorities.

Audit committees

Schedule 3 to the Banking Act gives the Bank wide discretion in determining whether an institution should have non-executive directors. The Act makes it clear that there is no absolute requirement for an institution to have non-executive directors on its board or for it to establish an audit committee. However, in considering whether an institution has adequate systems of control, the Bank will take into account whether, and if so the manner in which, the duties of non-executive directors or the functions of an audit committee are undertaken as outlined in section 3 of the consultative paper issued in January 1987.⁽¹⁾

In discussing with an institution the appropriate number of non-executive directors it should have on its board and

(1) *The role of audit committees in banks.*

whether it should have an audit committee, the Bank will have regard to the size of the bank, the nature and complexity of its business and to the group structure within which it operates. In principle, the Bank has no objection to the audit committee of the holding company of an authorised institution extending its responsibilities to cover that institution. In considering such an arrangement, the Bank would wish to know whether the holding company audit committee has sufficient resources and skills to carry out this task, whether its individual members have executive responsibilities for the management of the institution and whether the scope of its terms of reference are in accordance with those outlined in the consultative paper.

During discussions on the Bank's consultative paper the question arose as to whether, in order to ensure its independence, the internal audit function⁽¹⁾ should report direct to the audit committee. There are attractions in such a proposal: it would enhance the status and authority of the audit committee and the internal audit function would gain because it would be seen to be truly independent of executive management. However, the Bank does not consider that it would be appropriate for an arrangement to be introduced which gave the audit committee an executive function.

The Bank considers that the independence of the internal audit function can be achieved satisfactorily by its reporting to a body or individual other than the audit committee or a non-executive director, for instance to the board as a whole or to a senior executive. It should, however, have the right to discuss matters with the audit committee without prior reference to executive management. The overriding objective is that the internal audit function should be independent of the accounting function and of the executives responsible for the areas of activity upon which it reports.

The suggestion was made in relation to paragraph 3.2(d) of the consultative paper that consideration be given to extending the duties of an audit committee to include a duty to monitor the activities of officers and directors in their dealings and transactions with their institution. The Bank considers that the audit committee should review the

(1) As defined in BSD/1987/2.

general policy governing those dealings and transactions, and monitor the manner in which policy is complied with, but should avoid an executive responsibility for compliance itself.

It was suggested also that the requirement relating to the qualities of the chairman of an audit committee (paragraph 5.4 of the paper) is too onerous. It was not intended to be so. The Bank does not rule out a situation where the chairman confines himself to being aware of the broad implications of the pronouncements of accountancy and supervisory bodies but at the same time is able to familiarise himself at reasonably short notice with the detail of those pronouncements, and to be kept fully up to date with them, communicating with the bodies themselves or with competent advisors outside the institution.

The relationship of the audit committee with external auditors, reporting accountants and supervisors (referred to in paragraph 5.9) will inevitably attract increasing attention as experience is gained from the new reporting arrangements (see below). The Bank believes that the audit committee should not be burdened with matters of an administrative or routine nature arising from the new relationships, but only those of strategic importance which fall within the committee's terms of reference.

Finally, it should be emphasised that the appointment of an audit committee does not, and should not, alter the power and responsibility of the board as a whole. An audit committee can make a positive contribution towards establishing and maintaining an effective control environment only if it is not appointed simply as a token of compliance. As an internal supervisory body, the primary benefit is its independence and objectivity in relation to management. For that reason, considerable care should be exercised in making certain that the role of the audit committee is clearly defined and that management is not able to exert undue influence over its work.

The Bank's relationship with auditors and reporting accountants

The past year has seen the completion of a major policy initiative designed to enlist the assistance of the accountancy profession in the process of bank supervision.

This initiative took the form of three consultative papers: on records and systems, on prudential returns and on the relationship generally, which were followed by three notices.⁽¹⁾

The importance of this new area of policy was reflected in the drafting of the Banking Act 1987. First, the requirement for a bank to have adequate records and systems of control is now part of an explicit statutory criterion for authorisation under the Act; second, the Act gives the Bank powers to require a bank to provide a report by suitably qualified persons ('reporting accountants') on any aspect of its business; and third, the Act provides that auditors and reporting accountants are free to communicate with the Bank about their client banks' affairs without breaching any duty to those clients.

Briefly, the practical effect of the introduction of the new policy in 1988 means that the Bank expects to receive from every authorised institution:

- a reporting accountants' report on 'accounting and other records and internal control systems'—annually;
- a reporting accountants' report on prudential returns—as specified by the Bank from time to time; and
- *ad hoc* reports from auditors and reporting accountants, on their initiative, when circumstances arise that justify the need for this kind of communication.

These reports will be supplemented by regular trilateral discussions between the Bank, the management of the institution, and their auditors or reporting accountants, and, as an exceptional measure, by bilateral meetings between the Bank and auditors or reporting accountants.⁽²⁾

(1) (a) *Guidance note on accounting and other records and internal control systems and reporting accountants' reports thereon* (BSD/1987/2);
(b) *Guidance note on reporting accountants' reports on Bank of England returns used for prudential purposes* (BSD/1987/3); and
(c) *The Bank of England's relationship with auditors and reporting accountants* (BSD/1987/4).

(2) The accountancy profession has recently issued an Exposure Draft *Auditing Guidelines, Banks* which describes and explains the new responsibilities of auditors under the Banking Act and the role of reporting accountants.

The Bank will place considerable reliance on the reports received. Reporting accountants will need to ensure they are familiar with the Bank's supervisory approach and practice; they should have experience in undertaking work of a similar nature and must have appropriate professional skills and resources. Furthermore, they must be readily available to meet Bank officials and have a continuing relationship with their client which enables them to report to the Bank, direct or via the client, on an *ad hoc* basis. The Bank will have regard to these matters when approving the appointment of reporting accountants.

It is likely in practice that UK-incorporated institutions will appoint their firm of auditors as reporting accountants and the Bank has decided to approve the appointment of firms of accountants which are qualified to act as auditors under the 1985 Companies Act. Only in exceptional circumstances will the appointment of a firm of reporting accountants be approved if that firm does not qualify as auditors under the Companies Act.

The Bank's relationship with securities and other supervisors

As the major financial markets become increasingly integrated, it has become important to establish good lines of communication with regulators of other financial institutions which are either owned by banks or operate in the same market place. This is particularly important where a bank is subject to supervision by more than one regulator. In the case of many investment businesses, formal mechanisms are now in place for devolving the monitoring of financial data in order to minimise problems of supervisory overlap. In other cases, less formal mechanisms have been designed to ensure that there is adequate communication between supervisors looking at different parts of a banking group.

Memoranda of Understanding with The Securities and Investments Board (SIB) and self-regulating organisations (SROs)

Supervisors share a common objective of avoiding as far as possible imposing a burden of multiple regulation, which would inevitably increase the overall cost of regulation to banks at a time when there is considerable competitive pressure on banks to contain overheads.

During 1987 the Bank continued discussions with the SIB and SROs in order to develop arrangements aimed at minimising supervisory overlap in those cases where a UK-incorporated institution is subject to multiple authorisation. The terms of these arrangements are set out in the Memoranda of Understanding (MoU) which were agreed in March 1988 with the SIB, TSA and IMRO. These arrangements provide for one supervisor (the lead regulator) to monitor an institution's financial position on behalf of the others. In the case of all banks, it has been agreed that at least initially the Bank will be the lead regulator. However, the financial services supervisor will in all cases monitor an institution's compliance with conduct of business rules.

The terms of the MoU provide that in those cases where the Bank is the lead regulator, the Bank will monitor the capital adequacy of a bank on behalf of the SIB or SRO. Where banks have more than *de minimis* securities trading business, the arrangements become more complex. In the case of banks which are members of TSA, for example the Bank will alert TSA whenever a bank's capital falls below requirements using a measure which incorporates TSA's position and counterparty risk requirements for securities trading⁽¹⁾ and the Bank's risk asset ratio on its banking business. The Bank will also continue to assess the capital adequacy of each bank using its standard definition of capital. In principle, where a bank's business is almost exclusively securities trading or investment-related, and where non-investment business is negligible, the SIB/SRO will be the monitoring supervisor. In such cases, the SIB/SRO will calculate on the Bank's behalf the institution's capital ratio in accordance with rules agreed between the SRO and the Bank, but using the Bank's standard definition of capital.

UK branches of overseas banks

In authorising an overseas bank intending to establish a branch in the United Kingdom the Banking Act 1987 empowers the Bank to place reliance upon the home supervisory authority. Thus the Bank may satisfy itself that certain of the criteria specified in Schedule 3 to the Act are met if the relevant supervisory authority in the home country confirms that it is satisfied with the prudent

(1) In certain cases, however, banks may choose instead to measure their capital requirement on their securities business in accordance with Wholesale Markets Supervision Division's Grey Paper: *The regulation of the wholesale markets in sterling, foreign exchange and bullion*, April 1988.

management and overall financial soundness of the bank, and second, if the Bank is satisfied with the nature and scope of the supervision exercised by that authority. In accordance with the principles of shared supervisory responsibility embodied in the Basle Concordat,⁽¹⁾ the Bank monitors the activities of the UK branch while relying on the home supervisor to monitor the capital adequacy and the management of the bank as a whole.

The Financial Services Act supervisors, who do not have such explicit statutory discretion, have had to consider carefully the extent to which they are able to rely upon the overseas supervisor in authorising the carrying on of investment business through a branch operation in the United Kingdom.

In October 1987 the SIB issued a preliminary paper on the financial regulation of the capital adequacy of overseas institutions (including banks) with branches in the United Kingdom. Consultations on the SIB's proposals took place between the SIB, SROs, the Bank and other interested parties, as a result of which some modifications were made by the SIB to its proposals for the development of lead regulation arrangements with overseas supervisors. The Bank commended the revised proposals to the overseas banking supervisors concerned as a solution which avoided the need for overseas banks' investment businesses to be transferred to UK-incorporated subsidiaries.

The SIB's revised proposals⁽²⁾ propose classifying branches into three categories:

- (a) Where the home supervisor is willing to share information and home supervision is adequate. The SIB would, on application from the institution concerned, disapply its financial regulation rules and would not seek to apply a local financial requirement in their place.
- (b) Where the home supervisor was willing to share information but home supervision was evolving. The SIB would, on application from the institution concerned, disapply its financial regulation rules and

(1) *Principles for the supervision of bank's foreign establishments*, issued in May 1983.

(2) *The financial regulation of overseas institutions with UK branches*, issued in March 1988.

apply a local financial requirement (but not branch capital) to the UK branch.

- (c) Where the home supervisor was unwilling or unable to share information, or home supervision was inadequate, the SIB would not disapply its financial regulation rules. (This would very likely require UK incorporation unless the company carries out all or virtually all its business in the UK branch.)

To allow more time to discuss its lead regulation proposals with overseas supervisors, the SIB has introduced a transitional provision temporarily exempting overseas institutions authorised by these supervisors from financial regulation. It is intended that these discussions should be concluded by the end of August.

In order to facilitate the acceptance by overseas supervisors of the SIB's proposals the Bank has undertaken to act as an intermediary in those cases where an overseas supervisor prefers to report the information required by the SIB to the Bank rather than direct to the SIB. In some countries there are statutory constraints on the ability of the banking supervisor to pass on information other than to another banking supervisor.

The Bank has also agreed to the SIB's proposal that in the case of a bank branch the Bank would confirm to the SIB at regular reporting dates that the liquidity of the branch did not give it cause for concern. This report would also provide confirmation that the Bank was not aware of any material problems affecting the UK branch.

Ad hoc contacts with securities regulators

In the immediate aftermath of the stock market fall of last October, the first concern of bank supervisors was to find out how participants in the London and overseas equities markets, particularly those owned by British banks, were affected. In order to keep abreast of events, a working group was established bringing together supervisors from different parts of the Bank as well as from The London Stock Exchange.

In the first few weeks after Black Monday, this group met two or three times a week, and established daily contact with bank and securities market regulators in other financial centres around the world. The discussions of this

group served as an essential information exchange, and helped the Bank to monitor the position of individual institutions owned by banks as well as bank exposures to other market participants.

Relationships with other supervisors within the Bank

The process of consultation between bank and other supervisors continues on an informal basis within the Bank between Banking Supervision Division and those responsible for supervising the gilt-edged and wholesale money markets. Close liaison is also maintained between gilt-edged and wholesale markets supervisors.

