PO-CH/NL/0096 PT A

Part. A.

SECRET

(Circulate under cover and notify REGISTRY of movement)

Begins: 28/6/85.
Ends: 24/3/87.

APPOINTMENTS IN CONFIDENCE.

PO -CH /NL/0096

PART A

Chancellor's (Lawson) Papers:

THE NEW BANKING BILL AND THE EFFECTS IN THE CITY

PO -CH /NL/0096
PART A

Disposal Directions: 25 Years

[signature]
4/8/95

007/5

FROM: DAVID PERETZ
DATE: 28 JUNE 1985

CHANCELLOR

cc: PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monck
Mr Lavelle
Mr Lankester
Mr Sedgwick
Mr O'Donnell
Mr Ridlington
Mr Heywood

LLOYDS BANK ECONOMIC BULLETIN : EXCHANGE RATE AND £M3

You asked for a comment on the suggestion made by Christopher Johnson in the June Lloyds Bank Economic Bulletin that part of the "black hole" in company finances reflected flows that would cause £M3 growth to slow when the £ was weak (and vice versa).

2. I attach a short note, mainly the work of Messrs Ridlington and Heywood.

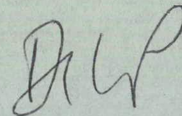
3. It is of course not a new thought. In 1980/81 we thought one of the reasons for rapid £M3 growth might be the increased attractions of the £ - with £ bank deposits one of the available range of assets - as an international investment medium. The same factors that were raising the exchange rate were tending to add to £M3 growth. While non-resident deposits are excluded from £M3, some non-resident flows are likely to appear as resident holdings (eg. if held in the name of UK subsidiaries). Residents can also be expected to hold more of their assets in sterling when the £ is strong and expected to rise. This was one of the reasons why we decided to give weight to the exchange rate alongside £M3 in judging monetary conditions.

4. But there is no simple or predictable relationship between £M3 and the £, for a number of reasons:-

(i) In principle it is expectations about future movements, not the level of the £, that matter. Companies may be as

prepared to pay the cost of currency hedging if they think the £ (or the $) has risen to a level that is unsustainably high as they are on other occasions when they think an existing trend likely to continue.

(ii) The analysis in the attached note really only applies when monetary conditions are basically sound. Obviously if £M3 were growing fast in a way that reflected conditions that were genuinely lax, then one would expect the £ to fall. Evidence from both indicators would then be pointing the same way.



D L C PERETZ

LLOYDS BANK JUNE ECONOMIC BULLETIN: BLACK HOLE IN COMPANY FINANCE

The Chancellor asked for comments on this article by Christopher Johnson in the latest Lloyds Bank Economic Bulletin (copy attached). In particular he was interested in the points made in paragraph 6 of the conclusion. The thesis in that paragraph seems to be as follows:-

(i) When companies expect sterling to depreciate they borrow more in sterling and deposit more overseas in foreign currency and other assets.

(ii) This activity explains, at least in part, a total of £8 billion unrecorded spending by industrial and commercial companies (ICCs).

(iii) The process tends to be reversed when sterling is expected to rise.

(iv) As a result £M3 is a misleading indicator, since it rises slowly when the pound is weak, and rapidly when the pound is strong.

ICCs unindentified transactions and overseas investment

2. There is nothing new in the description of ICCs transactions and the problems associated with the very large discrepancy between ICCs' sources and uses of funds (the "black hole" in the jargon of the Lloyds Bulletin). The CSO are currently investigating the reasons for the discrepancy. As a preliminary estimate, a figure for 1984 in excess of £8 billion seems to be of the right order of magnitude.

3. The sign of the unidentified item means that either ICCs' sources of funds are over-recorded or that uses of funds are under-recorded. The June 1985 BEQB suggests that the unidentified item may be explained by over-estimates of ICCs' profits (sources over-

recorded) or under-estimates of investment or acquisition of financial assets (ie. uses of funds under-recorded). Errors in measurement of profits and investment are not thought to be major factors, but it does seem to be quite likely that ICCs are acquiring more financial assets, particularly overseas assets, than the official statistics suggest. Data revisions between May 1984 and May 1985 show that the discrepancy in ICC accounts in 1983 has fallen by £3½ billion, of which £3 billion reflects an upward revision to the estimated acquisition of overseas financial assets. A similar pattern applies to the discrepancy for 1982.

4. ICCs' acquisition of overseas financial assets has risen sharply since 1981. This is not surprising. The abolition of exchange controls and the depreciation of sterling appear to have encouraged the acquisition of overseas assets. Rapid innovation in the financial markets is also likely to have encouraged this kind of diversification. For example the advent of the currency swaps market has effectively reduced the cost to domestic companies of borrowing in foreign currency which must, in turn, have reduced the cost of acquiring overseas assets.

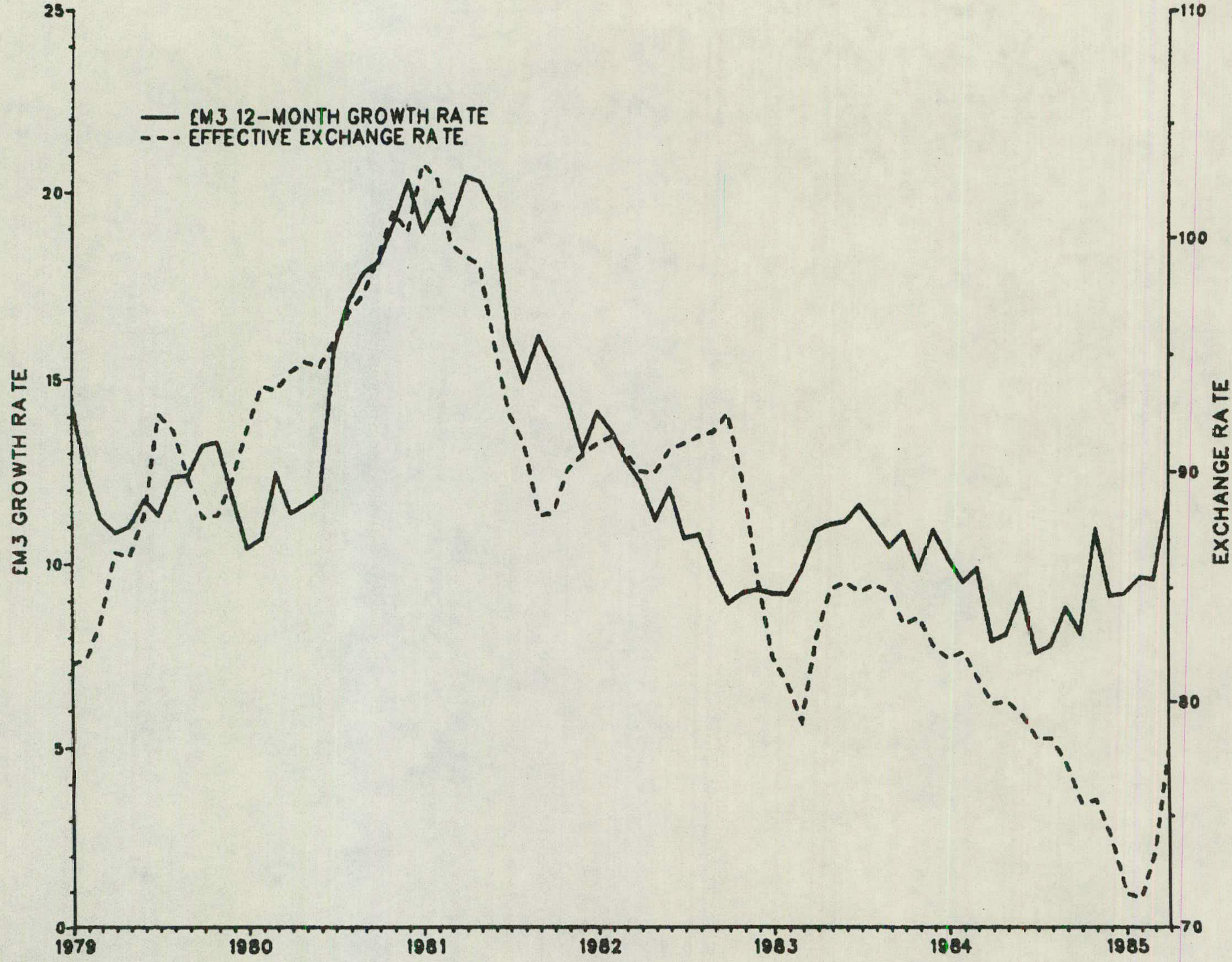
ICCs acquisition of overseas assets, £M3 and the exchange rate

5. The explicit contention of the article is that ICCs have been increasing their funds by borrowing sterling and selling this sterling for foreign currency which is invested in overseas assets not picked up in the statistics. It is not clear though that this would reduce £M3 as Mr Johnson appears to suggest: indeed one might expect the rise in bank lending to be associated with a rise in £M3. It would only be if ICCs were financing the purchase of overseas assets by running down sterling deposits that £M3 would fall.

6. As Johnson argues, speculative switching of this nature should in principle be associated with an *expectation* of a sterling depreciation greater than that encapsulated in the £/$ interest rate differential. In practice, companies are most likely to do this when such switching would result in a reduction in their net exposure

to future exchange rate movements - eg. if they have known future foreign currency commitments. It is possible that similar hedging activity by financial institutions is equally or more important. For example, some insurance companies apparently hedge their dollar portfolios against currency risk by raising matching dollar loans, switching the proceeds into sterling and placing them on deposit. That would add to £M3 deposits. So it may well be that expectations of a fall in sterling do put downwards pressure on £M3, in a variety of ways (and vice versa). This does not of course mean that £M3 would necessarily be distorted downwards when the £ was low or the $ high. Those could easily be the circumstances in which companies decided to cover themselves against a fall in the $/rise in the £.

7. In fact, there is no clear evidence that £M3 growth is particularly low when the pound is weak or falling, or vice versa. The attached chart suggests this has been true on occasions, but often not.


£M3 GROWTH & THE EFFECTIVE EXCHANGE RATE 1979-85
£M3 12-MONTH GROWTH RATE
EFFECTIVE EXCHANGE RATE
£M3 GROWTH RATE
EXCHANGE RATE
0
5
10
15
20
25
70
80
90
100
110
1979
1980
1981
1982
1983
1984
1985

001/114

CONFIDENTIAL

FROM: R J BROADBENT
DATE: 13 December 1985

PS/CHANCELLOR

cc:
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Mr Cropper
Mr H Davies
Mr Lord

CITY ENQUIRY

The Chief Secretary has seen the record of the Chancellor's morning meeting of 11 December at which the possibility of some kind of enquiry into the City, headed by a judge, was raised. He thinks that a City enquiry of this sort would be a great mistake. He thinks it would look defensive; it would produce either useless or awkward conclusions; and in the meantime, it would produce a steady stream of comment and a source of press attention as everyone gave evidence.

R J BROADBENT
Private Secretary

CONFIDENTIAL

014/2768

FROM: R J BROADBENT

DATE **7 February 1986**

APS/CHANCELLOR

C/ This seems sensible – I discussed with APS/CST beforehand. Up to you whether you attend, but Whips said they'd prefer you to vote on Wages Bill. Rs 10/2

cc:
PS/FST
PS/MST
PS/EST
Sir P Middleton
Mr Peretz

Good

Note. Told APS/CST. Ro 11/2

DEBATE ON THE ROSKILL REPORT

A debate on the Roskill report will take place on Thursday, 13 February between 7pm and 10pm. The Chief Whip's Office have suggested that it would be desirable for a Treasury Minister to be present at both the opening and the closing of the debate. The Chief Secretary has therefore agreed to be on the bench for the opening of the debate and the Economic Secretary will be there for the close.

Paul Pegler

PAUL PEGLER

"BIG BANG" BALL

FROM: A ROSS GOOBEY
DATE: 7 MAY 1986

CHANCELLOR

cc CST
FST
MST
EST
Mr Cropper
Mr Tyrie

Mr P Lilley - H/C

"BIG BANG" BALL

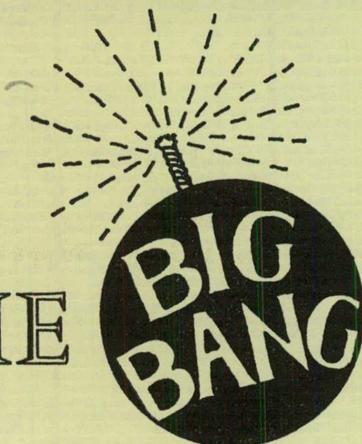
Nicholas Goodison's office has informed me that he has dissuaded the promoters from proceeding with this abomination.

A ROSS GOOBEY

BIG BANG BALL

PRAYERS

This is not an invitation. Shall I say that you have never organised such an event or are too busy...?
D 2/4



THE BIG BANG BALL

Rt. Hon. Nigel Lawson M.P.,
11 Downing St.,
London SW1.

11th April 1986.

Dear Chancellor,

We are writing to you concerning the impending "Big Bang" within the City of London which will occur on the 27th October 1986 and heralds some very important and far-reaching changes for those working in or involved with the City.

We feel that this unique occasion should not pass unmarked and we propose that holding a Big Bang Ball would give all those within the City a most enjoyable memory of the passing of the old ways. More importantly, it would also provide an opportunity for the City and its institutions to enhance their image in the eyes of the country as a whole by raising a substantial amount of money for charity. The members of the committee, who are drawn from leading City firms, all have previous experience in organising London Balls or Oxford Summer Balls.

The Duke of York's Headquarters in Chelsea has already been provisionally reserved for Friday 24th October and outline plans for the overall organisation of the Ball and for fund-raising have been laid.

We are writing to yourself and to several other leading public figures as we feel that support and advice from the highest level is essential for us in order to achieve our ambitious charitable objective.

We would therefore welcome your thoughts on the subject and any help or advice that you may be able to give us.

We look forward very much to hearing from you.

Yours faithfully,
on behalf of the Big Bang Ball Committee,

Peter Bristowe

Chairman.

15 HILLGATE PLACE, LONDON W8 7SL 01-727-0059
Executive Committee: G P Bristowe (Chairman) C M Aldous P W J Robinson J J Robins
Miss C E Dunn Miss J Hargreaves C B Hovenden

2940/040

SECRET

FROM: M NEILSON
DATE: 12 August 1986

PPS

cc: Sir P Middleton
Mr A Wilson
Mr Cassell
Mrs Lomax
Mr Peretz
Mr Hall
Mr Board
Mr D Jones
Mr Evershed
Mr Grinlinton
Mr Blower
Mr Brummell T.Sol
Mr Hyett T.Sol
Mr Nicolle BoE

Ch
Letter from Gov below. You will be able to discuss it at lunch on Tuesday
29/8

GOVERNORS LETTER: NATIONAL INTEREST POWER IN BANKING BILL

The Economic Secretary has seen the Governor's letter of 7 August proposing that the decision not to include a "national interest" power in the Banking Bill should be reconsidered, and has commented that he doubts whether the case against is any weaker now.

M NEILSON

SECRET

003/007

SECRET

FROM: **M A HALL**

9 September 1986

1. **ECONOMIC SECRETARY**

2. **CHANCELLOR**

c c Sir Peter Middleton
Mr A Wilson
Mr Cassell
Ms Lomax
Mr Peretz
Mr D Jones
Mr Board

GOVERNOR'S ~~LETTER~~ [7 AUGUST] OF 2 SEPTEMBER : NATIONAL INTEREST POWER IN BANKING BILL

It is perhaps surprising that the Governor has returned to the charge so soon, though Lloyds/Standard Chartered appears to have shaken him. When he spoke to you about this in March, you agreed to a joint Bank/Treasury group undertaking a quick study of the issues. This was duly done and Mr Cassell reported during May. (A copy of the group's report is attached, should you want to look at it again.) While the issue is clearly complex, this latest consideration resulted in a fairly clear decision against putting national interest takeover powers in the Banking Bill. You agreed to keep an open mind about action in the future if the general climate were to change, perhaps prompted by a controversial takeover bid.

2. The Lloyds/Standard Chartered case cannot really be said to change the picture, since it first emerged in April and the case ran more or less contemporaneously with our study and your subsequent discussions with the Governor.

3. Nothing else has happened since to warrant a change in the policy.

4. A draft reply to the Governor is attached. Your discussion with him is in the record of the lunch, but since distribution of these notes is highly restricted, it would be helpful to have a more accessible reply.

M A HALL

SECRET

SM1/2

CHANCELLOR OF THE EXCHEQUER

FROM: A C S ALLAN

DATE: 12 SEPTEMBER 1986

CHANCELLOR

cc Sir P Middleton

FOLLOW-UP TO BILATERAL

Two points you asked me to follow up at your bilateral with Sir P Middleton on Wednesday.

(i) FIM tell me that the Banking Bill is on target for introduction on the first day of the new Session; it should be complete except possibly for a few very minor points.

(ii) Mr Grice tells me that the Bank are now writing up their study of broad money, though we have not yet seen anything. The plan is for the Governor to use it in a speech at Loughborough on 22 October. But it appeared that we would be able to see it in time for the Mansion House Speech, and possibly be able to use some of the material.

ACSA

A C S ALLAN

3107/7

CONFIDENTIAL UNDER SECTION 19 OF THE 1979 BANKING ACT

Ch
You will be seeing David Scholey at the Dinner this evening
AWK 27/10

FROM: MRS J R LOMAX
DATE: 27 OCTOBER 1986

Ch
Also note on GKN below

MRS LOMAX TO CH/EX 27/10

CHANCELLOR

RELIANCE GROUP/MERCURY

I have been in touch with the Bank supervisors about Mr Steinberg. You should treat what follows in strict confidence - in particular, the supervisors would be very unhappy if it got back to Mr Scholey that you knew of his conversations with them.

2. David Scholey and Lord Garmoyle came in to see Rodney Galpin this morning. It was agreed that the Bank should seek an early opportunity to contact Steinberg and ask him to pay them a visit. Assuming he complies, they want to question him about his intentions towards Mercury, and about the range and nature of his current interests. They also intend to indicate that the UK authorities do not like contested shareholding situations, as potentially damaging to the confidence of depositors.

3. When the Bank made enquiries about Mr Steinberg last November, the US authorities described him as "a sharp cookie", but said there was nothing actually known against him. Unlike the notorious Mr Rich, he does not have a string of outstanding charges/convictions to put his unfitness beyond doubt. The Bank now propose to "rewarm" those enquiries, and in particular, to see what they can find out from the US insurance regulators about the Reliance Group.

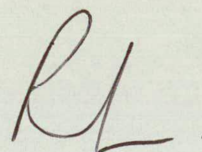
4. If this all sounds a little ineffectual, the truth is that the supervisors do not have a very big stick to wave in this case. Warburgs are a recognised bank, and (in contrast to LAT's) there

is no legal obligation to notify the Bank of changes in controllers, directors or managers. Nor does the existing legislation impose an explicit requirement that such persons should be "fit and proper" individuals. This is the case for licensed institutions, however, and it is clearly implicit in the criteria for authorisation as a recognised bank: ie that the institution "enjoys and has for a reasonable period of time enjoyed, a high reputation and standing in the financial community" and that the business of the institution is "carried on with integrity and prudence and with those professional skills which are consistent with the range and scale of an institution's activities".

5. Even so, under the existing law, the threat is a nuclear one - and scarcely credible in the case of Warburgs: that these criteria would cease to be met if Mr Steinberg acquired a stake of more than 15%, and that this would lead the Bank to revoke its authorisation.

6. Mr Steinberg's real intentions are, however, far from clear. It seems improbable that he genuinely wants to acquire a controlling stake - and this seems to be Warburg's view. A more likely explanation is greenmail, or some variant on it. But this is just a guess. David Scholey may be franker with you than the Bank supervisors are prepared to be with me.

7. As you know, the situation will change under the new Banking Bill. But the Bank supervisors discount the idea that Mr Steinberg is attempting to forestall the new legislation. And given the length of time before it will take effect, that seems a plausible surmise.



RACHEL LOMAX

From: Sir G.Littler
Date: 31 October 1986

MR ALEX ALLAN

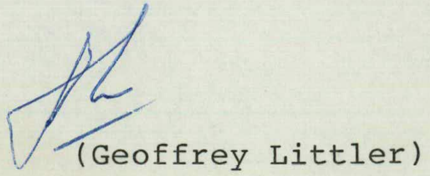
c.c. Sir P.Middleton
Mr Lavelle
Mr Cassell
Mr Huw Evans
Mr Peretz

BAKER/MIAZAWA AGREEMENT

I attach a text of the agreement announced today. I was not told anything of this while in Tokyo earlier in the week, although the Japanese Embassy gave me some advance warning today (and probably tried to contact me and failed yesterday when I was in Brussels).

2. I find the agreement puzzling. The apparent meat of it is a not very robust agreement to co-operate over exchange rates in the interests of stability at around present levels. Both sides express satisfaction with actions taken or intended by the other. I can see readily that the Japanese would be happy to secure this agreement, offering them some hope of avoiding a further fall in the dollar/yen rate. But what do the Americans get from it? The one-half per cent cut in the discount rate will not achieve much. The prospective tax changes may be important; but nothing is yet agreed by the Japanese Government or Diet. And the most recent US/Japanese finance bilaterals at official level ended with Mulford publicly complaining about lack of progress.

3. My only conclusion is that Baker may have seen value in registering agreement in this field in order to help persuade US opinion that agreements with Japan are possible and/or as a lever with which to press Japan in other fields later.



(Geoffrey Littler)

3107/51

CONFIDENTIAL
UNDER SECTION 19 OF 1979 BANKING ACT

B/F 24/11

FROM: MRS R LOMAX
DATE: 19 November 1986

PRINCIPAL PRIVATE SECRETARY

cc PS/Economic Secretary
Sir P Middleton
Mr Cassell

LOMAX TO PPS 19/11

MERCURY AND MR SAUL STEINBERG

In view of the story in this morning's Financial Times (attached) the Chancellor might like to note that Rodney Galpin had a meeting last Thursday morning with Saul Steinberg, one of his colleagues from Reliance, and his lawyer. Predictably, Steinberg said he had been misunderstood; his actions were in the interests of all the shareholders. He had warned David Scholey that he would want to make suggestions about the business, but he had been offered limited opportunity to do so, and what suggestions he had made had been ignored. Therefore he regarded himself as having been released from his undertaking. He asked what power the Bank had to prevent him acquiring a stake of more than 15%.

X| Under the existing legislation, the Bank have no formal power in respect of recognised banks. But Rodney Galpin made it clear that if Steinberg's stake were to rise above 15%, the Bank would want to make enquiries of the US regulatory authorities. Steinberg accepted this with alacrity, and offered to supply the necessary telephone numbers. The question of letters of comfort was not raised explicitly: the Bank suspect that Steinberg's response would be to demand a seat on the board in exchange.