Nineteen out of the twenty-three gilt-edged market makers (GEMMs) are currently owned by banks or form part of wider banking groups. Although the GEMMs, as separately capitalised entities, are supervised on the basis of their own committed capital and risk positions, there is an obvious common interest in the strength of the parent and the performance of the GEMM. In view of this common interest, bank supervisors have established a close working relationship with their counterparts in Gilt-Edged Division and hold regular meetings to discuss developments in their respective areas. Where relevant, trilateral meetings are held to include non-Bank supervisors. Discussions are also held between the banking and gilt-edged supervisors on the co-ordination of specific policy issues.

Wholesale Markets Supervision Division (WMSD), in addition to their responsibility for the supervision of discount houses (see page 53), are also responsible under section 43 of the Financial Services Act for administering a new regime for firms acting as market makers or brokers in the wholesale sterling, foreign exchange and bullion markets. Many of the firms which have satisfied the criteria for inclusion on the section 43 list are banks already supervised by Banking Supervision Division which will remain responsible for assessing those banks' financial soundness.

In implementing this new regime bank supervisors will liaise closely with wholesale markets supervisors. Bank supervisors have already assisted their colleagues in WMSD by providing information relevant to the decision to include an institution on the section 43 list. This close liaison will continue on a regular and informal basis to ensure that banks maintain adequate systems and controls

in respect of their wholesale markets activity. All banks, whether or not they are listed, will be required in their wholesale market dealings to observe the London Code of Conduct developed by WMSD and set out in the Bank's Grey Paper.

II.2 International policy

Convergence and the Basle Supervisors Committee

The Bank has played a prominent role in the negotiations in the Basle Supervisors Committee during the past year on the subject of convergence. The Committee, chaired by Mr Peter Cooke, an Associate Director of the Bank, met six times in 1987/88, devoting a large part of its time to the consideration of proposals for the convergence of capital adequacy. These proposals, which were agreed at the end of 1987,⁽¹⁾ supersede the UK/US proposals published in January 1987.

The Basle proposals have three principal elements:

- a common definition of capital, with special emphasis on equity capital and disclosed reserves arising from retained earnings (tier one or core capital), but also allowing a wider range of instruments to be included (at national discretion) within a second tier of supplementary capital. For the purposes of meeting the minimum capital standard, the total of supplementary elements should not exceed the total of core capital. Within supplementary capital, there are separate sub-limits on general provisions and term debt.
- a common system of risk weights applying to all balance-sheet assets and off-balance-sheet items to reflect their relative credit risk. The basic risk weight categories are 0, 20, 50 and 100 per cent.
- a standard minimum level of capital which banks will have to hold against their risk-adjusted assets and off-balance-sheet business. Transitional arrangements are envisaged allowing banks gradually to build up to the minimum standard of an 8% ratio by end-1992.

The above proposals would establish minimum levels for the capital adequacy of international banks. National authorities retain discretion to apply the standard to all banks and to require higher levels where this is judged

(1) *Proposals for the International Convergence of Capital Measurement and Capital Standards*, December 1987.

appropriate. The arrangements to be applied in the United Kingdom are discussed on pages 16-18 above.

The convergence proposals are directed at the measurement and control of credit risk. However, the Committee is aware that there are many other types of risk to which banks are exposed. Position risk proxies for investments are incorporated into the overall convergence framework, but the proposals do not set out to measure position risk, foreign exchange risk, interest rate risk or operational risk. The Committee is therefore currently exploring how far it may be possible to develop a common approach to these different areas of risk to which many international banks are exposed partly as a result of their diversification away from traditional banking business.

The sub-group on off-balance-sheet exposures has spent most of the year working on the off-balance-sheet section of the convergence proposals published in December 1987. This work will continue in 1988 as the comments received from banks on the proposals are evaluated. The sub-group has also begun to consider supervisory approaches to the analysis and measurement of foreign exchange risk. There is also a sub-group considering the problem of measuring interest rate risk. This has proved a difficult subject but the sub-group hopes to complete work on an analytical paper during the current year.

Parallel discussions with the object of developing a solvency (or risk asset) ratio have also been undertaken between members of the European Community. Close contact has been maintained between Brussels and Basle in order to minimise the scope for inconsistency between these respective sets of proposals. This, of course, is particularly important for EC countries which, like the United Kingdom, are also members of the G10.

EC Directives and supervisory bodies

Completion of the internal market

In 1985 the European Council endorsed the proposals contained in the European Commission's white paper outlining plans for the completion of the Community's internal market by 1992. An important part of these proposals is the elimination of cross-border restrictions on financial services.

Existing European banking legislation falls short of the objective of completing the internal market by 1992. At present it comprises three Directives and two Commission Recommendations. Of foremost importance is the *First Banking Co-ordination Directive*,⁽¹⁾ adopted in 1977. In broad terms it required Member States to establish systems of authorisation for their credit institutions and set out the minimum criteria to be applied in national systems. It also paved the way for future development of policy in this field, being followed in 1983 by the *Consolidated Supervision Directive*⁽²⁾ which obliged Member States to supervise credit institutions with financial subsidiaries on a consolidated basis. In 1986 the *Bank Accounts Directive*⁽³⁾ was adopted. When implemented in national legislation, it will bring a degree of harmonisation for bank accounts throughout the Community.

Two Commission Recommendations were also adopted in 1986 relating to *large exposures*⁽⁴⁾ and *deposit protection arrangements*.⁽⁵⁾ The large exposures policy which the United Kingdom has implemented for banks (see page 22 above) takes account of the recommendation and is in several respects stricter. Similarly the United Kingdom's deposit protection arrangements satisfy the provisions of the latter recommendation, which simply asks Member States with such schemes to satisfy themselves that they are adequate and those without to consider establishing one.

To achieve its objectives of an internal market by 1992, the Commission has been working on three key new Directives:

- (a) a draft *Second Banking Co-ordination Directive*

This is the centrepiece of the Commission's proposals for the banking sector which, along with the liberalisation of capital movements and other Community instruments in the banking field (on own funds, solvency ratio, large exposures, deposit protection), seeks to eliminate the remaining barriers to freedom of establishment in the banking sector and to afford full freedom to provide banking services without establishment.

(1) 77/780/EEC
(2) 83/350/EEC
(3) 86/635/EEC
(4) 87/62/EEC
(5) 87/63/EEC

The core of the Directive is a proposed single banking licence enabling credit institutions incorporated in a Member State to enjoy mutual recognition throughout the Community by virtue of their home country authorisation. The exercise of such freedom whether through a branch or by cross-border provision of services will cover a wide range of banking services (which includes all forms of transactions in securities). These benefits will extend also to EC-incorporated banks under third country ownership, and in view of this the Commission has inserted a reciprocity clause into the text. This would empower it to require Member States to delay granting authorisation to subsidiaries of institutions from third countries denying reciprocal arrangements to any Member State.

With the development of a single banking licence, home country supervisors of the Member States will become responsible for the authorisation and overall supervision of the Community-wide branch operations of their credit institutions. However, host authorities will retain exclusive responsibility for measures arising from the implementation of monetary policy and, pending further co-ordination of EC standards, primary responsibility for the supervision of liquidity and position risk.

Introduction of home country control is dependent on the essential harmonisation of a number of supervisory standards, also covered by the Directive: in particular a prescribed minimum level of capital for authorisation and for continuing business (ECU 5 million); supervisory control over major shareholders and banks' participations in the non-bank sector; and sound accounting and control mechanisms. As harmonisation of these aspects alone would not fully ensure the soundness of credit institutions, it is proposed that the provisions of the Directive will only take effect when Community legislation is in place on own funds and a harmonised solvency ratio.

(b) a draft *Own Funds Directive*

This sets out to lay down a standard Community definition of 'capital for prudential supervision purposes. The Directive draws a boundary around the kinds of resources which Member States may allow

their banks to count as capital, although Member States will have the option to be more strict if they wish. The *Own Funds* definitions have undergone substantial modification during the last year as the Commission has sought to ensure broad compatibility with the framework developed by the Basle Supervisors Committee.

(c) a draft *Solvency Ratio Directive*

This will not only introduce a uniform risk weighting system for all Community credit institutions but also establish a minimum risk asset ratio to which they will be subject, provisionally set at 8% in line with the Basle proposals. Although a new concept to the United Kingdom, a published minimum level for banks' risk asset ratios is common practice in many other countries. The proposals are substantially similar to those of the Basle framework.

Other proposals which will have important implications for the banking sector are those concerning the liberalisation of capital movements within the Community which will further develop the Commission's plans for the internal market. The intention is to remove all remaining barriers to the ability of an individual or firm to transfer capital anywhere in the Community; only reasons of monetary or prudential regulation will be allowed to impede such flows. Under discussion also are proposals for the filing of accounting documents by bank branches located in the Community; the reorganisation and winding up of credit institutions (which include the extension of deposit protection coverage); and, at an early stage, the harmonisation of consumer protection rules governing electronic payment systems.

Member States have also been involved in long-term discussions with the Commission over proposed measures directed at abolishing obstacles faced by institutions undertaking mortgage business throughout the Community and, allied to this, the introduction of a system of mutual recognition for mortgage bonds.

EC supervisory bodies

As briefly mentioned in last year's Report, the banking supervisors of Member States meet in two separate fora. First, the *Banking Advisory Committee*, a high-level

policy-making committee of supervisors and government officials, established under the terms of the First Banking Co-ordination Directive, to work alongside and assist the Commission with the work of co-ordination of policy in the banking field. Secondly, the *Contact Group of EC Supervisory Authorities* ('*Groupe de Contact*') an informal group of senior representatives of the EC banking supervisory authorities, created in 1972, whose principal aim is to achieve closer understanding of supervisory practices and to promote practical co-operation.

The two groups maintain a close working relationship, particularly on technical and practical supervisory matters. During the year they have continued to monitor and develop the observation ratios relating to solvency, profitability and liquidity of credit institutions in Member States. While the annual observation ratio exercises for profitability and liquidity will continue unchanged, the Advisory Committee has taken the decision to abandon the traditional solvency calculation for 1988 in favour of a new calculation. This is to give Member States the opportunity to test the impact on their banks of the capital adequacy framework currently proposed in the draft Own Funds and Solvency Ratio directives, and in particular the provisional 8% minimum risk asset ratio. At the same time the results of the exercise will provide the Commission with sufficient data to enable it to propose a definitive minimum ratio. A large number of UK banks are participating in this exercise.

Part III Operational supervision

The legal framework

The Board of Banking Supervision

The Board of Banking Supervision under the Banking Act 1987 was established in November 1987, having previously operated on a non-statutory basis throughout the earlier part of the year under review. At its monthly meetings it has reviewed, and provided expert advice to the Bank on, all aspects of the work of Banking Supervision Division.

The Board's own Annual Report appears on pages 73-74.

The Banking Act 1987

The Banking Bill received Royal Assent on 15 May 1987. Its main provisions were summarised in last year's Report.

Part V of the Act, which deals with disclosure of information received by the Bank, was brought into force on 15 July 1987. The bulk of the rest of the Act came into force on 1 October 1987. The only remaining major provision—the requirement in section 38 for institutions to report large exposures to the Bank—was brought into force on 1 April 1988.⁽¹⁾

In May 1987 the Secretary of State for Trade and Industry announced measures to facilitate co-operation between the Panel on Take-overs and Mergers and other regulators. Pursuant to this aim the Panel was added to the list in section 84 of the Act of persons to whom the Bank may disclose information; this addition came into force on 13 August 1987.

The commencement orders and other statutory instruments made under the Act are summarised in Appendix 4.

(1) The final provision to be brought into force—the repeal of section 193 of the Financial Services Act 1986—took effect on 29 April 1988. Alternative provisions to exempt deposit-taking incidental to the investment business of persons authorised or exempted under the Financial Services Act have been made in regulation 14 of the Banking Act 1987 (Exempt Transactions) Regulations 1988.

The Banking Supervision Guide

In September 1987 a Guide to banking supervision under the new Act was issued. The Guide provides applicants and authorised institutions with a summary of the provisions of the Act most relevant to them and provides guidance on the manner in which the Bank conducts its supervision. In addition, it gave details of notification requirements under the Act applicable to authorised institutions and to others.

The Guide is divided into seven parts:

- Part I describes the provisions of the Act concerning the control of deposit-taking.
- Part II describes the system of authorisation by the Bank and the statutory criteria for authorisation and contains the questionnaires required to be completed by applicant institutions and their directors, controllers and managers.
- Part III outlines the nature of the Bank's supervisory regime, statistical and monetary control requirements and certain other continuing obligations to which authorised institutions are subject.
- Part IV deals with various notification requirements under the Act, including among others those applicable to persons proposing to become shareholder controllers or indirect controllers and to significant shareholders of UK-incorporated authorised institutions.
- Part V summarises the provisions of the Act relating to the restriction and withdrawal of authorisation, and the giving of directions.
- Part VI describes the provisions of the Act applicable to overseas institutions proposing to establish or having representative offices in the United Kingdom.
- Part VII sets out certain other matters of interest to applicants, authorised institutions and representative offices.

- Finally, a number of notices published by the Bank on supervisory, monetary control and other matters are attached in an Appendix to the Guide.

The Guide was sent to all authorised institutions, the auditors of those authorised institutions incorporated in the United Kingdom, other banking and financial supervisors, the main UK banking associations and accountancy bodies and to leading London solicitors.

Statement of principles

Section 16 of the Act provides that the Bank shall publish a statement of principles. This statement is being published simultaneously with this Report and is available separately on request. The statement sets out the principles which guide the Bank in interpreting the minimum criteria for authorisation in Schedule 3, in judging the grounds for revocation in section 11 and in exercising its power to grant, revoke or restrict an authorisation. It includes a section on the application of the fit and proper criterion to shareholder and indirect controllers; this is of particular relevance to the Bank's wider powers in respect of changes in the control of banks given to the Bank under the new Act.

Supervision under the Act

Authorisations

The numbers of applications and authorisations fell below those of recent years because the abolition of the two-tier system in October 1987 meant that no authorisations now arise from moves between licensed institution and recognised bank status, as shown in Table IX.

In the seven months between the period covered by last year's Report and the coming into force of the 1987 Act, six institutions were granted recognition as banks and seven institutions were granted licensed deposit-taking authority. From October 1987 to the end of the Bank's year eight institutions were granted authorisation under the 1987 Act. Of the total of twenty-one authorisations, fourteen were overseas-incorporated institutions wishing to operate UK

Table IX

Applications and authorisations

Year to end-February	1983	1984	1985	1986	1987	1988
Applications	36	37	23	25	34	21 ^(a)
Authorisations	25	26	28	18	37	21

(a) Including the submission under the 1987 Act of two applications which lapsed on the repeal of the 1979 Act and thus had to be resubmitted.

branches (compared with sixteen in 1986/87), four were subsidiaries of overseas institutions (seven in 1986/87) and three were other UK-incorporated institutions (fourteen in 1986/87).

Of the institutions authorised at end-February 1988, 254 were overseas-incorporated institutions with UK branches (the same as at end-February 1987), 72 were UK-incorporated subsidiaries of overseas institutions (67 in 1986/87), and 24 were UK-incorporated joint ventures between overseas institutions and, in some cases, between overseas and UK institutions (23 in 1986/87). The geographical origin of authorised institutions is very wide, with banks from 75 countries having offices here, as shown in Appendix 6.

A list of authorised institutions at the Bank's year-end, showing changes during 1987/88, is attached at Appendix 7. The list is regularly updated and is available from the Bank on request.

Table X shows the changes in the number of authorised institutions over the past five years. The fall over the past year reflects the increase in surrenders and revocations (see pages 48-50 below).

Table X

Number of authorised institutions

End-February	1984	1985	1986	1987	1988
UK-incorporated	358	355	343	334	313
Incorporated outside the UK	240	250	252	254	254
	598	605	595	588	567

Prudential/statistical returns and interviews

The Bank's supervisory system is based on regular discussion with management of the financial information contained in prudential/statistical returns. These regular contacts assist the Bank in its assessment of the quality of management and in satisfying itself that each authorised institution continues to conduct its business prudently and to meet other relevant criteria.

Just under three thousand interviews were conducted during 1987/88 (an average of over five per institution). Of these, about one third were routine discussions with management based on the prudential returns and two thirds were non-routine meetings to discuss specific issues. Just under half of the routine prudential interviews were held on the institution's premises. Additionally, officials visited a number of countries in the Middle East and Europe, taking the opportunity to hold discussions with local bank supervisors and to visit UK banks' offices and the head offices of institutions with branches in the United Kingdom.

The Bank generally takes the initiative when arranging meetings but, in the event that management of an institution becomes aware of any significant developments in the institution's business or has significant proposals for change, it is expected to inform the Bank without delay. The Bank also expects to be consulted in good time before an institution amends or departs significantly from the business plan submitted in support of its application for authorisation.

Investigations, visits and reviews

Last year's Report explained the various means available to the Bank to extend its understanding of an institution's business.

One investigation begun in the period covered by last year's Report was the subject of considerable public interest: the investigation under section 17 of the 1979 Act into Standard Chartered Bank. In February 1987, the Bank appointed inspectors to investigate in the interests of depositors the circumstances and nature of Standard Chartered's defence against the bid from Lloyds Bank which had been made the previous year. By January 1988, the Bank was able to publish the main conclusions of the inspectors' investigation, which confirmed that there was no evidence of any breaches of the terms of the Take-over Code, the Companies Act or the Company Securities (Insider Dealing) Act.

The Bank's statutory powers of investigation were used in 1987/88 on a number of occasions. Under the 1979 Act one report was required from an institution under section 16 and one investigation by a firm of chartered accountants was commissioned under section 17. Under the 1987 Act, the corresponding provisions in sections 39 and 41 were used seven and five times respectively, often in connection with the revocation, restriction or surrender of an authorisation. It is intended that section 39 will in future be used on a routine basis to require banks to commission reports from reporting accountants (see pages 29-31 above).

The use of the section 17/41 powers compared with previous years is shown in Table XI.

In addition to statutory investigations, the Bank undertook a large number of visits and reviews. In 1987/88 there were

Table XI

Use of section 17/41 powers

Year to end-February	1983	1984	1985	1986	1987	1988
Number of investigations	2	4	3	5	4	6 ^(a)

(a) One under section 17 of the 1979 Act and five under section 41 of the 1987 Act.

164 reviews conducted with the agreement of the institutions concerned—an increase from 75 such reviews in the previous year. 38 reviews covered loan book quality, 28 operating and control systems and 98 both. 86 of these reviews were of domestic institutions and 78 of subsidiaries and branches of overseas banks.

Finally, as the foreign exchange market in London has grown, the number of visits to review exposure guidelines and to up-date the Bank's knowledge of institutions' foreign currency systems has increased. In 1987 there were 138 such visits (80 in 1986).

Accuracy and timeliness of prudential/statistical returns

Under the 1987 Banking Act it is an offence for a person knowingly or recklessly to provide information for supervisory purposes which is false or misleading. It is also an offence for an authorised institution to withhold from the Bank information which it knows or has reasonable cause to believe is of material relevance to its supervision. The provision for supervisory purposes of information which is false, misleading or inaccurate is also a ground for revocation of authorisation. These, and other provisions and developments, underline the importance for banks of reporting promptly and accurately.

In addition, procedures for monitoring the timely submission and completion of returns have been further enhanced, with regular exercises being carried out to identify institutions with a poor reporting record. Twenty-five institutions were asked to improve their reporting standards; further action was necessary in respect of eleven institutions which had been asked in the previous year to improve their reporting record.

Surrenders

There were thirty-three surrenders in 1987/88. In five cases authorisation was surrendered when it became apparent that the Bank's powers to revoke had become exercisable and that the Bank was likely to initiate revocation procedures. Seventeen institutions surrendered because of group reorganisations with deposit-taking authority either being granted to, or already existing in, a company elsewhere in the group; and sixteen institutions surrendered because of a decision to cease taking deposits in the United Kingdom.

In two cases in 1987/88 the Bank gave directions to safeguard the interests of depositors after the institutions gave a notice surrendering their authorisation.

Revocations and restrictions

During the year the Bank used its powers under section 7 of the 1979 Act to replace three authorisations under that Act with conditional licences.

Under the 1987 Act the Bank revoked under section 11 of the Act the authorisation of two institutions. In both cases the Bank gave directions to protect the interests of the institutions' depositors.

The Bank also restricted under section 12 of the Act the authorisation of two institutions, in one case by imposing a time-limit on the authorisation and in both cases by imposing conditions to protect the institutions' depositors and potential depositors.

In all cases where the Bank moved to revoke or restrict an authorisation it had the benefit of an accountants' report.

In every case it appeared to the Bank that some of the criteria in Schedule 2 to the 1979 Act or Schedule 3 to the 1987 Act were not fulfilled.

Reasons for concluding that the 'prudent conduct' criterion was not fulfilled included unsatisfactory nature or inadequate amount of capital; inadequate liquidity; inadequate provisions against bad and doubtful debts and failure to develop a provisioning policy; inadequate accounting records and systems of control; and failure to formulate a viable business strategy.

In four cases the Bank concluded that directors and controllers were not 'fit and proper' to hold their positions with the institutions concerned; in two cases that the business of the institution was not carried on with integrity and the professional skills appropriate to the nature and scale of its activities; and in two cases that the 'four eyes' criterion was not fulfilled as only one person was effectively directing the business.

Table XII shows the Bank's use of its revocation and restriction powers over the past six years.

This table is not a full record of the number of institutions which have experienced difficulties. As noted on page 48, a number of institutions surrender authorisation rather than face revocation.

Table XII

Revocations and restrictions^(a)

Year to end-February	1983	1984	1985	1986	1987	1988	
1979 Act							1987 Act
Outright revocation of full licence	1	—	—	5	1	2 ^(b)	Revocation of authorisation
Revocation of recognition and grant of conditional licence	—	1	—	1	—	} 5 ^(c)	Restriction of authorisation
Revocation of full licence and grant of a conditional licence	1	1	2	2	2		
Revocation of conditional licence and grant of further conditional licence	—	—	—	1	—		
Outright revocation of conditional licence	—	2	2	—	3	} —	Revocation of restricted authorisation
Outright revocation of transitional licence	4	—	—	—	—		

(a) The table records cases in the year that the Bank's formal notice of revocation or restriction was given. In some cases, the revocation did not take effect until the following year and in a few cases the institution surrendered (or a conditional licence expired) before the revocation notice took effect. In addition, the Bank has used its powers more than once in respect of a few institutions. It is *not* therefore a record of authorisations revoked or restricted but of the use of the Bank's powers.

(b) Both under the 1987 Act.

(c) Three under the 1979 Act and two under the 1987 Act.

Appeals

Last year's Report recorded that one applicant had appealed against the Bank's decision not to grant a licence under the 1979 Act. In the event, the applicant did not pursue the appeal.

This year, one institution lodged notices of appeal against the revocation of its authorisation and the giving of directions. Three directors of the institution also appealed against findings of the Bank that they were not fit and

proper persons for the particular positions which they held with the institution. The appeals were withdrawn by the institution and its directors shortly after the Bank's year-end and the revocation notice thus took effect.

Liquidations

Last year's Report recorded that, after the Bank's year-end for 1986/87, the Bank had petitioned under section 18 of the 1979 Act for a winding-up order in respect of Consumer Credit Investments Ltd, a licensed deposit-taker. The company went into liquidation with deposit liabilities outstanding. The Deposit Protection Board⁽¹⁾ has made payments to depositors.

The Bank did not make any applications for winding-up orders under section 92 of the 1987 Act during 1987/88.

The recent pattern of liquidations of authorised institutions (and those formerly authorised with outstanding deposit liabilities) is shown in Table XIII.

Table XIII

Liquidations

Year to end-February	1983	1984	1985	1986	1987	1988
Section 18 petitions	1	2	1	—	—	1
Creditor petitions	—	—	1	—	—	—
Company petitions	1	—	—	—	—	—
Voluntary	—	1	3	—	3	—

Enforcement

The prohibition on deposit-taking

The Bank undertook investigations into thirty-eight cases of possible illegal deposit-taking during the year, the majority under the provisions of the 1979 Act, as well as making a substantial number of other more general enquiries. Apart from cases identified by the Bank itself, the main sources of information were the public and government departments. Generally the investigation of suspected offences involves visiting the premises of those concerned, by appointment or otherwise, viewing the relevant records and interviewing those principally involved. Where deposits were found to have been taken illegally, the Bank's intervention normally resulted in full and swift repayment.