Y| This episode seems to have prompted a renewed interest in "national interest powers" to block foreign takeovers by the Board of Banking Supervision. It seems highly likely that the Governor will raise the matter with the Chancellor once again at his next lunch.

Rh

RACHEL LOMAX

Rt X, what are powers under new Banking Bill?
Rt Y, consider Steinberg's stake on grounds of undesirability, rather than nationality? Would a British Steinberg have 15% to be allowed to take control of a bank?

Mercury International claims Steinberg stake is near 13%

BY DAVID LASCELLES

MR SAUL STEINBERG, the US corporate raider, yesterday increased his stake in Mercury International Group, the UK parent of the S. G. Warburg merchant bank.

Mercury said it had been informed that Mr Steinberg's Reliance Group had bought 3.5m shares. In addition to those he already owns, this would bring Mr Steinberg's stake close to 13 per cent. A representative of Mr Steinberg in New York declined to comment.

Under UK disclosure rules, Mr Steinberg must declare any change in his holdings in Mercury within five days. On the Stock Exchange, Mercury shares closed 21p higher at 411p, down slightly from the day's high of 415p.

The purchase follows Mr Steinberg's renunciation last month of his one-year-old standstill agreement with Mercury, whereby he agreed to hold his stake at 10 per cent. He said he was dissatisfied with the management of the group and was acting to protect the interests of its shareholders. His announcement said he might raise his stake to over 15 per cent.

Mercury last night stood by its position that the group should remain independent without a dominant shareholder, and that it did not welcome Mr Steinberg's increased investment. He is already Mercury's largest shareholder.

His New York representative said it was inaccurate to describe Mr Steinberg as an arbitrageur as some press reports had done, since such activity was prohibited for executives of insurance companies, of which Reliance is one. Arbitrageurs trade the stocks of potential takeover candidates.

BF 24/11

BARNES TO PPS 21/11

FROM: P D P BARNES
DATE: 21 November 1986

PPS

cc Sir P Middleton
Mr Cassell
Mrs Lomax

MERCURY AND MR SAUL STEINBERG

The Economic Secretary has seen Mrs Lomax's minute to you of 19 November.

2. The Economic Secretary thinks this potentially explosive.

PB

P D P BARNES
Private Secretary

3743/051

CONFIDENTIAL

FROM: P D P BARNES
DATE: 24 November 1986

PS/CHANCELLOR

cc Sir P Middleton
Sir G Littler
Mr Cassell
Mrs Lomax
Mr M Hall
Mr Ilett
Mr D Jones

BANKING BILL : TAKEOVERS

I attach minutes of a meeting which the Economic Secretary held with the Chairmen of the Natwest and Midland Banks on 17 November.

2. The Economic Secretary has commented that we will need a good defensive line on bank takeovers at least by the time of Second Reading. He would like to draw to the Chancellor's attention the opinion expressed by the two Chairmen that a foreign takeover of a CLSB member would be undesirable, but that a Japanese and/or U.S. institution (Nomura and Citibank being the most likely) could be expected to go for one of them within the next two or three years. The Chairmen said they thought that no other major country would allow foreign control of one of its major banks, and that there could be public policy problems for the Government or Bank if there were a foreign cuckoo in the British nest.

PB

P D P BARNES
Private Secretary

PS/EST TO PS/CH 24/11

CONFIDENTIAL

3743/044

CONFIDENTIAL

FROM: P D P BARNES
DATE: 24 November 1986

NOTE OF A MEETING IN ROOM 51/2 TREASURY CHAMBERS ON MONDAY 17 NOVEMBER AT 11.30 AM

Those Present: Economic Secretary
Mr D Jones
Lord Boardman, Chairman, National Westminster Bank PLC
Sir Donald Barron, Chairman, Midland Bank PLC

BANKING BILL: EFT/POS AND TAKEOVERS

The Economic Secretary welcomed the Chairmen and apologised for not having been able to see them immediately before the publication of the Banking Bill. He explained that preparations for publication had made it difficult for him to accommodate additional meetings at short notice, and that in any case it would have been too late by that stage to amend the published version of the Bill.

2. Sir Donald Barron said that the Chairmen had come to see the Economic Secretary about two matters: EFT/POS; and the possibility of establishing a national interest power to prevent a foreign takeover of a major UK bank.

EFT/POS

3. On EFT/POS, the Economic Secretary explained that the Government had been reluctant to include the EFT/POS amendment in the published Bill because this would have widened the scope of the Bill and made it vulnerable to amendments. However, it would probably be possible to include the EFT/POS amendment in the Lords, where relevance, not scope, was the criterion for an amendment being in order. If the banks could demonstrate that EFT/POS was sufficiently urgent, and sufficiently different from other potential Consumer Credit Act amendments, for it

CONFIDENTIAL

to require inclusion in the Bill, then the Government would be prepared to consider allowing the inclusion of the EFT/POS amendment in the Lords. This, however, depended on the absence of a general campaign for other consumer-related amendments. The Economic Secretary said that, in order to prevent the possibility of complications in the Commons, the banks should delay making their case publicly until after the Commons Report stage. They would, however, be welcome to communicate with him informally in the meantime. Until then, the Economic Secretary said that the banks' public line should be that the Government had invited them to let him know the strength of the case for an early move on EFT/POS, and they were considering how to respond.

4. The Chairmen said that they were content with this approach. In making their case, they would stress how important it was to implement EFT/POS quickly.

Takeovers

5. On takeovers, the Chairmen said that they were concerned by the absence from the relevant parts of the Bill (clauses 21-24 and Schedule 3) of any reference to a national interest power to control takeovers. They thought it would be undesirable for a member of the CLSB to be taken over by a Japanese or US bank. This was both because the Bank of England would find it more difficult to have frank discussions with the CLSB if one of its members was foreign; and because public opinion in general, and banking customers in particular, would be strongly opposed to a major retail bank falling into foreign hands. The Chairmen thought that the major retail banks, with high profitability and low PE ratios by international standards, and also with a strong High Street presence, would be very attractive to potential foreign aggressors. There was a precedent for such a power in the Industry Act 1975.

6. The Chairmen thought that the Government's existing and proposed powers to prevent a foreign takeover of a UK bank were insufficient. It would be difficult to argue that the top

Japanese or US Banks were not "fit and proper persons" under the terms of the Banking Bill; or that in itself the acquisition would threaten depositors' interests. The attempted takeover of the Royal Bank of Scotland by the Hong Kong and Shanghai Bank showed that the ability for a takeover to be resisted by the Monopolies and Mergers legislation could prevent a bank takeover only on narrowly restricted grounds. Furthermore, the Government would have difficulty using reciprocity powers against, for example, Japanese institutions who already had banking licences in London. Nor did the Chairmen think that it would be possible or desirable to pass special legislation quickly if a takeover bid for one of the major banks was made.

7. The Economic Secretary said that he had considered carefully the arguments which the Chairmen were advancing when drafting the Bill. It was a difficult area but, although there was no black and white case, he had thought it better on balance not to include a national interest power in the Bill. He was not as convinced as the Chairmen that it would be by definition contrary to the national interest if one of the eight CLSB members - or a major accepting house - were to be taken over; especially given the significance of London as a leading international financial centre. It was difficult to say with precision where the line should be drawn. Furthermore, once a specific power existed there would be pressure on the Government to use it, even when it would not be desirable to do so. And the power could not be expressed in terms of named institutions or some special protected category of banks.

8. Nevertheless, the Government already possessed a formidable array of weapons. Persuasion by the authorities had been effective in the past and would remain of use in dealing with certain types of institution (including, possibly, the Japanese). Statutory powers under Monopolies and Mergers legislation had been effective in the Hong Kong/Royal Bank affair, though he acknowledged their limitations. On top of that, the new Banking Bill contained requirements for advance notification of all takeovers and gave the Bank powers to block them where there

were prudential grounds. Leveraged bids would presumably be disallowed on these grounds. There were also powers in the Financial Services Act which were designed to secure reciprocity with other financial markets and which would allow banking authorisations to be withdrawn or refused if there was insufficient reciprocity. These could serve as a deterrent and strengthen the Government's hand in resisting attempted foreign takeovers, especially perhaps by the Japanese.

9. Since takeovers that were undesirable for prudential or competitive reasons, or because of the absence of reciprocity, could be resisted under existing or proposed powers, the question was whether there was a strong enough case for further statutory powers on purely national interest grounds. It might not be easy to justify, nor to use, such powers if there were no prudential or reciprocity grounds, nor would it be likely that they could be used against EC countries. As the Chairmen themselves recognised, there would be other interests, such as those of bank shareholders, which would not be served by a national interest power to block foreign takeovers by banks. The Government would also need to square the assumption of any new powers with its general principle of non-intervention in the market , and the effect on wider diplomatic relationships had also to be taken into account. As for the Trading Act powers, these applied only to the manufacturing sector, were Labour legislation opposed by the present Government when in opposition, and had, in any case never been used. A strong case would have to be made out to justify giving special protection to banks, when other takeovers, even when controversial, had been allowed to proceed.

10. Although the difficulties appeared to outweigh the benefits of further statutory powers, the Economic Secretary said that he did not have a closed mind on this issue. He was grateful to the Chairmen for letting him know their views in private.

PB

P D P BARNES
Private Secretary

pup

CHAIRMAN

BARCLAYS BANK PLC
54 LOMBARD STREET
LONDON, EC3P 3AH

24 November 1986

The Rt.Hon.Nigel Lawson MP
Chancellor of the Exchequer
11 Downing Street
London
SW1

Dear Nigel

I thought you would wish to know that the board of Barclays Bank has decided to dispose of the bank's investment in Barclays National Bank of South Africa.

We are making the announcement today. A copy of our press statement is attached.

Please let me know if I can help futher.

Yours

Tim

T BEVAN

NEWS FROM

BARCLAYS

November 24, 1986

BARCLAYS GROUP'S STAKE
IN SOUTH AFRICAN ASSOCIATE
TO BE SOLD

The Barclays Group's remaining shareholding of 40.4% in Barclays National Bank ("Barnat"), its South African associate, is being sold.

Substantially all of the 29 million shares are being bought by Anglo American Corporation of South Africa, De Beers Consolidated Mines and The Southern Life Association together with other South African institutions, all at a price of R18 a share.

Sir Timothy Bevan, Barclays Group chairman, said:

"Since 1973, when our holding in Barnat was 100%, we have steadily reduced our stake at a time when our strategy has been to emphasise North America, Western Europe and the Far East as the principal areas for the bank's overseas growth. In consequence Barnat's contribution to our Group profits, once significant, has declined and was less than 3% in 1985. We have now concluded that, in the long term interests of our shareholders, our remaining Barnat shares should be sold.

"Without the direct Barclays connection, the South African bank will be free to pursue its own international aspirations. A change of name for Barnat was already planned and this is now to be accelerated. The correspondent banking relationship will be maintained."

(Ends)

BARCLAYS BANK PLC, Public Relations Department, 54 Lombard Street, London, EC3P 3AH. Telephone: 01-626 1567

12/3067

CONFIDENTIAL UNDER SECTION 19 OF THE BANKING ACT

FROM: MRS R LOMAX
3 December 1986

Thanks. Can Mrs L pse explain whether the Bank's objection to Mr S is that he is foreign, or that he is Mr S? What would they do about a Mr S who held a British passport? What would they hope to do? N.

CHANCELLOR

cc PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Hall

STEINBERG AND MERCURY

Mr Steinberg has now increased his holding in Mercury to over 15%, and announced that he is going further. As past exchanges have already shown, he clearly knows his Banking Act. The Bank of England and Warburgs are both extremely fussed. (They suspect he is driving up the share price in the hope that Warburgs will find a white knight to buy him out, it being out of the question for Warburgs to do so themselves.)

2. The Bank are now casting around rather desperately for some means of holding Steinberg up. They plan to ask him to pay them another visit, in the meantime staying his hand. They think they may have picked up some reference to a connection between Steinberg and Boesky which will give them some pretext. But since they are clearly not prepared to threaten revocation of Warburg's licence, it is a pretty empty threat - as Steinberg will not doubt divine. As an even longer shot, the Bank are also looking at the reciprocity provisions in the Financial Services Act. (However, as I have already told them, even if implemented, these provisions technically apply to refusal or revocation of authorisation, not blocking of takeovers: so I do not think they will find much joy there).

3. Incidentally, Mr Quinn reports that the Bank press office has been beseiged with inquiries and market rumours, in the wake of the Guinness announcement. There is much talk of resignations, and inspections of other banks in the pipeline. They are doing their best to calm things down.

RL

RACHEL LOMAX

LOMAX TO CH/EX 3/A

3108/21

CONFIDENTIAL

FROM: MRS R LOMAX
DATE: 5 DECEMBER 1986

CHANCELLOR

cc PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Hall
Mr D Board
Mr Ross Goobey

LOMAX TO CH/EX 5/12

BANK TAKEOVERS

Following your lunch with the Governor and your various comments on the Steinberg/Mercury saga, Roger Barnes of the Bank has produced the attached note on the Bank's powers to block takeovers under the new legislation, focusing in particular on the considerations that would be relevant to a decision to block a takeover on prudential grounds.

2. The note reveals an interesting hardening in the Bank's line on the practical value of the reciprocity powers in the Financial Services Act. The argument that the Act confers disqualification but not blocking powers is technically correct. But we thought it had been generally agreed with the Bank eg in Mr Cassell's group on bank takeovers earlier in the year, that a formal warning that the Treasury intended to use its reciprocity powers to disqualify an institution post-acquisition, would enable the Bank to block a takeover on prudential grounds. The Bank now seem to have changed their tune: the final paragraph of Roger Barnes' paper argues that actual disqualification would be required. "It is not for the Bank to use the intention as a ground for objection".

3. We shall need to discuss this interpretation further with the Bank, and seek legal advice. The Bank's present view would make the reciprocity powers virtually useless for blocking takeovers.

4. More generally, at Sir Peter Middleton's suggestion, we are taking a quick further look at the case for national interest powers, against the possibility that the Economic Secretary will come under pressure on this during Committee. We will let you

have a further note shortly. At this stage, I would only comment that the Bank may be unduly sanguine in thinking that national interest powers will give them cast iron powers against litigious foreigners: I suspect that Mr Steinberg and his like may be just as prone to challenge the use of national interest powers in the Courts.

5. Meanwhile the Bank are telephoning Mr Steinberg today. The grounds on which they have selected to urge him to stay his hand are:

- the fact that Warburgs has a gilt-edged market maker, and the Bank has a particular interest in the gilt-edged market;

- the existence of prudential guidelines concerning links between insurance companies and Banks, which operate irrespective of nationality (Mr Steinberg's Reliant is of course an insurance company).

6. Incidentally, they maintain that they would be just as unhappy if Robert Maxwell (say) wanted to take over Warburgs: the only additional leverage they could exert would be moral (desire for some sort of respectability, peerage etc). Not much use against a really determined British undesirable.

pp RACHEL LOMAX

BANKING BILL: FINANCIAL SERVICES ACT 1986
POWERS TO CONTROL THE ACQUISITION OF CONTROLLING STAKES IN BANKS

1 This note considers the limitations of the takeover powers in these two pieces of legislation, in the context of possible powers to block takeovers in the wider public, or national, interest.

Banking Bill

2 Clauses 21-24 of the Bill provide for the Bank to be given prior notification of changes of control and to be able to object to an intending controller proceeding. However, objections may be made only on prudential grounds. Briefly these are where the Bank is not satisfied that the person (whether legal or natural) is fit and proper; or that the interests of depositors and potential depositors would not be threatened by the acquisition; or that the minimum prudential criteria would continue to be fulfilled by the institution having regard to the person's likely influence on it. (These criteria include requirements that the institution be adequately capitalised etc, and carry on its business prudently, with integrity and appropriate professional skills.)

3 The onus is thus on the acquirer to satisfy the Bank. But the Bank is empowered to require information from the acquirer about himself, and his plans for the institution. The Bank must act properly and reasonably on the evidence. It must give adequate reasons for its objection. There is a right of appeal to a tribunal.

4 There are thus two key questions for the Bank to consider on a notification. Is the intending controller a fit and proper person to hold his position in terms of the Bill; and will the acquisition lead to the institution becoming unsound thus

threatening the deposits? Fitness and properness equate broadly to probity, and to competence and soundness of judgment in relation to the responsibilities of the position. The size of the proposed shareholding is a major consideration. The consequences for the acquirer, and for the institution, where a minor stake is to be acquired are likely to be very different to where majority control is sought. Matters which might be disregarded for a minority controller might be decisive if he were to be a 100% owner.

5 In considering a person's fitness etc, the Bank would have regard to his business record, his other business interests, and his financial soundness and strength. If his record showed that companies under his control had failed or he had been criticised by DTI inspectors or by a regulatory authority or some other body of standing, this might be sufficient for an objection to be sustained, though the criticism must be considered against any mitigating or countervailing factors, eg the age of the criticism and its context. Also, if a potential controller's business intentions for the institution were clearly not in its interests or if he proposed to put in new management who would not be fit and proper to hold their positions, an objection could again be successfully sustained.

6 It is unlikely however that an objection could be sustained against a businessman simply because he had taken short-term strategic positions in companies shares in the past. Whilst supervisors might have an instinctive concern that such a person would not be a desirable controller of a banking institution, it is nevertheless likely that such a person - who will inevitably have exhibited sound financial acumen - would take account of the supervisors' requirements. In other words, a controller is entitled to argue that his philosophy in respect of a non-banking company may be different from his philosophy in respect of a bank. Although the burden of proof is on the intending controller the Bank must have proper regard to all the circumstances and evidence before seeking to object.

7 The fact that an acquisition is unwelcome to the present owners and/or management of a bank would not by itself appear to constitute a proper ground for objection; were this so, existing owners and management would be undesirably protected from market forces. Nevertheless where there is a contest, the Bank would be entitled to have regard to the acquirer's proposals, and his capacity, for steering the institution through any turbulance associated with a contested takeover, and in particular to his capacity to maintain confidence in the institution, which might be sapped by the conflict.

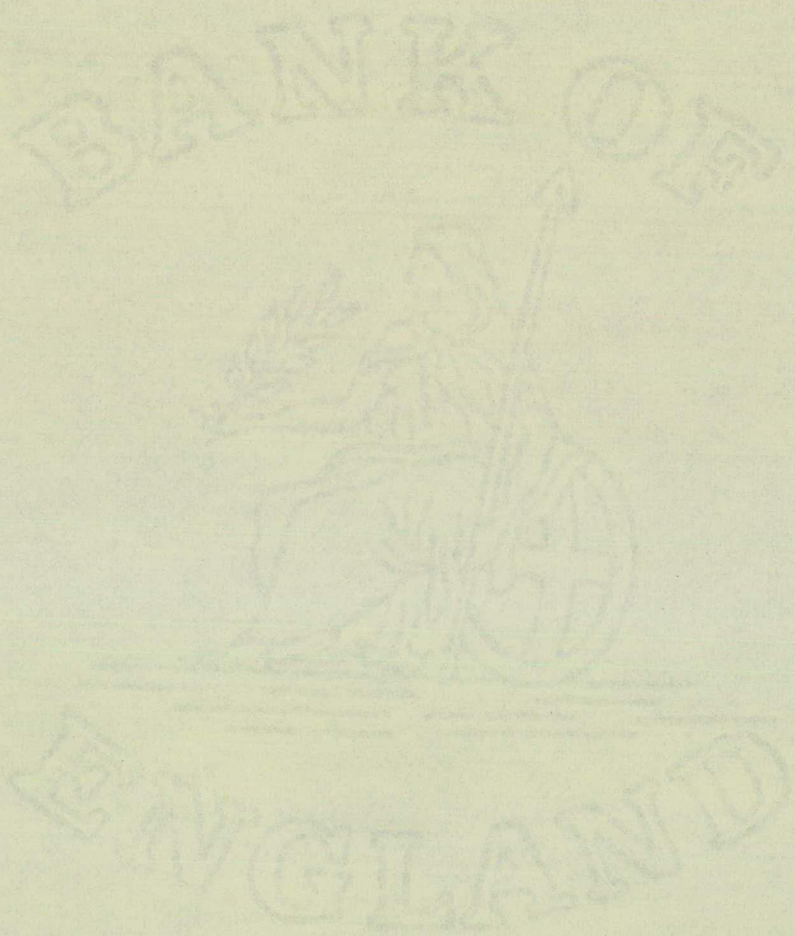
8 It would not, prima facie, be a ground for objection that the controller was foreign, or that he might not be readily amenable to, for example, the authorities' non-statutory monetary control guidance. The Bill is concerned with the stability of individual institutions, rather than the system.

Financial Services Act

9 Sections 183 to 186 of the Act allow the Treasury to revoke or restrict an authorisation under the Banking Act (disqualify in the language of the FS Act), on reciprocity grounds. For example if a controller of a bank was connected with a country which did not allow similar treatment to someone from the UK wishing to be a controller of a bank in that country. It is important to note that the Treasury's power lies against the authorised institution, not against the controller.

10 There are no powers in the FS Act to prevent an acquisition of all, or part of, an existing authorised institution. The powers operate post facto. It has been suggested that were the Treasury to tell the Bank that if a purchase of a controlling interest in a UK institution were to proceed they would use their power to disqualify the institution, then the Bank would be justified in blocking the acquisition on prudential grounds. The contention would be that it would not be in depositors' interests were the Treasury to disqualify the institution, so that the possibility should be avoided. In the Bank's view, this would be an improper use of its powers, and an objection notice susceptible of being

quashed on judicial review. The line of reasoning is that Parliament conferred disqualification, but not blocking, powers on the Treasury in the FS Act; and that for the Bank to use its prudentially based powers to meet the deficiency, would be an abuse of power, when at best there is no guarantee that the Treasury would actually issue an order. The correct procedure would be for the Treasury, through the Bank if necessary, to make clear their intention to disqualify, post acquisition and if the acquisition proceeded, despite this warning, then to disqualify. It is not for the Bank to use the intention as a ground for objection.



3108/33

FROM: MRS R LOMAX
DATE: 17 DECEMBER 1986

PS/ECONOMIC SECRETARY

cc PS/Chancellor
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Hall
Mr Ilett
Mr Murphy
Mr Cropper
Mr Ross Goobey

BUILDING SOCIETIES AND FINANCIAL SERVICES REGULATION

I have been back to both the SIB and BSA on the question of whether the polarisation rules will prevent building societies from marketing their own personal equity plans. The SIB are quite clear that polarisation will not affect any PEPs. The BSA feigned ignorance, though without great conviction.

2. At my suggestion, the BSA have agreed to write forthwith to the SIB, asking them to clarify the position on personal equity plans.