The wider investigative powers contained in sections 42 and 43 of the 1987 Act came into effect in October 1987. These enable the Bank to require information and documents in

(1) The Deposit Protection Board, a body corporate set up by the 1979 Act and continuing to exist under the 1987 Act, manages the Deposit Protection Scheme. Copies of its report and accounts for the year ended 29 February 1988 can be obtained from the Secretary, Deposit Protection Board, 19 Old Jewry, London, EC2R 8HA.

respect of suspected deposit-taking offences. The powers in section 42 were invoked against two companies in the year under review.

The Bank is, along with the Director of Public Prosecutions, a prosecuting authority in respect of offences under the Act, and liaises closely with the Crown Prosecution Service regarding decisions on prosecutions. Decisions in individual cases are governed by a number of factors, including the sufficiency of evidence, the seriousness of the alleged breach, the length of time since the suspected offence and the likelihood of recurrence.

Possible submission of false or misleading information

In 1982 the Bank petitioned successfully under section 18 of the 1979 Act for First Guarantee Trust Company Limited to be wound up following the emergence of serious liquidity problems.

A police investigation into the company's affairs has led to a director of the institution being charged with two offences under the 1979 Act, as well as with offences under the Theft and Companies Acts. The Banking Act offences (under section 5 of the 1979 Act) relate to the provision of 'false or misleading' information to the Bank in connection with the company's application for deposit-taking authority.

Advertising for deposits

Deposit advertisements must comply with the requirements of advertisements regulations. The Regulations issued under the 1979 Act have recently been replaced by regulations under the 1987 Act, though their provisions remain broadly unchanged (see Appendix 4). Regulations will continue to apply to advertisements issued in the United Kingdom which invite deposits with an institution's offices outside the European Community. However, deposit advertisements which are 'investment business advertisements' regulated by Financial Services Act rules are now excluded.

Representative offices of overseas institutions

The 1987 Act provided a six month transitional period within which the Bank was entitled to object to company or business names used by overseas institutions which had already notified the establishment of representative offices in the United Kingdom under the 1979 Act. An objection could be made if the Bank considered the name misleading to the public or otherwise undesirable. The Bank had concerns about the banking names previously notified by some twelve institutions. From its

investigations it appeared that all the institutions concerned either no longer maintained a representative office in the United Kingdom or had ceased using banking names. Consequently the Bank did not need to exercise its powers under section 76(3).

Any overseas institution wishing to establish a representative office in the United Kingdom is required under the 1987 Act to give two months' notice of its proposed name. Twelve institutions have given such notice under section 75 in the past year.

Banking names and descriptions

Forty-six authorised institutions have notified the Bank under section 70 of the 1987 Act of proposed business or company name changes and have subsequently changed their name. Most of these institutions wished to take advantage of the provision in the Act whereby a UK-incorporated authorised institution is permitted to use a banking name provided it has at least £5 million of paid-up share capital and/or undistributable reserves. The Bank did not issue any notices of objection to a proposed name change by an authorised institution in the period under review.

The Bank has also considered over one hundred names submitted by unauthorised institutions which included terms such as 'bank' or 'banking' with a view to assessing whether the name as a whole would be likely to breach the prohibition on the use of banking names contained under section 36 of the 1979 Act and its successor, section 67 of the 1987 Act. The Bank indicated that nineteen of the proposed names would appear to breach the prohibition.

Discount houses

In contrast to all other banks, the discount houses are supervised not by Banking Supervision Division but by the Bank's Wholesale Markets Supervision Division. Four of the eight discount houses remain independent; the other four are owned by other financial groups, all of which are now in non-UK ownership following the transfer in the autumn of 1987 of Alexanders Discount from Mercantile House to Credit Lyonnais.

The discount houses are subject to special capital tests, reflecting the particular nature of the risks to which they are exposed. In contrast to other banks, whose risks relate predominantly to credit exposure to the private sector,

discount houses' chief risks are of changes in the market value of their liquid, high quality assets caused by movements in the general level of interest rates. After undertaking a thorough analysis of the risks entailed in these holdings of marketable securities (mostly eligible bills and certificates of deposit), and the protection afforded by the existing supervisory tests, the Bank decided in mid-1987 that a relaxation would be appropriate. This was designed to bring the tests for the houses more into line with, although leaving them still more onerous than, the tests being developed for securities firms under the Financial Services Act. From July 1987 a house with assets of the highest quality under three months in maturity has been required to restrict its holdings to not more than eighty times capital base, rather than the forty times limit which applied previously. The permitted multiple of capital in longer maturity or higher risk assets was also increased. This relaxation was accompanied by an increase in reporting frequency to a fortnightly basis; and the Bank indicated that it would expect houses normally to operate less close to the new supervisory limits than they had to their previously lower ceilings.

In common with many other banks, discount houses have been included on the Bank's list of money-market institutions provided for under section 43 of the Financial Services Act. As a result their wholesale money-market transactions will become exempt from the provisions of that Act and instead continue to be subject to regulation by Wholesale Markets Supervision Division, conforming with the London Code of Conduct.⁽¹⁾

In order to avoid imposing a burden of dual regulation which would otherwise have been involved for those houses which have investment business under the Financial Services Act outside the exempt money-market area, and so also require to be authorised under that Act, Wholesale Markets Supervision Division has agreed a Memorandum of Understanding with The Securities Association. Under this agreement the Bank is accepted as lead regulator for all the houses and they are allowed to remain subject solely to the Bank's existing capital tests. The reporting burden falling on the houses is also minimised, since they are not required to complete any further forms beyond those already required by the Bank.

(1) Annex III to the Grey Paper, *The regulation of the wholesale markets in sterling, foreign exchange and bullion*, issued in April 1988.

Part IV Organisation and staffing of Banking Supervision Division

Staff

Over the past year, staff numbers in Banking Supervision Division have continued to increase, although not quite as rapidly as in 1986/87. The six-year trend is illustrated in Chart 7.

A further increase in staff (to a total of 199) is budgeted for the year to February 1989. This increase anticipates additional resource demands arising from work in connection with the Financial Services Act, from liaison with auditors and reporting accountants, and from generally enhanced supervision. The allocation of the Division's staff is shown in Table XIV, and the current structure of the Division is illustrated in the organogram attached as Appendix 5.

During 1987/88 five analysts were recruited with commercial banking experience, thus continuing the policy of direct recruitment started the previous year. The Division currently has four secondees from the clearing banks, five from firms of chartered accountants and one from the Building Societies Commission.

Training

1987/88 has seen a continuation of the enhanced training programme introduced following the recommendations of the Leigh-Pemberton Report on Banking Supervision. Staff of the Division attended a wide variety of external courses. In total, around two-thirds of the Division attended one or more of these external courses, a majority of which were tailor-made for the Division's needs for technical expertise in banking, legal and accountancy matters. More general management training is also provided, and two members of the Division are currently participating in MBA programmes.

In addition to external training, members of the Division have attended various internal courses including personal development and computer skills. New entrants who joined the Division during the summer and the graduates who were recruited in October participated in a five-week training course organised by the Division.

Chart 7
Staff numbers in Banking Supervision Division

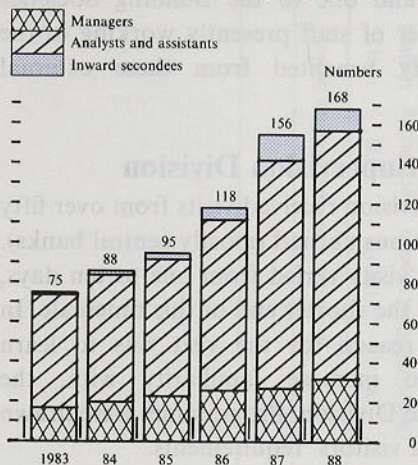


Table XIV
**Allocation of Banking Supervision
Division staff**

	Staff	Authorised institutions
UK retail & merchant banks	24	71
UK branches and subsidiaries of overseas banks	63	330
Medium and smaller UK institutions	43	158
Policy and legal matters	23	—
Administration	15	—
Total	168	559^(a)

(a) This figure excludes the eight discount houses, which are supervised by Wholesale Markets Supervision Division.

Graduates also attend a comprehensive graduate training programme organised by Personnel Division.

The programme of outward secondments continues. At end-February, five members of the Division were on training secondments: one to a merchant bank, one to a clearing bank, one to a firm of chartered accountants, one to the Department of Trade and Industry's Companies Investigation Branch and one to the Building Societies Commission. A number of staff presently working in the Division have already benefited from these external training secondments.

Visits to Banking Supervision Division

During the year the Division received visits from over fifty personnel from institutions abroad (mostly central banks). The duration of these visits varied from one to ten days, although most were at the shorter end of this timescale. In almost all cases the reason for the visit was to learn something of, or to increase familiarity with, the supervisory work of the Division. Programmes were drawn up to match individual visitors' requirements.

Technology

The past year has seen a continuation of the Bank's investment in technology to improve the operational efficiency of the Division. There are now more than 100 workstations throughout the Division, offering wordprocessing and a spreadsheet capability to analysts and managers, as well as an electronic office network. The Division is currently undertaking trials on a management information system with an integrated database and word processing capability. When the new system comes on line, it will be one of the largest databases of financial information in the City.

Appendix 1

Country debt provisioning matrix

Analysis of country debt recoverability (see explanatory notes overleaf)

Category	A			B			C										Total
Criterion	'A' factors			'B' factors			Economic and miscellaneous factors										
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)		
	Moratorium in effect	Country rescheduled at any time since Jan. 1983, or in process of rescheduling since Jan. 1983	Second or more rescheduling of principal amounts rescheduled since Jan. 1983	Significant arrears of interest or principal to IFIs	Arrears of principal on original or rescheduled loans from other external creditors	Arrears of interest on original or rescheduled loans from other external creditors	Interest service ratio	Visible import cover	Debt/GDP ratio	Debt/exports ratio	Not meeting IMF targets/unwilling to go to IMF	Unfilled financing gap over next 12 months	Market price	Over-dependence on single primary commodity export	Other factors		
Weight	0-3 months = 3 3-12 months = 6 More than 12 months = 10 3, 6, or 10	10	5	0-3 months = 4 More than 3 months = 8 10	0-3 months = 4 More than 3 months = 8 4 or 8	0-3 months = 4 More than 3 months = 8 4 or 8	More than 15% = 2 More than 25% = 4 2 or 4	Less than 2 months = 4 Less than 4 months = 2 2 or 4	More than 50% = 2 More than 75% = 4 2 or 4	More than 300% = 2 More than 500% = 4 2 or 4	3	2	Less than 80% = 2 Less than 50% = 4 2 or 4	2	0 to 5		

57

Translation of matrix score to provision range

Score	Provision
10-24 (of which 10 from Categories A and B)	5-15%
25-40 (of which 10 from Categories A and B)	16-25%
41-55	26-40%
56-70	41-60%
71-83	61-100%

Notes to the matrix

'A' Factors

(1) Moratorium in effect

Unilateral action by a country to limit its debt payments, either totally or partially, to any creditor.⁽¹⁾ Score 3 if moratorium has been in effect for up to 3 months, score 6 for between 3-12 months. Any moratorium over 12 months scores 10.

(2) Country rescheduled at any time since January 1983, or in process of rescheduling

Country that has rescheduled either commercial or official debt since January 1983 or is currently in rescheduling negotiations.

(3) Second or more rescheduling of principal amounts rescheduled since January 1983

Country that has rescheduled principal already rescheduled since January 1983.

'B' Factors

(4) Significant arrears of interest or principal to IFIs

Country that is in arrears⁽²⁾ on either interest or principal to the international financial institutions (International Monetary Fund, World Bank, Regional Development Banks) over the threshold to be declared ineligible to draw on the General Resources Account (in the case of the IMF) or to stop disbursement of loans (in the case of the World Bank and Regional Development Banks).

(5) Arrears of principal on original or rescheduled loans from other external creditors

Any current arrears of principal on loans (either original or rescheduled) from external creditors other than those in category (4). Score 4 for arrears of up to 3 months and 8 for arrears in excess of this period.

(6) Arrears of interest on original or rescheduled loans from other external creditors

Any current arrears of interest on loans (either original or rescheduled) from other external creditors. Score 4 for arrears of up to 3 months and 8 for arrears in excess of this period.

'C' Factors

Economic and miscellaneous factors

(7) Interest service ratio

This is defined as interest payable divided by the value of exports of goods and services in the latest available 12 months and rounded to one decimal place. An interest service ratio between 15.0% and 24.9% scores 2, one of 25.0% or more scores 4.

(8) Visible import cover

This is defined as the number of months' import cover (ie, the annual value of imports divided by 12 and then divided into reserves for the latest available period, the result rounded to one tenth of a month). Reserves should include gold valued at 75% of the market price for the relevant period (at end-1987 for instance this would be \$363 per oz).

(1) Any creditor

It is only intended that a moratorium in respect of a general class of creditor should be scored. Thus, suspension of payments to an individual creditor or creditor country would not be scored. If a moratorium is about to end the score should be reduced to 3 where applicable.

(2) Arrears

In this context arrears arising out of temporary administrative delay and which are expected to be corrected within a relatively short period of time should not be scored, whereas generalised, observable and non-correcting arrears should be scored.

Import cover of 1.9 months or less scores 4. Cover between 2.0 and 3.9 months scores 2.

(9) Debt/GDP ratio

This is defined as total external debt divided by gross domestic product for the latest available period expressed as a percentage and the result rounded to the nearest one tenth of a percentage point. Ratios between 50.0% and 74.9% score 2; ratios of 75.0% and over score 4.

(10) Debt/exports ratio

This is defined as the total external debt divided by the value of exports of goods and services for the latest available twelve months expressed as a percentage, the result rounded to the nearest percentage point. A debt/exports ratio in the range of 300% to 499% scores 2. A debt/exports ratio of 500% or more scores 4.

(11) Not meeting IMF targets/unwilling to go to IMF

A country should score under this criterion if it is in breach of IMF targets (ie performance criteria for any programme, eg standby adjustment facility or structural adjustment facility) or is unable or unwilling to go to the IMF.

(12) Unfilled financing gap over next twelve months

Country has an unfilled external financing gap between its prospective payments outflows and its prospective inflows over the next twelve months after taking into account all currently available sources of finance.

(13) Market price

Secondary market 'bid' price for the country's debt (as a percentage of face value): between 50.0% and 79.9% score 2, below 50.0% score 4.

(14) Over-dependence on single primary commodity export

Score 2 if 30.0% or more of the value of a country's exports of goods and services in the latest available 12 months comprised of a single primary commodity.

(15) Other factors

Score any number from 0 to 5 depending on your assessment of other conditions in the country (whether economic or political) which affect its ability to repay indebtedness both now and in the future.

Current supervisory notices

The following is a list of policy and practice notices issued by Banking Supervision Division which are currently in force.

Title	Date of issue
Measurement of capital	September 1980
Foreign currency exposure	April 1981
Measurement of liquidity	July 1982
Connected lending; accounts; large exposures; fraudulent invitations; floating charges (BSD/1983/1)	April 1983
Foreign currency options	April 1984
Notice on advertising code of conduct	March 1985
Note issuance facilities/revolving underwriting facilities (BSD/1985/2)	April 1985
Statistical notice to monetary sector institutions (released in conjunction with previous paper)	April 1985
Further notice on advertising code of conduct and attachments	November 1985
Large exposures in relation to mergers and acquisitions (BSD/1986/1)	February 1986
Subordinated loan capital (BSD/1986/2)	March 1986
Consolidated supervision (BSD/1986/3)	March 1986
Measurement of capital (BSD/1986/4) (amendments to the 1980 paper)	June 1986
Statistical notice to monetary sector institutions (released in conjunction with previous paper)	June 1986
Large exposures (BSD/1987/1)	September 1987
Guidance note on accounting and other records and internal control systems and reporting accountants' reports thereon (BSD/1987/2)	September 1987
Guidance note on reporting accountants' reports on Bank of England returns used for prudential purposes (BSD/1987/3)	October 1987
The Bank of England's relationship with auditors and reporting accountants (BSD/1987/4)	December 1987
Large underwriting exposures (BSD/1987/1.1) (to be read in conjunction with the large exposures paper)	February 1988
Advertising for deposits (BSD/1988/1)	April 1988

Current consultative papers

The following is a list of consultative policy papers issued by Banking Supervision Division which are now being discussed with the banking community and other interested parties.

Title	Date of issue
Accountants' reports to supervisors: requirements for branches of overseas banks	May 1986
The role of audit committees in banks	January 1987
Loan transfers and securitisation (8/87)	December 1987
Explanatory paper on the proposals for international convergence of capital measurement and capital standards (1/88) (released in relation to the consultative paper on this subject issued by the Basle Supervisors Committee)	January 1988
Proposals for a stock of high quality liquidity (2/88)	March 1988

Banking Act 1987: orders and regulations

The following orders and regulations have been introduced:

1987 No 1189 (C 32) The Banking Act 1987 (Commencement No 1) Order 1987

This brought into force on 15 July 1987 the provisions of the Act relating to restrictions on disclosure of information obtained by the Bank, the making of orders, interpretations, certain consequential amendments and repeals, the application of the Act to Northern Ireland, its short title and commencement.

1987 No 1292 The Banking Act 1987 (Disclosure of Information) (Specified Persons) Order 1987

This specified the Panel on Take-overs and Mergers for the purposes of section 84 of the Act. The effect of specifying was to permit the Bank to disclose to the Panel information which would otherwise be restricted, if disclosure is for the purpose of enabling or assisting the Panel to discharge any of its functions. The order came into force on 13 August 1987.

1987 No 1299 The Banking Appeal Tribunal Regulations 1987

These made provisions with respect to appeals under Part I of the Act against decisions of the Bank to refuse to grant authorisation; to revoke authorisation; to impose restrictions or give directions, or as to the restrictions imposed or directions given; or that a person should not become or should cease to be a director, controller or manager of an authorised institution. Provision is made as to the time and manner in which appeals are to be brought, the evidence and procedure at the hearing, the procedure after the hearing, the payment of costs of appeals and miscellaneous matters connected with them. The Regulations came into force on 1 October 1987.

1987 No 1336 (S 95) The Banking Appeal Tribunal (Scottish Appeals) Regulations 1987

These made similar provisions to the Banking Appeal Tribunal Regulations 1987 in respect of Scottish appeals. The Regulations came into force on 1 October 1987.

1987 No 1664 (C 50) The Banking Act 1987 (Commencement No 2) Order 1987

This brought into force on 1 October 1987 all the provisions of the Act which were not already in force, except section 38 and the entry in Schedule 7 relating to section 193 of the Financial Services Act 1986 and section 108(2) in so far as it relates to that entry.

1988 No 502 (C 16) The Banking Act 1987 (Commencement No 3) Order 1988

This brought into force on 1 April 1988 section 38 of the Act (which relates to reports of large exposures).

1988 No 644 (C 20) The Banking Act 1987 (Commencement No 4) Order 1988

This brought into force on 29 April 1988 the entry in Schedule 7 relating to section 193 of the Financial Services Act 1986 and section 108(2) in so far as it relates to that entry.

1988 No 645 The Banking Act 1987 (Advertisements) Regulations 1988

These Regulations, which came into force on 29 April, re-enacted the Banking Act 1979 (Advertisements) Regulations 1985 (SI 1985 No 220; amended by SI 1987 No 64). They apply to deposit advertisements (which are defined in section 32(5) of the Banking Act 1987 (c22)) subject to the

exclusions specified in regulation 2. In particular, the Regulations do not apply where the deposits are to be made only with offices in the United Kingdom or another Member State of the European Community, or, if there is no indication of the offices with which the deposits are to be made, if the deposit-taker carries on business there. The one change of substance from the previous Regulations is that these Regulations exclude advertisements which invite only such deposits as are incidental to investment business and which are regulated by rules made in the context of the Financial Services Act 1986. In addition, there are minor and drafting amendments.

The Regulations specify matters which must and matters which must not be included in advertisements to which the Regulations apply, and in particular require the inclusion of particulars about the person taking the deposit, and contain provisions in connection with references to the deposit-taker's assets and liabilities, deposit protection arrangements, interest on deposits and the currency in which deposits will be made.

The Banking Act 1979 (Advertisements) Regulations 1985 were revoked.

1988 No 646 The Banking Act 1987 (Exempt Transactions) Regulations 1988

These Regulations, which came into force on

29 April, prescribed certain transactions as transactions to which the prohibition on deposit-taking imposed by section 3 of the Banking Act 1987 does not apply. They re-enact the Banking Act 1979 (Exempt Transactions) Regulations 1986 with amendments. In addition to minor and drafting amendments they make the following three changes of substance.

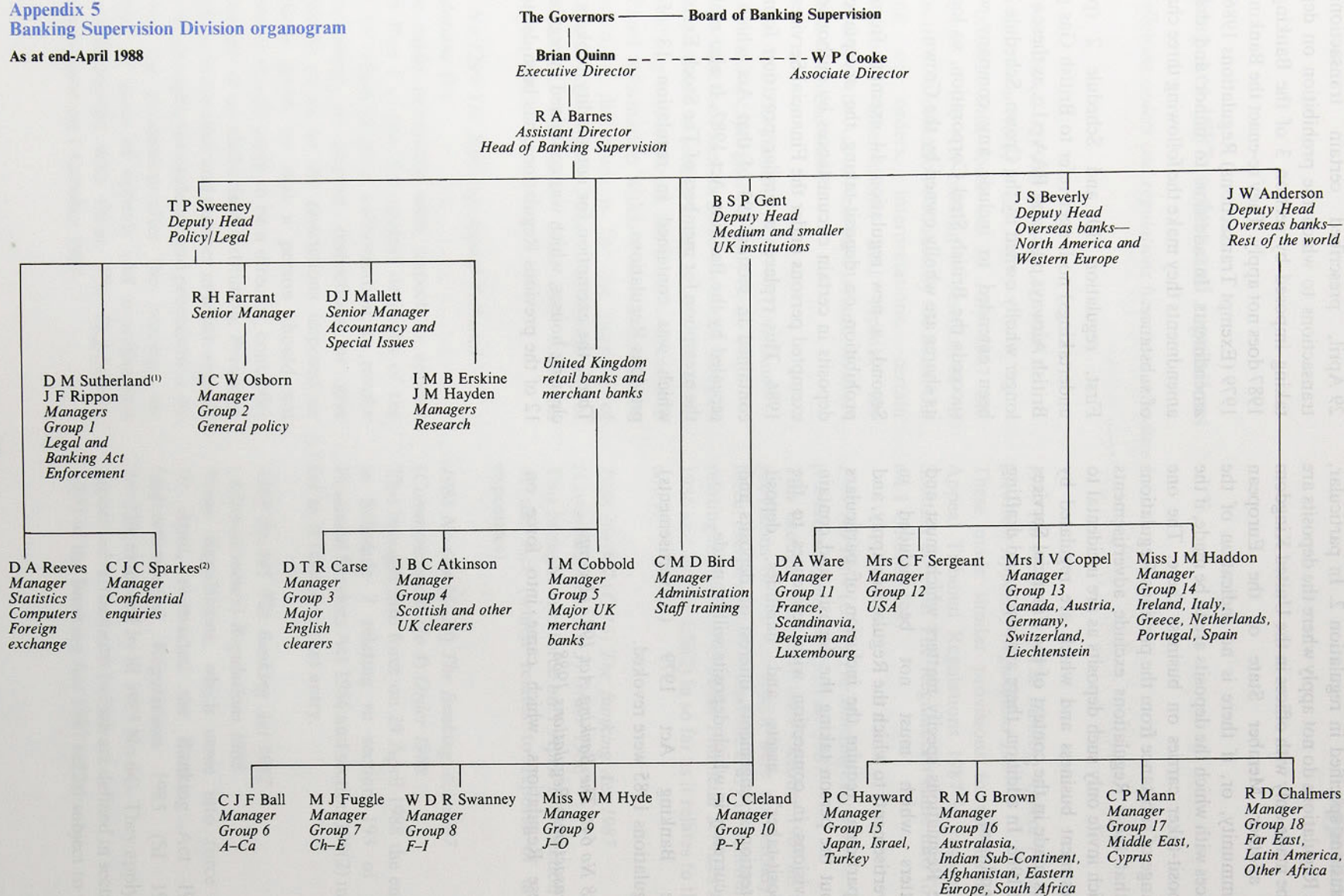
First, regulation 10 and Schedule 2 (public undertakings) no longer refer to British Gas p.l.c., British Airways p.l.c. and BAA p.l.c. as these are no longer wholly owned by the Crown. Schedule 2 has been extended to include any company which succeeds the British Steel Corporation, so long as its shares are wholly owned by the Crown.

Second, a new regulation 14 exempts from the prohibition on deposit-taking the acceptance of deposits in certain circumstances by authorised or exempted persons under the Financial Services Act 1986. This replaces a similar provision formerly contained in section 193 of that Act which was repealed by the Banking Act 1987. It also replaces the exemption for members of The Stock Exchange which was contained in regulation 13 of the previous Regulations.