3. The meeting between the BSA and the SIB has been fixed for 9 January. It is fairly clear that SIB officials (including Ken Berrill) are quite sympathetic to the building societies' case on polarisation, though I suspect the opinion on the Board is more divided.

4. I see no reason for Ministers to express any views in writing at this stage. But we will keep a close eye on developments.

RL

RACHEL LOMAX

CONFIDENTIAL

FROM: F CASSELL
6 January 1987

CASSELL TO CH/CX 6/1

CHANCELLOR

cc Sir Peter Middleton
Mrs Lomax

SIR MARTIN JACOMB AND THE SIB

I understand that you are seeing Sir Martin tomorrow evening. You have no doubt seen the attached piece by Christopher Fildes in yesterday's 'Telegraph' reporting that he will soon be leaving the SIB and implying that this follows disagreements with Sir K Berrill.

On the first point, as you will recall, Sir Martin was only very reluctantly persuaded by the Governor to stay on as Deputy Chairman of the SIB and made it plain at that time that he would only wish to do so for one year - to May next. He has now, evidently definitely decided to leave then.

Fildes suggests that this is a further symptom of the general "unhappiness" at SIB. I have asked David Walker for his view on this. He thinks that the way Fildes has presented the story is misleading. Certainly, Sir Martin is disappointed at the way SIB is developing on legalistic and bureaucratic lines, but this is largely a disappointment about the general trend of developments in the City, to which the SIB itself is reacting.

There is no doubt a problem with Sir K Berrill. This might best be summed up as his particular "style" of working - good, and extremely quick, at solving concrete problems as they come along, but much less good at maintaining contact with those he is supposed to be supervising and hence getting to understand their problems as they emerge. This style has contributed to the widespread impression that the SIB is something remote, detached and basically hostile. This is where the departure of Sir Martin will be such a serious loss. It will be extremely difficult to find a successor who is similarly known and trusted

by the City. But someone with those qualities is desperately needed to provide the 'accessibility' that SIB needs.

F CASSELL

MONDAY JANUARY 5, 1987

Daily Telegraph

CHRISTOPHER FILDES

Sir Martin looks for his exit from SIB

17

DIRECTORS of the Securities and Investments Board are at odds with the policies of the chairman, Sir Kenneth Berrill. The board, they say, is not concentrating as it should on the protection of investors, instead being drawn into the detailed regulation and reorganisation of the City.

Sir Martin Jacomb, deputy chairman, voices his reservations: "I think the structure has become, perhaps inevitably, rather legalistic, with less emphasis on simple principles coupled with a lot of surveillance."

His words carry particular weight because Sir Martin was the City's architect of the system of self-regulation. He headed the inquiry, set up by the Governor of the Bank of England, whose report foreshadowed the new board. The Governor, so the City believes, pressed him to be its chairman.

In the event, he became chairman of Barclays de Zoete Wedd, which vies with Mercury to be our biggest investment banking group and has quite enough to do without the SIB. He is not a man who makes or needs to make dramatic gestures but I expect that, early this year, it will be quietly announced that he is leaving the SIB.

Other directors make no secret of their unhappiness. Their dissent is awkwardly timed for the SIB. Today week Paul Channon, Trade and Industry Secretary, will have powers under the Financial Services Act to delegate powers to a supervisory board. All assume, though the Act does not say so, that this will be the SIB.

For another week, the SIB will retain its peculiar form as a private company with limited liability backed by the Bank of England. It has full-time directors in Sir Kenneth, the chairman, and Roy Croft, the chief executive, who has come over from the Department of Trade and Industry. The remaining directors are non executives, mostly from the financial markets, their customers and their professional advisers and auditors.

Once given the go-ahead the SIB will in turn recognise self-regulating organisations for different activities. It has adopted the principle of "scope". This implies that the SROs must neither be so large as to be unwieldy (or, perhaps, powerful in their own right) nor so small as to lack the people and resources to do their work.

It is a tidy vision but the City's markets, having grown organically, do not always fit in. The commodity markets hope to have an SRO in the Association of Futures Brokers and Dealers but it looks short of scope, not to say subscriptions.

So the financial futures market finds itself shoehorned in complaining bitterly that this creates an artificial distinction between its business and the cash business from which it derives (in gilts, Eurobonds and so on) and that this barrier may cause more regulatory trouble than it cures.

At the other pole is the Securities Association, which has taken on the regulatory work of the Stock Exchange and the international securities traders. It has inherited all the subscriptions and the skilled staff that an SRO could wish for. It, too, is caught up in persistent wranglings about its scope.

One director sees this as a symptom of mistaken priorities. He wants to see the SIB put more effort into the surveillance of investment businesses—into establishing good networks of information, promoting swift spot checks, making examples.

Sir Martin Jacomb—his departure provides an opportunity.

Another phrases that more strongly. The SIB, he says, is spending only one-fifth of its time in trying to protect the private investor from malpractice and four fifths on trying to reorganise the markets—which, he adds, may or may not need it.

Back come the obstructions which the City revolution and the Big Bang were intended to demolish.

The dissenters had hoped for a simpler approach to protecting investors, based on the fullest disclosure, backed up by surveillance. Life insurance brokers, for instance, would have been required to disclose their commissions. Bank managers would have been required to say when they were giving independent advice and when, on their bank's behalf, they were recommending its wares. (Instead, the hapless manager is caught in another SIB doctrine: "Polarisation").

In common with most of the City, the dissenters accepted the SIB as a fair price for regulation by practitioners, within a framework of statute. Some now complain that the SIB is writing the statutes and that the practitioners are not performing.

Sir Martin stresses what has been achieved. "We've etched on to the SIB a proper involvement with the real markets but with the difficulty emerging of continuing to ensure the right input from market performers."

The answer to the SIB's difficulties may well prove to come from the Bank of England. The Bank, having conjured the SIB into being, has stood back from its work. There is no one from the Bank among its directors.

Last year brought talk of the Bank as having some general responsibility for the SIB, or acting as an additional layer between the SIB and the Department of Trade. Lately, though, the Bank has been more concerned to assert its own authority over the wholesale financial markets—with the air of a man trying to jam the remaining piece of a jigsaw puzzle into a hole that seems to be left.

Sir Martin's departure will be the Bank's opportunity. What more natural than to find a successor from the highest levels of the Bank? The appointment will be an omen to be watched.

12/3

MR 9/14

PERSONAL

RECORD OF LAST MEETING 7/1

FROM: A C S ALLAN
DATE: 8 January 1987

CHANCELLOR'S MEETING WITH SIR MARTIN JACOMB: 5 PM 7 JANUARY

The Chancellor reported to Sir P Middleton his discussion with Sir Martin Jacomb. Sir Martin had said that he had always planned to be a member of the SIB for one year only. And he found that the work took up far more time than he had available.

2. Sir Martin said the SIB was at present run by Berrill and Weinberg in tandem. He thought Weinburg was far too bureaucratic and had an obsession with detail. He thought Berrill was not allocating his time sensibly between the important and minor issues. The SIB had meetings which lasted from 2 pm to 6 pm, including endless explanations to non-participants about how the markets worked.

3. He saw three solutions:

(i) his replacement should be a recently retired practitioner, who could devote much more time;

(ii) he thought there should be more practitioners on the board - even those members currently with City experience were not practitioners in the securities market;

(iii) it would be helpful to have a Bank of England representative on the SIB, as a first step towards ending the artificial divorce between the supervision of banking and securities business.

4. He thought the three main issues before the SIB were:

(i) Polarisation. He had fought very hard against Berrill and Weinberg on this and thought the decision was very bad. But it was too late to change it now.

(ii) Scope of SROs. He was strongly in favour of wide scope for SROs, and thought it made no sense for there to be a separate financial futures SRO: financial futures should be covered by ISRO/SE.

(iii) Surveillance. He thought there was currently too much of an obsession with setting up rules, and not enough with setting up systems for surveillance of whether institutions were meeting those rules.

5. The Chancellor had suggested to Sir Martin that he should discuss some of these issues with the Governor or Deputy Governor.

ACSA

A C S ALLAN

psl/60A

UNCLASSIFIED

FROM: A C S ALLAN
DATE: 13 January 1987

CHANCELLOR

MEETING ON BANKING BILL

There are two main subjects for your meeting tomorrow:

- composition of the Board of Banking Supervision; and
- Bank takeovers.

Composition of BBS

2. The Economic Secretary has proposed a compromise package in his Private Secretary minute of 22 December. From your talk with the Governor on the plane, it sounds as if he might wear most of it - except the idea that the additional member should by statute be a non-City person.

Takeovers

3. A wadge of papers from Rachel Lomax on this. It may be most sensible to take her note rather than the paper itself as the agenda. Your point about adding a banking track record to the criteria for determining whether someone is "fit and proper" has been taken on board as an amendment to the Bill. Otherwise, the arguments are by now pretty familiar.

Other issues

4. There are one or two other points for discussion:

(i) Timing of report stage. I believe the Economic Secretary is considering delaying the report stage (I think so that he can have more time to work on his Budget starters). There are dangers in this: it would delay the Bill getting into the Lords, and hence potentially add to the

log-jam there; and it does increase the risk that the Bill might get lost if there was an early Election;

(ii) <u>handling in the House of Lords</u>. You earlier expressed doubts about Lord Beaverbrooke rather than Lord Young taking the lead in the House of Lords. I gather the Economic Secretary feels it would help the low-key presentation to have Lord Beaverbrooke doing it;

(iii) <u>the title of the Bill.</u> Martin Hall's note of 8 January recommends against changing the title to "Banking Supervision Bill".

AA

A C S ALLAN

BRITISH BANKERS' ASSOCIATION

10 LOMBARD STREET · LONDON EC3V 9EL

PRESIDENT

TELEPHONE: 01-623 4001
TELEX: 888364

21 January 1987

Sir Gordon Borrie
Director-General
Office of Fair Trading
Field House
Breams Buildings
London EC4

Dear Sir Gordon,

In informal discussions with your officials it was indicated that the Office of Fair Trading would find it helpful if the banks were to submit a paper setting out their arguments that polarisation - as the Securities and Investments Board plans to apply the concept to financial conglomerates - is anticompetitive. Accordingly, I enclose a paper on the subject. I am also sending you a copy of Counsel's opinion obtained by the banks on a particular part of the Board's proposals which has come to be known as the 'demonstrably better' test. I hope both of these will be helpful when you are considering the Board's rules and in making your report on them to the Secretary of State.

As you will see, the banks consider that the Board's proposals would seriously reduce competition with no benefit to the consumer.

You may like to know that copies of this letter, our paper and Counsel's opinion are being sent to the Secretary of State for Trade and Industry, the Under Secretary of State for Corporate and Consumer Affairs, to HM Treasury, the consumer bodies and all members of the SIB. The Building Societies Association - which, I understand, supports the general line of our paper but which may have some additional points to submit to you - has also received copies.

Yours sincerely,

Jeremy Morse

8/175/10

BRITISH BANKERS' ASSOCIATION

10 LOMBARD STREET · LONDON EC3V 9EL

SECRETARY-GENERAL:
KENNETH LUCAS

TELEPHONE: 01-623 4001
TELEX: 888364
FACSIMILE. 01 283 7037

POLARISATION AND FINANCIAL CONGLOMERATES

Introduction

1. The aim of polarisation is to ensure that the status of any investment advice given to an individual is clear. The banks - which account for a substantial share of life assurance sold in the United Kingdom - are in full support of this principle.