Third, the exemption for commodity brokers and clearing houses, which was contained in regulation 12 of the previous Regulations, has been deleted.

Appendix 5
Banking Supervision Division organogram

As at end-April 1988



(1) Secretary of Board of Banking Supervision.
(2) Secretary of Deposit Protection Board.

Geographical representation of overseas institutions

The following table shows the geographical origins and status of foreign banks and quasi-banks represented in the United Kingdom at end-February 1988.

Country of ownership	Branch operations	Subsidiary operations	Controlling (15% or more) stake in consortium banks	Representative offices ⁽¹⁾	Total
Afghanistan	—	1	—	—	1
Argentina	1	—	—	1	2
Australia	9	8	—	—	17
Austria	3	—	—	3	6
Bahamas	—	—	—	2	2
Bahrain	2	—	—	4	6
Bangladesh	1	—	—	—	1
Barbados	1	—	—	—	1
Belgium	3	1	—	2	6
Bermuda	—	—	—	2	2
Brazil	4	—	1	5	10
Bulgaria	—	—	—	1	1
Canada	6	4	—	1	11
Cayman Islands	—	—	—	1	1
China	1	—	—	—	1
Cuba	—	1	—	—	1
Cyprus	3	2	—	—	5
Czechoslovakia	1	—	—	—	1
Denmark	3	2	—	6	11
Ecuador	—	—	—	1	1
Egypt	2	—	—	—	2
Finland	2	1	1	2	6
France	13	6	1	5	25
German Democratic Republic	—	—	—	1	1
Germany, Federal Republic	15	—	1	2	18
Ghana	1	—	—	—	1
Gibraltar	—	—	—	2	2
Greece	1	—	—	2	3
Hongkong	3	2	1	—	6
Hungary	—	1	—	—	1
India	6	—	—	—	6
Indonesia	1	—	—	3	4
Iran	5	—	1	—	6
Iraq	1	—	—	—	1
Ireland	6	2	—	—	8
Israel	2	2	—	2	6
Italy	10	3	2	24	39
Japan	23	6	2	19	50
Jordan	1	—	1	—	2
Kuwait	1	1	—	2	4
Lebanon	3	—	—	3	6
Liechtenstein	—	1	—	—	1
Luxembourg	2	—	—	5	7
Malaysia	2	—	—	—	2
Mexico	4	—	1	2	7
Netherlands	6	1	—	2	9
New Zealand	2	1	—	—	3
Nigeria	5	—	—	1	6
Norway	2	1	—	2	5
Pakistan	5	—	—	—	5
Panama	—	—	—	1	1

(1) This covers only those representative offices included in a list published by the Bank.

Country of ownership	Branch operations	Subsidiary operations	Controlling (15% or more) stake in consortium banks	Representative offices ⁽¹⁾	Total
Philippines	2	—	—	—	2
Poland	1	—	—	—	1
Portugal	3	—	—	2	5
Qatar	1	—	—	—	1
Rumania	—	—	1	—	1
Saudi Arabia	3	—	1	2	6
Singapore	4	—	—	—	4
South Africa	4	—	—	2	6
South Korea	6	—	—	4	10
Spain	7	1	—	8	16
Sri Lanka	1	—	—	—	1
Sweden	3	4	1	4	12
Switzerland	11	1	1	9	22
Taiwan	1	—	—	—	1
Thailand	3	—	—	—	3
Turkey	2	1	—	5	8
United Arab Emirates	4	—	—	1	5
Uruguay	—	—	—	1	1
United States	35	17	9	20	81
USSR	—	1	—	—	1
Venezuela	—	—	—	2	2
Yemen Arab Republic	—	—	—	1	1
Yugoslavia	—	—	1	8	9
Zambia	1	—	—	—	1
Totals	254	72	26⁽²⁾	178	530⁽³⁾

(1) This covers only those representative offices included in a list published by the Bank.

(2) Representing 21 institutions. In addition there are three other consortium banks.

(3) Representing 525 institutions.

Authorised institutions

List of institutions authorised at 29 February 1988

1 UK-incorporated⁽¹⁾

- A1 Credit p.l.c.
 ANZ Merchant Bank Ltd.
 Adam & Company p.l.c.
 Afghan National Credit & Finance Ltd.
 Airdrie Savings Bank
 Aitken Hume Ltd.
 Ak International Bank Ltd.
 Albaraka International Bank Ltd.
 Alliance Trust (Finance) Ltd.
 Allied Arab Bank Ltd.
 Anglo-Romanian Bank Ltd.
 Anglo Yugoslav Bank Ltd.
 Henry Ansbacher & Co. Ltd.
 Arbuthnot Latham Bank Ltd.
 Argonaut Securities Ltd.
 Assemblies of God Property Trust
 Associated Credits Ltd.
 Associated Japanese Bank (International) Ltd.
 Associates Capital Corporation Ltd.
 Atlanta Trust Ltd.
 Atlantic International Bank Ltd.
 Auban Finance Ltd.
 Authority Bank Ltd.
 Avco Trust Ltd.

 B.A.I.I. p.l.c.
 B.C. Finance Ltd.
 BNL Investment Bank p.l.c.
 Banco Hispano Americano Ltd.
 Bank in Liechtenstein (U.K.) Ltd.
 Bank Leumi (U.K.) p.l.c.
 Bank of America International Ltd.
 Bank of Boston Ltd.
 Bank of Cyprus (London) Ltd.
 Bank of Scotland
 Bank of Tokyo International Ltd.
 Bank of Wales p.l.c.
 Bankers Trust International Ltd.
 Banque Belge Ltd.
 Banque Nationale de Paris p.l.c.
 The Baptist Union Corporation Ltd.
 Barclays Bank p.l.c.
 Barclays de Zoete Wedd Ltd.
 Barclays Bank Trust Company Ltd.
 Baring Brothers & Co. Ltd.
 Benchmark Bank p.l.c.
 Beneficial Trust Ltd.
 Bradford Investments p.l.c.
 British & Commonwealth Merchant Bank p.l.c.
 The British Bank of the Middle East
 British Credit Trust Ltd.
 The British Linen Bank Ltd.
 British Railways Savings Company Ltd.
 Brown, Shipley & Co. Ltd.
 Bunge Finance Ltd.
 Burns-Anderson Trust Company Ltd.
 Business Mortgages Trust p.l.c.

 CL-Alexanders Discount p.l.c.
 Canadian Laurentian Bank Ltd.
 James Capel Bankers Ltd.
 Carlyle Finance Ltd.
 Castle Phillips Finance Co. Ltd.
 Cater Allen Ltd.
 Central Capital Mortgage Corporation Ltd.
 Chancery Securities p.l.c.
 The Charities Aid Foundation Money Management Company Ltd.
 Charter Consolidated Financial Services Ltd.
 Chartered Trust p.l.c.
 Charterhouse Bank Ltd.
 Chase Investment Bank Ltd.
 Chemical Bank International Ltd.
 Chesterfield Street Trust Ltd.
 Citibank Trust Ltd.
 Citicorp Investment Bank Ltd.

 City Merchants Bank Ltd.
 City Trust Ltd.
 Clive Discount Company Ltd.
 Close Brothers Ltd.
 Clydesdale Bank p.l.c.
 Clydesdale Bank Finance Corporation Ltd.
 Combined Capital Ltd.
 The Commercial Bank of the Near East p.l.c.
 Commercial Financial Services Ltd.
 Consolidated Credits & Discounts Ltd.
 Co-operative Bank p.l.c.
 Coutts & Co.
 Coutts Finance Co.
 Craneheath Securities Ltd.
 Credito Italiano International Ltd.
 Credit Suisse First Boston Ltd.
 Cyprus Finance Corporation (London) Ltd.

 Daiwa Europe Bank p.l.c.
 Dalbeattie Finance Co. Ltd.
 Darlington Merchant Credits Ltd.
 Dartington & Co. Ltd.
 Deacon Hoare & Co. Ltd.
 Den norske Creditbank p.l.c.
 The Dorset, Somerset & Wilts Investment Society Ltd.
 Dryfield Finance Ltd.
 Dunbar Bank p.l.c.
 Duncan Lawrie Ltd.
 Dunsterville Allen p.l.c.

 EBC Amro Bank Ltd.
 E.T.Trust Ltd.
 Eagil Trust Co. Ltd.
 East Anglian Securities Trust Ltd.
 East Midlands Finance Co. Ltd.
 Eccles Savings and Loans Ltd.
 Edington p.l.c.
 Ensign Finance Ltd.
 Enskilda Securities-Skandinaviska Enskilda Ltd.
 Equatorial Bank p.l.c.
 Euro-Latinamerican Bank p.l.c.
 Euromed Fundings Ltd.
 European Brazilian Bank p.l.c.
 Everett Chettle Associates
 Exeter Trust Ltd.

 FIBI Bank (U.K.) Ltd.
 Fairmount Trust Ltd.
 Family Finance Ltd.
 Federated Trust Corporation Ltd.
 FennoScandia Bank Ltd.
 Financial and General Securities Ltd.
 James Finlay Corporation Ltd.
 First Indemnity Credit Ltd.
 First Interstate Capital Markets Ltd.
 First National Securities Ltd.
 Robert Fleming & Co. Ltd.
 Ford Financial Trust Ltd.
 Ford Motor Credit Co. Ltd.
 Foreign & Colonial Management Ltd.
 Forward Trust Ltd.
 Robert Fraser & Partners Ltd.

 Gerrard & National Ltd.
 Girobank p.l.c.
 Goldman Sachs Ltd.
 Goode Durrant Trust p.l.c.
 Granville Trust Ltd.
 H.T.Greenwood Ltd.
 Gresham Trust p.l.c.
 Greyhound Guaranty Ltd.
 Grindlays Bank p.l.c.
 Guinness Mahon & Co. Ltd.
 Gulf Guarantee Trust Ltd.

(1) Including partnerships formed under the law of any part of the United Kingdom.

HFC Trust & Savings Ltd.
Habibsons Bank Ltd.
Hambros Bank Ltd.
Hampshire Trust p.l.c.
The Hardware Federation Finance Co. Ltd.
Harrods Trust Ltd.
Harton Securities Ltd.
Havana International Bank Ltd.
The Heritable & General Investment Bank Ltd.
Hill Samuel & Co. Ltd.
Hill Samuel Personal Finance Ltd.
C. Hoare & Co.
Holdenhurst Securities p.l.c.
Humberlyde Finance Group Ltd.
Hungarian International Bank Ltd.

IBJ International Ltd.
Industrial Funding Trust Ltd.
International Commercial Bank p.l.c.
International Mexican Bank Ltd.
International Westminster Bank p.l.c.
Investors in Industry p.l.c.
Investors in Industry Group p.l.c.
Iran Overseas Investment Bank Ltd.
Itab Bank Ltd.
Italian International Bank p.l.c.

Jabac Finances Ltd.
Japan International Bank Ltd.
Jordan International Bank p.l.c.
Leopold Joseph & Sons Ltd.

King & Shaxson Ltd.
Kleinwort Benson Ltd.

Lazard Brothers & Co. Ltd.
Legal & General (Money Managers) Ltd.
Libra Bank p.l.c.
Little Lakes Finance Ltd.
Lloyds Bank p.l.c.
Lloyds Bank (BLSA) Ltd.
Lloyds Bank (France) Ltd.
Lloyds Bowmaker Ltd.
Lloyds Merchant Bank Ltd.
Lombard Bank Ltd.
Lombard & Ulster Ltd.
Lombard North Central p.l.c.
London Arab Investment Bank Ltd.
London & Continental Bankers Ltd.
London Law Securities Ltd.
London Scottish Bank p.l.c.
Lordsvale Finance Ltd.

MLA Bank Ltd.
McDonnell Douglas Bank Ltd.
McNeill Pearson Ltd.
Manchester Exchange and Investment Bank Ltd.
W.M. Mann & Co. (Investments) Ltd.
Manufacturers Hanover Ltd.
The Mardun Investment Co. Ltd.
Marks and Spencer Financial Services Ltd.
Mase Westpac Ltd.
Matheson Bank Ltd.
Medens Trust Ltd.
Meghraj Bank Ltd.
Mercantile Credit Company Ltd.
Mercury Provident p.l.c.
Merrill Lynch International Bank Ltd.
The Methodist Chapel Aid Association Ltd.
Midland Bank p.l.c.
Midland Bank Finance Corporation Ltd.
Midland Bank Trust Company Ltd.
Minorities Finance Ltd.
Minster Trust Ltd.
Moneycare Ltd.
Samuel Montagu & Co. Ltd.
Moorgate Mercantile Holdings p.l.c.
Morgan Grenfell & Co. Ltd.
Moscow Narodny Bank Ltd.
Mount Banking Corporation Ltd.
Mutual Trust and Savings Ltd.
Mynshul Trust Ltd.