2. What is at issue is the precise way in which the Securities and Investments Board plans to achieve this aim in respect of financial conglomerates. There are principles already contained in SIB's conduct of business rules to prevent possible abuses of situations where firms offer independent advice and also sell in-house products. The rules include requirements for 'best advice' and 'best execution', the need for firms to subordinate their own interests to those of their customers and to disclose any interest in a transaction. Polarisation would be an unnecessary addition to all these safeguards.

3. The principle of polarisation seems to have been developed as part of a compromise reached between the Marketing of Investments Board Organising Committee and the insurance industry. The root cause of the problems faced by MIBOC in devising a regulatory framework for insurance intermediaries was the tradition that intermediaries are remunerated by insurers, even when they are agents acting on behalf of the insured. Having decided that it was not possible to attack the root cause, the regulators have had to deal as best they can with the various consequences: confusion over status, the difficulty of securing 'best advice', and disclosure of commissions. They have chosen to take a firm line on status, but not on commission disclosure. On 'best advice' they have opted for more stringent constraints where the intermediary and the provider are related by ties of ownership than in other circumstances. This compromise may suit the specialist insurance intermediaries, but it is not suitable for other participants in the market.

4. Forcing firms to be polarised either as 'company representatives' - which would never be allowed to give independent advice - or as 'independent intermediaries', may be feasible for specialist businesses in the insurance sector: we express no view on that. It could not work, however, for banks and building societies without significantly eroding their main benefit to consumers, namely flexibility and breadth of service under one roof. In the case of building societies, this flies in the face not only of common sense but of government policy, as expressed in the new Building Societies Act. It should also be borne in mind that the vast majority of customer complaints about the selling of life assurance concern the activities of salesmen, according to a survey just published by the Office of Fair Trading, 'The

selling of insurance policies' (December 1986). Products sold by banks and building societies give the least cause for dissatisfaction.

5. Even a cursory examination of the history of the Board's thinking on polarisation reveals that the idea was conceived - largely under the auspices of MIBOC - without thought of the implications for financial conglomerates.

6. The first consultative paper mooting polarisation, 'Life assurance and unit trusts: independent intermediaries, tied agents and company representatives', was issued in December 1985. It was made clear then that a 'purist approach' in the selling of life assurance and unit trusts was favoured, but the application of such an approach to the circumstances of financial conglomerates was not addressed. Then, in April last year, the Board issued a policy statement, 'Life assurance and unit trusts and the investor', indicating that it intended to adopt the principle of polarisation. Only at that time - following representations from the banks among others - were the implications of this concept for financial conglomerates seriously considered. The Board simply stated that it was 'in the course of discussions with those concerned as to how the principles set out in this document can best be applied to conglomerates'. Discussions subsequently occurred during which the banks gave in-depth explanations about how they operated and the impracticability of the proposals as far as they were concerned. These explanations seem to have made very little impact.

7. The Board's proposals were not only devised without due consideration of the nature of conglomerates like banks, they were also contemplated only in the context of life assurance and unit trusts. This seems to have been an unfortunate by-product of the establishment of what, in effect, were two Boards. The scope of MIBOC extended only to the regulation of life assurance and unit trusts. That meant that polarisation was not considered properly in relation to the regulation of financial services in general. This approach was bound to create anomalies which would be most evident in the context of financial conglomerates which offer their customers a full range of financial services. It seems that once MIBOC was dissolved, its proposals were simply 'bolted on' to SIB's other plans. It is sad that the first major overhaul of the regulatory framework for financial services for 40 years has been produced in such a piecemeal fashion.

8. The objection of the banks to polarisation is that it would be anticompetitive and therefore reduce the level of service to the consumer. The White Paper 'Financial Services in the United Kingdom: a new framework for investor protection' (January 1985) noted that one of the Government's principal objectives in putting forward the Financial Services Bill was to stimulate competition. Polarisation is anticompetitive in a number of different respects.

Barrier to entry

9. The proposals would erect a major barrier to entry in the different intermediary sectors of the life assurance and unit trust industry. Institutions opting to provide one service - either that of an independent intermediary or of a company representative - would be debarred automatically from providing the other. This would mean that banks and building societies which chose to be company representatives in, say, life assurance could not meet the needs of customers who wanted a full and independent advisory service from the same institution. They would only be

able to recommend an in-house product irrespective of what the competition might be offering. This cannot be what Parliament intended.

10. The Board has agreed that where no in-house product is available company representatives could act only as a 'channel of communication' for the service of a group independent intermediary. But branch staff could not become involved in the advice being given. For many customers this would be too remote. Experience shows that the vast majority value convenience and can be put off altogether from seeking a particular investment service if they cannot be advised on the spot. This convenience is especially important for customers who live in country areas and who are dependent on their bank or building society branch. More importantly, perhaps, the customer may be forced to take much more time to complete complex, but perfectly ordinary, financial transactions: he will not appreciate this enforced complication.

11. Worse still, institutions which chose, say, to sell in-house unit trusts could not at the same time offer an independent service in life assurance even though the two products are quite different, satisfying different objectives. This comes from the Board's policy of lumping life assurance and unit trusts together in the mistaken view that they are 'interchangeable'. Yet, a high proportion of the life assurance arranged through banks and building societies is related to lending; these circumstances are quite different from those where a customer has money to invest in unit trusts. The recent survey by the Office of Fair Trading referred to above shows that the public rely particularly on the advice of banks and building societies when purchasing mortgage-related life policies. There are numerous other differences between the two types of product. As well as the range of investments open to fund managers and the tax considerations, unit trusts are much more flexible than many life assurance products: there is a liquid secondary market and no surrender penalties. Indeed, unit trusts are more akin to purchases of stocks and shares in this respect.

Distortion of competition

12. SIB intends to allow independent intermediaries to recommend group products only when to do otherwise would be 'demonstrably to the disadvantage of the customer'. This would be a blatant distortion of competition, putting in-house products at an unfair disadvantage. Banks which had opted to be independent intermediaries could not - other than in exceptional circumstances - sell a group product even when a customer had expressed a preference for one. Even if an in-house product was genuinely believed to be the best on the market, the difficulty of proving that could force the bank or building society to 'play safe' and recommend an alternative.

13. Clearly, there is scope for a possible conflict of interest in these circumstances, as there is in the case of a securities firm effecting a transaction from its own book. However, as already noted, there are principles in SIB's conduct of business rules to prevent possible abuses of such situations.

Cost

14. The retraining and additional administration involved in ensuring that staff complied with the burdensome requirements of polarisation would increase

costs. These increased costs would impinge disproportionately on organisations such as banks, building societies, estate agents etc whose staff are engaged in a range of activities extending beyond the selling of life assurance and unit trusts.

Market anomalies

15. By applying polarisation to the selling of life assurance and unit trusts, anomalies would arise in the market for financial services in general. This would be most evident in the case of financial conglomerates whose customers have access to a whole range of services. For example, banks opting to be independent intermediaries could not sell their own unit trusts but could sell an in-house personal equity plan. They could sell a personal pension plan invested only in deposits, but not one invested in unit trusts or life assurance. Similarly, an institution which chose to be a company representative could comment on the advice a customer had received from a stockbroker but not on the advice of an insurance broker.

16. For all these reasons, the banks believe they should be able both to be company representatives and to offer independent advice under proper disclosure. This would mean that any possible confusion in the mind of the customer would be dispelled by full disclosure to him of the service being provided at the time. As already noted, the principle of disclosure as a protection for the investor is already written into SIB's draft rules. It is difficult to see why it should be supplemented with the artificiality of polarisation in relation to the sale of life assurance and unit trusts. The effect of SIB's present policy is to negate the concept of the creation of financial conglomerates which have been widely recognised as desirable to stimulate competition in the market place.

January 1987

THE COMMITTEE OF LONDON AND SCOTTISH BANKERS

JOINT OPINION

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1. The SIB has put forward proposals for the regulation of the activities of those engaged in the selling of Life Assurance and Unit Trusts. In the case of independent intermediaries the proposal is that there should be a duty to give "best advice" to the client. That duty is said to involve an obligation :

> "To take reasonable steps to seek out and recommend what the intermediary genuinely believes to be the best product for that customer available from any company in the market."

SIB document entitled "Life Assurance and Unit Trusts and the Investor" - paragraph 16.

2. Independent Intermediaries will often operate as members of a group of companies which include a Life Office or a Unit Trust (termed a "Group Product

Company"). In such a case the SIB is minded to impose two additional obligations on the intermediary :

(a) The intermediary will be required to disclose its relationship with the Group Product Company in any case where the intermediary recommends a product of the Group Product Company; and

(b) The intermediary will be deemed to have failed to satisfy the "best advice" duty where "business is placed with the Group Product Company unless the intermediary can demonstrate that it has positive grounds for believing that the clients' interest would be less well served by investing in another company's product."

This is known as "the demonstrably better proviso".

The effect of the second duty will depend upon how SIB interpret it. But it would seem to have the consequence that an independent intermediary could not place business with any company in his Group unless he could establish a bona fide belief that all other non-Group products or, at any rate, all others known to him, were worse for the client. If two products were equally good he would be bound to recommend the non-Group product.

3. We understand that the SIB has proposed the second duty on the grounds that it represents the general law of agency. We are instructed to advise whether that is so.

4. It is well established that an agent for reward is bound to exercise such skill and care in the carrying out of his instructions as is reasonably to be expected from an agent in the position of the agent in question, having regard to the experience and expertise that such agent holds himself out as possessing. The duty is sone of reasonable care: see Bowstead Agency, Article 42; and the cases there cited from Beale v South Devon Ry Co. (1864) 3 H&C 337 to Whitehouse v Jordan (1981) 1 WLR 246. If the client were to claim that his agent had failed to fulfil that duty it would be for the clients to establish it.

5. Accordingly a financial intermediary will owe to his client a duty to take reasonable care to obtain the product most suited to his client's needs. But he will not impliedly warrant that the product he selects has that characteristic so as to expose himself and his company to a claim in damages if, despite all due care on his part, a better product could in fact have been found. Nor will he be liable if he could not show that all other products or all other products known to him were worse. If the client were to claim that the

intermediary was negligent in recommending a Group product the Court would, no doubt, in practice, scrutinize with care the intermediary's reasons for selecting that product. But, subject to the point made below, the fact that a Group product was selected would not itself be either negligence or evidence of negligence.

6. We are, accordingly, of the opinion that the demonstrably better proviso goes further than that which would be implied at common law. It does so both as to the scope of the duty (i.e. an obligation not to select Group products unless all others are worse or believed to be worse) and the onus of proof (the onus being on the intermediary to demonstrate at least a belief that all other products or all other products known to him were worse). We would also think it to be very difficult for an intermediary to satisfy the proviso in practice, given that, as SIB point out in their Discussion Note - page 3

> "In the case of Life Assurance and Unit Trust products it is often only in the exceptional case that the "best advice" requirement may point unambiguously at one company .... intermediaries will be able to justify a choice from a number of broadly comparable companies."

7. We have concerned ourselves in this Opinion only with the duty of care owed in law by an agent. Agents also owe duties to their principals not to place themselves in a position where their interest and their

duty may conflict, e.g. by themselves contracting with their client, or to make a profit from doing so, without the free and informed consent of the client. In the case off a group of companies this obligation would probably prohibit the intermediary from buying a Group product for the client without full disclosure of the intermediary's relationship with the Group. We do not propose to consider this aspect of the matter further. It is that principle which has given rise to the proposal to impose the duty set out at 2(a). It is, we understand, the duty of care at common law that has given rise to the proposal to impose the demonstrably better proviso which, for the reasons which we have stated, ~~impose~~ extends in our view, beyond the obligations ordinarily imposed upon agents.

Robert Alexander

ROBERT ALEXANDER Q.C.

C.S.C.S. Clarke

CHRISTOPHER CLARKE Q.C.

Temple, EC4

22nd December 1986.

MR 9/19

FROM: A C S ALLAN
DATE: 22 January 1987

CHANCELLOR

GEOFFREY TAYLOR

(Sorry about my rather breathless report just before Cabinet - I was seeing what could be sorted out before the informal meeting started this morning.)

As I said then, I had demarches from Peter, Rachel and Robert this morning all very concerned about the decision. The main points were

(i) It risked very bad publicity to remove Mr Taylor at this late stage, even if done behind the guise of him stepping aside because of the pressure of his other commitments.

(ii) The Bank feel very strongly about this, and it would be ill-advised to antagonise them on a relatively minor issue when we may well need to win their support for help on the Banking Bill (eg over national interest powers).

(iii) Mr Taylor was the candidate agreed with the BBA, so the banking industry is most unlikely to raise any fuss.

(iv) The Treasury is not on very strong grounds in saying it knew nothing of Mr Taylor's involvement with Daiwa, since apparently Geoff Littler has known about it for some time.

2. The Governor rang the Economic Secretary, as arranged, and put the Bank view that Mr Taylor was the best qualified candidate, and that his long association with the Midland would be seen a full justification for his membership. The Economic Secretary said he fully understood the Bank's concerns, but felt that the presentational disadvantages of having the banking member of the review being the Chairman of a Japanese institution in London would create great difficulties at a time when takeovers, receprocity and

national interest powers were such major issues. He agreed that he would see Mr Taylor himself to explain the position.

3. I put officials views to the Economic Secretary on the way to the Banking Bill Committee. He said he would not want to change his decision unless you felt he should.

4. I subsequently spoke to Rachel, who felt she had no alternative but to go ahead with the informal meeting and lunch today. She made the point - which I think must be right - that it would look exceptionally rude for the Economic Secretary have Mr Taylor in <u>today</u>. If the decision to get him to stand down is confirmed, it would be much better to invite him in privately either tomorrow or early next week.

A C S ALLAN

C. I think there's a lot of useful material here, but it needs to be a bit tauter to have maximum effect. The best contrasts seem to me between the Govt's measures on the City, and Labour's attitude to Clay Cross, ~~the miners' strike~~ political campaigns with ratepayers' money, & creative accounting. backed up by the miners' strike & Wapping.

FROM: A ROSS GOOBEY

DATE: 27 JANUARY 1987

CHANCELLOR OF THE EXCHEQUER

Many thanks. Will wait for a suitable occasion. AH

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Mr Cropper
Mr Tyrie

THE CITY AND LOCAL AUTHORITIES - A CONTRAST

You asked me to work up a line which contrasted the Government's approach to the City, and the City's response, with the Labour Party's approach to Local Authorities.

2. Mr Tebbit has widened this a little (on C4 News last week) by making a similar comparison about Trades Unions.

3. The following is a draft:

"1. I want tonight to draw a contrast between the attitude of this Government and its predecessors and putative successors to the rule of law.

2. I said in the House last week that ours is the party of law and order. The Labour Party, in one of its periodic attacks of sanctimonious righteousness, has been smearing the whole financial services sector with the sins of a few miscreants and trying to associate the Government with their wrongdoing.

3. And yet, what are the facts? This Government has introduced new laws which control the whole range of the City's activities: insider dealing has been made illegal for the first time; the Financial Services Act, which does not fully come into force until the second half of this year, has been passed and now the Serious Frauds Office is to be established.

4. The striking fact of the matter is that the Government is pursuing the malefactors quickly and with vigour, supported by the City itself, which has nothing to gain and everything to lose if it is seen not to be the centre of honest and straightforward dealing on which its reputation and business has been built.

5. Contrast this if you will with two other areas of political activity - the local authorities and the unions.

6. In the local authorities we remember that in 1975 the then Labour Government passed an Act of Parliament which restrospectively indemnified the Clay Cross councillors for their action in defying the 1972 Housing Finance Act. We remember the scandals in the North-East and Swansea in the 1970s where Labour Party-dominated councils became corrupted by their control and bribery occurred.

7. But we don't have to look back into the 1970s to see this area of corruption. Labour councils up and down the country are employing their fellow councillors from neighbouring boroughs, squeezing out the apolitical career officers and replacing them with political appointees, often with very little relevant experience. They extend their propaganda departments and add political conditions to their contracting tenders. In Islington a Council Committee Chairman found himself in negotiation over wages with his own brother. In Leicester the council's tender applications demand information about nuclear power contracts and contracts with South Africa.

8. The Councillors in some areas are building up "cabinets" of personal assistants - there is one post advertised this week in The Guardian for a Personal Assistant to the "Chair" of the Housing Committee in

Could make the point that Labour can't really find anything to criticise in the Govt's handling of events in the City, but can't bring themselves to welcome it, so are reduced to smears.

with the cooperation of

And this sort of corrupt practice is going on today.

pushing career officials aside

who have

Brent. No qualifications are mentioned but there is a salary of up to £14,400. [I can guess one qualification needed: identification with the Labour Party.]

9. I have no objection to political advisers in central or local government, indeed there are three political advisers in the Treasury, but there is a difference. Their jobs exist only as long as the Government; were there to be a change of Government, they would lose their jobs. The appointments in Brent and councils like them are permanent. What will happen when the Conservatives return to power in Brent and all the officers are Labour appointees with overt political leanings?

I'm not sure this contrast comes off.

10. The recent report of [?] concluded that the Civil Service had not been politicised; a similar statement could not be made about local government. That stinks of corruption to me - jobs for the boys and girls.

11. And yet the local authority despots resist with might and main any attempt to correct this situation. They spend ratepayers' money on political campaigns to resist rate-capping or promote nuclear-free zones.

e the GLC spending £X,000 on giving evidence to the Layfield enquiry.

12. To avoid cutting some of their peripheral but high-profile programmes, they have now gone in for creative accounting hoping that Mr Kinnock will ride to their rescue. Unfortunately for them Mr Kinnock on this faltering Rosinante with his faithful Sancho Hattersley by his side will never have the opportunity.

13. The Audit Commission has analysed many of these councils and come to the conclusion that they are very badly managed. So appalling is the political atmosphere in boroughs like Brent and Lambeth that they cannot recruit qualified senior officers to run the council, and decisions are made by the small groups at the centre of the elected council and their appointees.

14. The Labour Party leadership has barely scratched the surface of these iniquities. Expelling half-a-dozen Militants in Liverpool does not balance the adoption of some of the more extreme council leaders as Parliamentary candidates.

15. Labour locally and nationally are cultivating these growing abuses to the detriment of true democracy.

16. And what of the unions? When we came to office the trades union leaders were almost above the law. The agreements they signed were not legally enforceable, they could incite their members to break contracts and to ruin the businesses of companies with whom their members had no dispute through secondary picketing. So this Government introduced laws which gave power back to the members and redressed the balance between unions and managers.

17. But in 1983 the Chairman of a TUC Committee said about the new laws:

> "... if it is a bad law .... I will oppose the law and I will influence other people to oppose the law .... if that means breaking the law I will do it"

and that other well-known but now strangely subdued member of the Labour Party Arthur Scargill said in 1982 "We will defy the law".

18. And only this weekend Mr Denis Skinner was heard to egg on the rioters at Wapping with the view that Labour would have to win the next election "on the streets".

19. So let us hear no more of this sickening cant from Labour. Law-breaking must be sought out and punished. I make no distinction between law breaking by industrialists or financiers or by social security

fraudsters. The difference is that, whereas Labour tries to put its supporters above morality and the law, this Government will root out wrongdoing whatever its source."

A.R.G.

A ROSS GOOBEY

3886/009

SECRET

FROM: C W KELLY

DATE: 3 February 1987

1. SIR P MIDDLETON

2. CHANCELLOR

cc Sir G Littler

THE FUTURE OF HONG KONG FINANCIAL MONETARY SYSTEM

The letter of 29 January from the Foreign Secretary's office records that now Sir David Wilson has been appointed Hong Kong Governor-designate the financial dialogue with the Chinese agreed during the discussions about the Hong Kong and Shanghai Bank is being set in hand.

2. We had hoped that the discussions would begin earlier. But the timetable was thrown out by the death of Sir Edward Youde. It would have looked odd to begin discussions on such an important subject before a new Governor-designate had been appointed, and might have suggested to the Chinese that we had some ulterior motive for being in such a hurry. The delay is unfortunate, but inevitable in the circumstances.

3. The obstacle has now been removed with the appointment of Sir David Wilson. The fact that he was closely involved as responsible Under-Secretary in the Foreign Office during the earlier discussions can only be helpful from our point of view. He is not immune to the normal FCO fear of doing anything which might upset the Chinese. But he is - I think - personally persuaded of the need to get things moving, and to do so quickly.

4. The plan now is for the Financial Secretary of Hong Kong to go to Beijing in the first week of March - as soon as he has got his Budget out of the way. The list of issues he intends to raise is shown in the attached telegram. The Foreign Secretary is sending

a personal letter about the talks to the Chinese Foreign Minister, and will reinforce this when he sees him, probably later in March.

5. There is no need for you to intervene in the correspondence.

C W KELLY

enc

SECRET

SECRET
DEYOU
ORIEL
FM HONG KONG
TO IMMEDIATE FCO
TELNO 242
OF 201005Z JANUARY 87

STRICTLY PERSONAL FOR HUM, HONG KONG DEPARTMENT FROM ACTING GOVERNOR

MIPT : FUTURE OF HONG KONG'S FINANCIAL AND MONETARY SYSTEM

1. REVISED LIST OF ISSUES TO RAISE DURING JACOBS' FIRST VISIT IS AS FOLLOWS:

(I) IMPORTANCE OF MAINTAINING STABILITY OF HONG KONG'S FINANCIAL SYSTEM IN PERIOD UP TO AND BEYOND 1997. BUT IMPOSSIBILITY OF FREEZING PRESENT SYSTEM. MUST DEVELOP IN ORDER TO SURVIVE AND PROSPER.

(II) VALUE OF DISCUSSING TOGETHER ANY CHANGES TO THE PRESENT STRUCTURE WHICH ARE SEEN AS EITHER NECESSARY OR DESIRABLE TO ENSURE SMOOTH TRANSITION AND THE CONTINUED, EFFECTIVE WORKING OF THE FINANCIAL SYSTEM.

(III) OFFER, AS A GESTURE OF GOOD FAITH, THAT THE BANK OF CHINA MIGHT JOIN THE EXCHANGE FUND ADVISORY COMMITTEE.

(IV) SUGGEST THAT A ''TEACH-IN'' ON THE PRESENT MONETARY SYSTEM MIGHT PROVIDE A HELPFUL PLATFORM ON WHICH TO BUILD.

(V) IF APPROPRIATE FORUM PRESENTS ITSELF, IDENTIFY A NUMBER OF SPECIFIC ISSUES WHICH WE SEE AS WORTH ADDRESSING IN FUTURE MEETINGS, E.G.:

(A) FUTURE ROLE IN HONG KONG OF BANK OF CHINA GROUP, IN PARTICULAR IN RELATION TO NOTE ISSUE.

(B) PLANS FOR OTHER PRC FINANCIAL ENTITIES UNDERTAKING BANKING IN HONG KONG (CITIC, CHINA MERCHANTS, CHINA RESOURCES).