N.I.I.B. Group Ltd.
National Guardian Finance Corporation Ltd.
National Westminster Bank p.l.c.
NatWest Investment Bank Ltd.
The Nikko Bank (U.K.) p.l.c.
Noble Grossart Ltd.
Nomura Bank International p.l.c.
Northern Bank Ltd.
Northern Bank Development Corporation Ltd.
Northern Bank Executor & Trustee Company Ltd.
Norwich General Trust Ltd.
North West Securities Ltd.

Omega Trust Co. Ltd.
Oppenheimer Money Management Ltd.
Orion Royal Bank Ltd.

PK English Trust Company Ltd.
PaineWebber International Bank Ltd.
Panmure Gordon Bankers Ltd.
The People's Trust & Savings Ltd.
Philadelphia National Ltd.
Phillips & Drew Trust Ltd.
Pointon York Ltd.
Postipankki (U.K.) Ltd.
Prestwick Investment Trust p.l.c.
Privatbanken Ltd.
Provincial Bank p.l.c.

Quin Cope Ltd.

Ralli Investment Company Ltd.
R. Raphael & Sons p.l.c.
Rathbone Bros. & Co.
Rea Brothers Ltd.
Reliance Trust Ltd.
Riggs A P Bank Ltd.
N.M. Rothschild & Sons Ltd.
Roxburghe Guarantee Corporation Ltd.
The Royal Bank of Scotland p.l.c.
Royal Trust Bank
RoyScot Trust p.l.c.

SBCI Swiss Bank Corporation Investment banking Ltd.
SDS Bank Ltd.
SFE Bank Ltd.
SP Finance Ltd.
Saudi International Bank
(Al-Bank Al-Saudi Al-Alami Ltd.)
Scandinavian Bank Group p.l.c.
Schroder Leasing Ltd.
J. Henry Schroder Wagg & Co. Ltd.
Scotiabank (U.K.) Ltd.
Scottish Amicable Money Managers Ltd.
Secombe Marshall & Campion p.l.c.
Secure Homes Ltd.
Security Pacific Trust Ltd.
Shawlands Securities Ltd.
Shire Trust Ltd.
Singer & Friedlander Ltd.
Smith & Williamson Securities
Société Générale Merchant Bank p.l.c.
Southsea Mortgage & Investment Co. Ltd.
Spry Finance Ltd.
Standard Chartered Bank
Standard Chartered Bank Africa p.l.c.
Standard Chartered Merchant Bank Ltd.
Standard Property Investment p.l.c.
Sterling Bank & Trust Ltd.
Svenska Handelsbanken p.l.c.

TCB Ltd.
TSB England & Wales p.l.c.
TSB Northern Ireland p.l.c.
TSB Scotland p.l.c.
The Teachers & General Investment Co. Ltd.
Thames Trust Ltd.
Thorncliffe Finance Ltd.
Treloan Ltd.
Trucanda Trusts Ltd.
Tyndall & Co. Ltd.

UBAF Bank Ltd.
Ulster Bank Ltd.
Ulster Bank Trust Company
Union Discount Company Ltd.
The United Bank of Kuwait p.l.c.
United Dominions Trust Ltd.
Unity Trust Bank p.l.c.

Vernons Trust Corporation

Wagon Finance Ltd.
Wallace, Smith Trust Co. Ltd.
S.G. Warburg & Co. Ltd.
Welbeck Finance p.l.c.
Western Trust & Savings Ltd.
Whiteaway Laidlaw Bank Ltd.
Wimbledon & South West Finance Co. Ltd.
Wintrust Securities Ltd.

Yamaichi Bank (U.K.) p.l.c.
Yorkshire Bank p.l.c.
H.F. Young & Co. Ltd.

2 Incorporated outside the United Kingdom⁽¹⁾

- African Continental Bank Ltd.
 Algemene Bank Nederland N.V.
 Allied Bank of Pakistan Ltd.
 Allied Banking Corporation
 Allied Irish Finance Co. Ltd.
 Allied Irish Banks p.l.c.
 Allied Irish Investment Bank p.l.c.
 Al Saudi Banque S.A.
 American Express Bank Ltd.
 Amsterdam-Rotterdam Bank N.V.
 Arab African International Bank
 Arab Bank Ltd.
 Arab Banking Corporation B.S.C.
 Australia & New Zealand Banking Group Ltd.
- Badische Kommunale Landesbank Girozentrale
 Banca Commerciale Italiana
 Banca della Svizzera Italiana
 Banca Nazionale dell'Agricoltura SpA
 Banca Nazionale del Lavoro
 Banca Serfin S.N.C.
 Banco Central, S.A.
 Banco de Bilbao, S.A.
 Banco de la Nación Argentina
 Banco de Sabadell
 Banco de Santander, S.A.
 Banco de Vizcaya, S.A.
 Banco di Napoli
 Banco di Roma SpA
 Banco di Santo Spirito
 Banco di Sicilia
 Banco do Brasil S.A.
 Banco do Estado de São Paulo S.A.
 Banco Espírito Santo e Comercial de Lisboa
 Banco Exterior—U.K. S.A.
 Banco Mercantil de São Paulo S.A.
 Banco Nacional de México S.N.C.
 Banco Português do Atlântico
 Banco Real S.A.
 Banco Totta & Açores E.P.
 Bancomer S.N.C.
 Bangkok Bank Ltd.
 Bank Julius Baer & Co. Ltd.
 Bank Bumiputra Malaysia Berhad
 Bank für Gemeinwirtschaft A.G.
 Bank Handlowy w Warszawie S.A.
 Bank Hapoalim B.M.
 Bank Mees & Hope N.V.
 Bank Mellat
 Bank Melli Iran
 Bank Negara Indonesia 1946
 Bank of America N.T. & S.A.
 Bank of Baroda
 The Bank of California N.A.
 Bank of Ceylon
 Bank of China
 Bank of Credit and Commerce International S.A.
 Bank of India
 The Bank of Ireland
 Bank of Montreal
 Bank of New England N.A.
 The Bank of New York
 Bank of New Zealand
 The Bank of Nova Scotia
 Bank of Oman Ltd.
 Bank of Seoul
 The Bank of Tokyo, Ltd.
 The Bank of Yokohama, Ltd.
 Bank Saderat Iran
 Bank Sepah-Iran
 Bank Tejarat
 Bankers Trust Company
 Banque Belgo-Zairoise S.A.
 Banque Bruxelles Lambert S.A.
 Banque du Liban et d'Outre-Mer S.A.L.
 Banque Française du Commerce Extérieur
 Banque Indosuez
 Banque Internationale à Luxembourg S.A.
 Banque Internationale pour l'Afrique Occidentale S.A.
 Banque Nationale de Paris
 Banque Paribas
 Banque Worms
 Barbados National Bank
 Bayerische Hypotheken—und Wechsel—Bank A.G.
 Bayerische Landesbank Girozentrale
 Bayerische Vereinsbank
 Beirut Riyad Bank S.A.L.
 Bergen Bank A/S
 Berliner Bank A.G.
- Berliner Handels-und Frankfurter Bank
 Byblos Bank S.A.L.
- CIC—Union Européenne, International et Cie
 Caisse Nationale de Crédit Agricole
 Canadian Imperial Bank of Commerce
 Canara Bank
 Cassa di Risparmio delle Provincie Lombarde
 The Chase Manhattan Bank, N.A.
 Chemical Bank
 Cho Hung Bank
 Christiania Bank og Kreditkasse
 The Chuo Trust & Banking Co., Ltd.
 Citibank N.A.
 Commercial Bank of Korea Ltd.
 Commerzbank A.G.
 Commonwealth Bank of Australia
 Confederacion Española de Cajas de Ahorros
 Continental Illinois National Bank and Trust Company of Chicago
 Copenhagen Handelsbank A/S
 Crédit Commercial de France
 Crédit du Nord
 Crédit Lyonnais
 Credit Lyonnais Bank Nederland N.V.
 Crédit Suisse
 Creditanstalt-Bankverein
 Credito Italiano
 Cyprus Credit Bank Ltd.
 The Cyprus Popular Bank
- The Dai-Ichi Kangyo Bank, Ltd.
 The Daiwa Bank, Ltd.
 Den Danske Bank af 1871 Aktieselskab
 Deutsche Bank A.G.
 Deutsche Genossenschaftsbank
 The Development Bank of Singapore Ltd.
 Discount Bank and Trust Company
 Dresdner Bank A.G.
- Fidelity Bank N.A.
 First Bank National Association
 First Bank of Nigeria Ltd.
 First City National Bank of Houston
 First Commercial Bank
 First Interstate Bank of California
 The First National Bank of Boston
 The First National Bank of Chicago
 First Republic Bank Dallas, N.A.
 First Wisconsin National Bank of Milwaukee
 Fleet National Bank
 French Bank of Southern Africa Ltd.
 The Fuji Bank, Ltd.
- Ghana Commercial Bank
 Girozentrale und Bank der österreichischen Sparkassen A.G.
 Göttabanken
 Gulf International Bank B.S.C.
- Habib Bank A.G. Zurich
 Habib Bank Ltd.
 Hanil Bank
 Harris Trust and Savings Bank
 Hessische Landesbank-Girozentrale
 The Hokkaido Takushoku Bank, Ltd.
 The Hongkong and Shanghai Banking Corporation
- The Industrial Bank of Japan, Ltd.
 The Investment Bank of Ireland Ltd.
 Irving Trust Company
 Istituto Bancario San Paolo di Torino
- Jyske Bank
- Kansallis-Osake-Pankki
 Keesler Federal Credit Union
 Korea Exchange Bank
 Korea First Bank
 Kredietbank N.V.
 The Kyowa Bank, Ltd.
- Landesbank Stuttgart Girozentrale
 The Long-Term Credit Bank of Japan, Ltd.
- Malayan Banking Berhad
 Manufacturers Hanover Trust Company
 Mellon Bank, N.A.
 Middle East Bank Ltd.
 The Mitsubishi Bank, Ltd.
 The Mitsubishi Trust and Banking Corporation
 The Mitsui Bank, Ltd.
 The Mitsui Trust & Banking Co. Ltd.

(1) Includes partnerships or other unincorporated associations formed under the law of any Member State of the European Community other than the United Kingdom.

Morgan Guaranty Trust Company of New York
Multibanco Comermex S.N.C.
Muslim Commercial Bank Ltd.

NCNB National Bank of North Carolina
National Australia Bank Ltd.
National Bank of Abu Dhabi
National Bank of Canada
National Bank of Detroit
The National Bank of Dubai Ltd.
National Bank of Egypt
National Bank of Fort Sam Houston
National Bank of Greece S.A.
The National Bank of Kuwait S.A.K.
The National Bank of New Zealand Ltd.
National Bank of Nigeria Ltd.
The National Commercial Bank
National Bank of Pakistan
Nedbank Ltd.
Nederlandsche Middenstandsbank N.V.
New Nigeria Bank Ltd.
The Nippon Credit Bank, Ltd.
Norddeutsche Landesbank Girozentrale
The Northern Trust Company

Osterreichische Länderbank A.G.
Oversea-Chinese Banking Corporation Ltd.
Overseas Trust Bank Ltd.
Overseas Union Bank Ltd.

Philadelphia National Bank
Philippine National Bank

Qatar National Bank S.A.Q.

Rabobank Nederland
(Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A.)
Rafidan Bank
Republic National Bank of New York
Reserve Bank of Australia
The Riggs National Bank of Washington, D.C.
Riyad Bank
The Royal Bank of Canada
The Rural and Industries Bank of Western Australia

The Saitama Bank, Ltd.
The Sanwa Bank, Ltd.
Saudi American Bank
Seattle-First National Bank

Security Pacific National Bank
Shanghai Commercial Bank Ltd.
The Siam Commercial Bank, Ltd.
Skandinaviska Enskilda Banken
Société Générale
Sonali Bank
State Bank of India
State Bank of New South Wales
State Bank of South Australia
State Bank of Victoria
State Street Bank and Trust Company
The Sumitomo Bank, Ltd.
The Sumitomo Trust and Banking Co. Ltd.
Svenska Handelsbanken
Swiss Bank Corporation
Swiss Cantobank (International)
Swiss Volksbank
Syndicate Bank

TC Ziraat Bankasi
The Taiyo Kobe Bank, Ltd.
The Thai Farmers Bank Ltd.
The Tokai Bank, Ltd.
The Toronto-Dominion Bank
The Toyo Trust & Banking Company Ltd.
Trade Development Bank
The Trust Bank of Africa Ltd.
Turkish Bank Ltd.
Türkiye İş Bankasi A.Ş.

Uco Bank
Ulster Investment Bank Ltd.
Union Bank of Finland Ltd.
Union Bank of Nigeria Ltd.
Union Bank of Switzerland
United Bank Ltd.
United Mizrahi Bank Ltd.
United Overseas Bank (Banque Unie pour les Pays d'Outre Mer)
United Overseas Bank Ltd.

Volkskas Ltd.

Westdeutsche Landesbank Girozentrale
Westpac Banking Corporation

The Yasuda Trust & Banking Co., Ltd.

Zambia National Commercial Bank Ltd.
Zivnostenská Banka National Corporation

Changes to the list

The following changes were made during the year to the list of authorised institutions:

Additions

1 UK-incorporated

BNL (U.K.) p.l.c.
Carlyle Finance Ltd.
Euromed Fundings Ltd.
McDonnell Douglas Bank Ltd.
The Nikko Bank (U.K.) p.l.c.
Yamaichi Bank (U.K.) p.l.c.

2 Incorporated outside the United Kingdom

Banca della Svizzera Italiana
Bergen Bank A/S
Berliner Handels-und Frankfurter Bank
Confederacion Española de Cajas de Ahorros
Gotabanken
Skandinaviska Enskilda Banken
Svenska Handelsbanken

Deletions

1 UK-incorporated

Arab Bank Investment Co. Ltd.
Armada Investments Ltd.
Bank of Ireland Finance Ltd.
Barclays Bank U.K. Ltd.
Boston Trust & Savings Ltd.
Cedar Holdings Ltd.
Charterhouse Japhet Credit Ltd.
Consumer Credit Investments Ltd.
The Continental Trust Ltd.
Credit Services Ltd.
Cue & Co.
European Arab Bank Ltd.
Finova Finance Ltd.
Gota (U.K.) Ltd.
Grosvenor Acceptances Ltd.
IFICO Trust Ltd.
Lloyds Bowmaker Finance Ltd.
Lombard Street Investment Trust Co. Ltd.
Manufacturers Hanover Finance Ltd.
Manufacturers Hanover Export Finance Ltd.
Midland Montagu Ventures Ltd.
Milford Mutual Facilities Ltd.
The North of Scotland Finance Co. Ltd.
PKFinans International (U.K.) Ltd.
Thomas Barlow & Bro. Ltd.
Tullett and Riley Money Management Ltd.
N.H. Woolley & Co. Ltd.

2 Incorporated outside the United Kingdom

Central Bank of India
First National Bank of Maryland
InterFirst Bank Dallas N.A.
Marine Midland Bank N.A.
Punjab National Bank
Texas Commerce Bank N.A.
Union Bank of India

Name changes

1 UK-incorporated

ANZ Finance Ltd. to Humberclyde Finance Group Ltd.
A P Bank Ltd. to Riggs A P Bank Ltd.

Ak International Ltd.	to	Ak International Bank Ltd.
Al Baraka International Ltd.	to	Albaraka International Bank Ltd.
Alexanders Discount p.l.c.	to	CL-Alexanders Discount p.l.c. ⁽¹⁾
Allied Dunbar & Co. p.l.c.	to	Dunbar Bank p.l.c.
Anglo-Yugoslav (LDT) Ltd.	to	Anglo Yugoslav Bank Ltd.
Authority & Co. Ltd.	to	Authority Bank Ltd.
BMI (Hampshire) Ltd.	to	Hampshire Trust p.l.c.
BNL (U.K.) p.l.c.	to	BNL Investment Bank p.l.c.
Bank of London & South America Ltd.	to	Lloyds Bank (BSLA) Ltd.
The Bank of Nova Scotia Trust Company (United Kingdom) Ltd.	to	Scotiabank (U.K.) Ltd.
Barrie Vanger & Co. Ltd.	to	Atlanta Trust Ltd.
Benchmark Trust Ltd.	to	Benchmark Bank p.l.c.
British & Commonwealth Merchant Bank Ltd.	to	British & Commonwealth Merchant Bank p.l.c.
Canada Permanent Mortgage Corporation (U.K.) Ltd.	to	Central Capital Mortgage Corporation Ltd.
Carolina Bank Ltd.	to	Panmure Gordon Bankers Ltd.
Cayzer Ltd.	to	British & Commonwealth Merchant Bank Ltd.
Daiwa Europe Finance p.l.c.	to	Daiwa Europe Bank p.l.c.
The English Trust Company Ltd.	to	PK English Trust Company Ltd.
Equatorial Trust Corporation p.l.c.	to	Equatorial Bank p.l.c.
FIBI Financial Trust Ltd.	to	FIBI Bank (U.K.) Ltd.
FennoScandia Ltd.	to	FennoScandia Bank Ltd.
First Co-operative Finance Ltd.	to	Credit Services Ltd.
First National Boston Ltd.	to	Bank of Boston Ltd.
Habibsons Trust and Finance Ltd.	to	Habibsons Bank Ltd.
The Heritable and General Trust Ltd.	to	The Heritable & General Investment Bank Ltd.
Holden Hurst Securities Ltd.	to	Holden Hurst Securities p.l.c.
Iran Overseas Investment Corporation Ltd.	to	Iran Overseas Investment Bank Ltd.
ItaB Group Ltd.	to	Itab Bank Ltd.
Jordan Finance Consortium p.l.c.	to	Jordan International Bank p.l.c.
Laurentian Financial Services Ltd.	to	Canadian Laurentian Bank Ltd.
Liechtenstein (U.K.) Ltd.	to	Bank in Liechtenstein (U.K.) Ltd.
Lombard Acceptances Ltd.	to	Lombard Bank Ltd.
London and Arab Investments Ltd.	to	London Arab Investment Bank Ltd.
London Interstate Bank Ltd.	to	SDS Bank Ltd.
London Scottish Finance Corporation p.l.c.	to	London Scottish Bank p.l.c.
Lordsvale Finance Ltd.	to	Lordsvale Finance p.l.c.
MLA Finance Ltd.	to	MLA Bank Ltd.
Manchester Exchange Trust Ltd.	to	Manchester Exchange and Investment Bank Ltd.
Matheson Trust Co. Ltd.	to	Matheson Bank Ltd.
Meghraj & Sons Ltd.	to	Meghraj Bank Ltd.
Mount Credit Corporation Ltd.	to	Mount Banking Corporation Ltd.
Nomura International Finance p.l.c.	to	Nomura Bank International p.l.c.
PaineWebber International Trust Ltd.	to	PaineWebber International Bank Ltd.
Provincial Trust Ltd.	to	Provincial Bank p.l.c.
RoyScot Trust Ltd.	to	RoyScot Trust p.l.c.
St. Michael Financial Services Ltd.	to	Marks and Spencer Financial Services Ltd.
Sterling Trust Ltd.	to	Sterling Bank & Trust Ltd.
Swiss Bank Corporation International Ltd.	to	SBCI Swiss Bank Corporation Investment banking Ltd.
Tyndall & Co.	to	Tyndall & Co. Ltd.
The United Bank of Kuwait Ltd.	to	The United Bank of Kuwait p.l.c.
Unity Trust p.l.c.	to	Unity Trust Bank p.l.c.
Venture Finance Ltd.	to	Deacon Hoare & Co. Ltd.
Whiteaway Laidlaw & Co. Ltd.	to	Whiteaway Laidlaw Bank Ltd.

2 Incorporated outside the United Kingdom

First National Bank of Minneapolis	to	First Bank National Association
RepublicBank Dallas N.A.	to	First RepublicBank Dallas N.A.
Wurttembergische Kommunale Landesbank Girozentrale	to	Landesbank Stuttgart Girozentrale

(1) Supervised by Wholesale Markets Supervision Division.

Annual Report by the Board of Banking Supervision

Board of Banking Supervision Membership as at 29 February 1988

Chairman: The Rt Hon Robert Leigh-Pemberton	}	<i>ex officio</i>
Sir George Blunden		
R D Galpin ⁽¹⁾		
Sir Donald Barron DL		
J A Caldecott		
A J Hardcastle		
N J Robson		
Harry Taylor		
Deryk Vander Weyer CBE		

This is the first report since the Board was formally established under the Banking Act 1987 following the appointment, jointly by the Chancellor of the Exchequer and the Governor, of the six independent members in November 1987. The Board had previously operated on an informal basis since May 1986. All the independent members statutorily appointed had previously served on the informal Board. Mr Caldecott, Mr Hardcastle, Mr Robson and Mr Vander Weyer served throughout the period under review; Sir Donald Barron and Mr Taylor joined the Board in May 1987. Although the terms of office of independent members will normally be for five years, the expiry of the initial appointments has been phased.

Within the Board the independent members provide a source of professional and practitioner advice to the ex-officio members on matters relating to the Bank's responsibilities under the Banking Act. They keep under review all aspects of the work of the Bank's Banking Supervision Division. The

Board's functions are advisory, and executive responsibility remains with the Bank.

The Board met thirteen times during the year to the end of February 1988.

Meetings were held each month to consider developments in banking supervisory policy and practice, and the conduct of individual cases in which the Bank was considering the possible use of its various powers under the Act. The Board also held an additional meeting to consider in detail one case which had been of concern and where the Bank saw a need for more urgent advice. There were no instances of disagreement between the ex-officio members and the independent members requiring notification to the Chancellor of the Exchequer pursuant to section 2(5) of the Act.

During the period, the Board was consulted by the Bank on a large number of individual cases and informed of developments in many other cases.

(1) Mr Galpin subsequently resigned from his position as Director of the Bank with effect from 31 March 1988. He was succeeded as Executive Director responsible for banking supervision and ex-officio member of the Board by Mr Brian Quinn.

These ranged from new applications for authorisation and proposals for changes of control of authorised institutions to, in some cases, concerns on the part of the Bank about possible threats to the interests of depositors.

The independent members' advice was sought on a wide range of issues relating to continuing development of the Bank's supervisory arrangements. The implications for banks of changes in the markets in which they participate—for example of the sharp falls in equity markets in October 1987—were also reviewed.

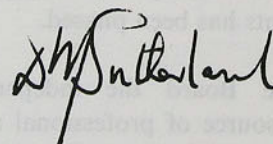
The Board gave a high priority during the period to the question of provisioning against sovereign risk. Members were concerned about disparities in levels of provisioning, both as between different banks in the United Kingdom and between banks in different countries. They encouraged, as a matter of some urgency, the Division's initiative in developing a coherent basis for objective decision-taking on provisioning levels. The matrix which the Bank has since constructed and made available to banks has been a helpful framework for such decisions and has attracted considerable interest both in the United Kingdom and abroad.

The Board has taken a close interest in the arrangements being developed by the Bank with the Securities and Investments Board and the self-regulating organisations for the supervision of banks requiring authorisation under both the Banking and the Financial Services Act. Agreements between the Bank and the relevant regulatory bodies have been reached which reflect

the separate statutory responsibilities of the various regulators. The Board will follow closely the working of these arrangements.

The Board was consulted on the Division's initiatives on other aspects of supervisory policy including, in particular, the various notices and consultative papers prepared for issue to authorised institutions. In the case of the proposals developed by the Bank to introduce a requirement for a stock of sterling primary liquidity, the Board felt that there was a need for a new approach extending to foreign currency liabilities also. The Board's concerns were reflected in amended proposals published by the Bank in a consultative paper shortly after the end of the period under review. The Board was also closely involved in development of the Bank's proposals on the treatment of large underwriting exposures within the general reporting framework applying to large exposures. In addition, independent members gave advice on the structure and role of audit committees in banks in the light of points made in the course of consultations on the Bank's published proposals.

On the international front, the Board endorsed the Bank's initiative aimed at promoting a greater convergence of banks' capital adequacy standards internationally, based on a common system of measurement. Members see this as a necessary development, bearing in mind the global markets within which international banks now operate. They have been encouraged by the progress made in discussions in both the Basle Supervisors Committee and the European Community.



Secretary, by order of the Board