(C) FUTURE ROLE OF HSBC (EG WILL IT KEEP ITS PRESENT QUASI-CENTRAL BANKING FUNCTIONS) AND ITS LIKELY LONGER-TERM ASPIRATIONS.

(D) FUTURE ROLE, AND ACCOUNTABILITY OF, THE EXCHANGE FUND.

AKERS-JONES

YYYY

HMLNAN 7478

LIMITED.

HD. HKD.
PS|PUS
MR GILLMORE
SIR D. WILSON.

SECRET - DEYOU -

RA7.25

FROM: A C S ALLAN
DATE: 4 February 1987

CHANCELLOR

DRINKS WITH SIR MARTIN JACOMB

This meeting is at Sir Martin's request. But there are a few points you might raise with him, if he does not raise them himself.

His successor at SIB

2. A cabal of John Caines, Roy Croft and David Walker seem to have cooked up the idea that his successor should be Rachel Waterhouse. This has now (just) been put to the Treasury at official level. It seems completely counter to the views Sir Martin put to you - which were that his replacement should be a recently retired practitioner. But he does not seem to have put his views nearly forcefully enough to the Bank of England (who admire the effort and energy Rachel Waterhouse has put in). This is clearly going to be very difficult to handle, since the last thing we want is more leaks from the SIB press officer to the effect that Chancellor ditches Waterhouse.

3. You may remember when you discussed this with Peter, the names floated were Ian Fraser, John Bearing (though Peter was not keen), and David Montague (who you subsequently saw for drinks).

Capital adequacy

4. There are problems over the likely capital adequacy rules for members of the Securities Association (SE plus ISRO). Extrapolating the rules for gilt edge market makers produces such large requirements for these firms that much of the business would

be in danger of going off shore. So the Securities Association and SIB are proposing lower numbers. This upset the Bank, who worked out a compromise whereby the proposals would describe the way the ratios would be calculated but without putting any numbers in yet (the next stage is for the rules to go to the OFT for comment). DTI are unhappy about this, and discussions are still going on.

Other issues

5. Other topical points are

(i) Takeover panel.

(ii) City regulation (Guinness, Morgan Grenfall, Standard Chartered etc.)

(iii) Polarization - where the SIB rules do seem to be coming under increasing fire.

(iv) National interest power It could be useful to try out on Sir Martin the idea of toughening up the reciprocity powers.

AA

A C S ALLAN

Hill Samuel

1314/7

[CONFIDE]NTIAL

* Note @ Cw. M.

[F]ROM: MRS R LOMAX
[D]ATE: 6 February 1987

SIR PETER MIDDLETON

cc: Principal Private Secretary
PS/Economic Secretary
Mr Cassell
Mr Hall

Ch
DTI are getting trigger happy AA

HILL SAMUEL

This is just to alert you that the DTI are actively considering the case for a Section 432 Companies Act investigation into Hill Samuel, in connection with possible offences against the Companies Act at the time of the Turner/AE bid. As I understand it, no new evidence has come to light: the DTI have been ploughing through their old files on takeovers during the past few weeks and have been prompted to take this one off the back burner by a written PQ asking them if they propose to have a Companies Act inspection.

2. I have discussed this case with the Bank before. The banking supervisors did look into the circumstances surrounding the indemnity at the time of the Takeover Panel reprimand, and they say they were convinced that the money involved was Hill Samuel's, not the company's. The DTI now want to see the Bank's evidence: and they are considering what other offences against the Companies Act may have been involved.

3. I have asked to be kept in touch in the normal way. I am prompted to wonder whether we ought to give some more thought to the general principles involved in investigating possible offences by banks. It sometimes seems that DTI and the Bank start from quite different presumptions - which increases the chances of friction and bad feeling, and makes it more difficult to achieve mutually consistent outcomes in different cases. So far we have a Companies Act inspection into Guinness, supplemented by an internal inquiry into Morgan Grenfell, at the Bank's instigation: and an inquiry under Section 17 of the Banking Act into Standard Chartered, at their own request; and a purely

private investigation by a firm of solicitors into Cazenoves. The press are not entirely to be blamed for failing to see a clear thread running through all these decisions. Maybe this is a subject which could usefully be aired with the Deputy Governor and Brian Hayes, in your Group on City Issues?

RACHEL LOMAX

* Rachel's suggestion is a good one, & we will also need to consider - ourselves, & question the right way to proceed on HS. 2. More generally, I see from the WE press the PM is thinking of absorbing DEn within DTI. There is much to be said for this. There is, at least at a nominal level, a case for taking the City/securities business out of DTI & transferring it to HMT. While this is desirable on its own merits, it would also make the Energy-enlarged DTI a more manageable size. I should be grateful if Ron could work up a proposal I could put to the PM. He may want to discuss with me first. NL.

RA7.33

FROM: A C S ALLAN
DATE: 9 February 1987

CHANCELLOR

MEETING ON BANKING BILL

The main topic for the meeting is national interest power/reciprocity. We need to fix the line (and the tactics) urgently, if Report Stage next week. Attached piece in today's FT v unhelpful.

2. EST may also want to discuss non-executive directors and audit committees, following defeats in committee.

3. Amendments to deal with pressure on board of banking supervision have already been settled with the Governor.

AA

A C S ALLAN

SECRET

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

FROM: A J G ISAAC
19 February 1987

1. CHAIRMAN

2. PS/CHANCELLOR OF THE EXCHEQUER

FINANCE BILL: STAMP DUTY AND CGT IMPLICATIONS OF A BUDGET ANNOUNCEMENT

1. I have seen your note today addressed to the Private Office here, and discussed it with Mr Corlett and Mr Draper.

2. Let me say at once that we regret that the Chancellor has grounds for concern at the classification or distribution of Mr Draper's note of 18 February. Receipients within the Revenue were on a need to know basis, but we have taken action to reclassify the papers "Budget Secret".

3. You ask for an explanation. I have to say that the explanation seems to lie in two things:

- First, the substantive (and indeed most recent) papers available to Mr Draper were correspondence from Treasury Solicitor, classified "Budget Confidential", and enclosing the text of the relevant Finance Bill Clause. Following the usual rules, Mr Draper naturally used the same classification in his minute.

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cc PS/Economic Secretary
Sir Peter Middleton
Mr Romanski

Mr Battishill
Mr Isaac
Mr Corlett
Mr Draper
Mr McManus

- Second, we did not learn of the relevant proposals directly from the Treasury, but indirectly, and very late. This, perhaps, had two unfortunate consequences. First, we had to act very quickly indeed to take in hand the necessary amendments to the Finance Bill. Second, we did not have an opportunity to learn from the Treasury that the proposal is more sensitive than the classification of the Treasury papers on the face of it suggested.

4. As I have said, we are all sorry that this has caused trouble. It will, however, help us all to maintain the proper levels of security if the Treasury can inform us directly both of proposals where we have a "need to know", and of any particular circumstances or special sensitivity attached to them.

A J G ISAAC

C23/43

FROM: A C S ALLAN
DATE: 20 FEBRUARY 1987

CHANCELLOR

HILL SAMUEL

DTI rang me this evening with their draft reply to the PQ on Hill Samuel. This is:

> My Department has been kept informed by the Bank of England about the inquiry which, as part of its supervisory activities, it is making into this matter. The information currently available from this and other sources does not constitute sufficient grounds to justify an investigation under the Companies Act.

Two points strike me:

i. What inquiry? So far as I know, there is no formal Banking Act inquiry, but this seems designed to stimulate headlines "Bank reveals it has been holding an inquiry". I should have thought something more neutral was appropriate, on the lines "about the information it has received that part of its supervisory activities". I shall check with the Bank on Monday.

ii. "Currently" seems a little dangerous: it might be seen as carrying the implication that DTI expect further information which will justify an investigation. The sentence would still be true if "currently" was omitted.

A C S ALLAN

3745/032

RESTRICTED

FROM: P D P BARNES
DATE: 24 February 1987

PS/CHANCELLOR

cc Sir P Middleton
Sir G Littler
Mr Cassell
Mr Culpin
Mrs Lomax
Mr M Hall
Mr D Jones
Mr Evershed

Mr Croft Tsy Sol

C/ content for letter to issue?

CE 24/2

BANKING BILL

At Prayers last Friday (20 February), the Chancellor commissioned a draft letter from the Economic Secretary for the Chancellor to send to the Lord President, reflecting their more sanguine view of the problems that the national interest question would now cause in the Lords.

2. I attach a draft letter, agreed by the Economic Secretary, which also conveys his view that the there is now less danger that accepting the EFT/POS amendment would lay us open to other Consumer Credit Act amendments in the Lords.

3. The draft letter reflects comments on an earlier draft from FIM.

P D P BARNES
Private Secretary

3745/026

DRAFT LETTER FROM THE CHANCELLOR TO

The Rt Hon Viscount Whitelaw CH MC
Lord President of the Council
Privy Council Office
Whitehall
LONDON
SW1A 2AT

February 1987

BANKING BILL

As you will know, the Banking Bill had a successful Report and Third Reading in the Commons last Thursday.

2. The Opposition divided the House only once, on the question of whether the Treasury and the Bank of England should be able to object to persons when they considered that it would be contrary to the national interest for such persons to become controllers of an authorised institution. With the aid of an assurance from Paul Channon, which Ian Stewart quoted in the debate, that the question of foreign takeovers is being addressed in his review of competition and mergers policy and that for the present his policy in applying the Fair Trading Act power takes full account of the public interest, the Opposition amendment was defeated by 246 votes to 86. Both Ian and I think that it should now be difficult for the national interest lobby to make headway in the Lords though this may not stop some of the Clearing Bank Chairmen from trying to stir things up.

3. I should also mention the state of play on the EFT/POS amendment, about which you expressed concern in your letter to Ian of 24 October 1986. Ian's Private Secretary letter of 30 October explained that it might be reasonable to concede EFT/POS in the Lords, provided that the banks could demonstrate that an early decision on EFT/POS was essential and that it was of a different order and importance from other potential Consumer Credit Act amendments. Ian has now received a letter to this effect from the Association of Payment Clearing Services (APACS). There were no other Consumer Credit Act amendments proposed during the Bill's passage through the Commons nor were consumer matters prominent in debate. He thinks it unlikely that any will surface now. So I hope you will agree that there is no real obstacle to the EFT/POS amendment being introduced in the Lords. It is something that the Clearing Banks very much want, and could perhaps help to compensate for resisting their ambitions for a specific national interest power.

I am copying this letter to David Young and to Maxwell Beaverbrook.

NIGEL LAWSON

cc/ Sir P Middleton
Sir G Littler
Mr H P Evans
(no further copies to be taken)

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

2 March 1987

Dear Alex,

Mr. David Rockefeller came to see the Prime Minister this afternoon for what turned out to be a very general talk, mostly concerned with developments in Washington following the Tower Commission report. Mr. Rockefeller thought that the President could recover his standing but did not rule out the possibility that both Secretary Shultz and Secretary Weinberger would both have to go.

Mr. Rockefeller complimented the Prime Minister on the vitality of the City. The Prime Minister commented that there had been one or two serious problems. But you could not close a motorway just because there had been one or two accidents.

Mr. Rockefeller said that he was very worried about the failure of the United States' Administration to get to grips with the US budget deficit. The level of indebtedness of corporations and individuals was also a matter of concern.

The ratio of debt to income was higher than ever. Mr. Rockefeller thought that the Japanese were beginning to play a more constructive role in international economic questions. Both Nakasone and Miyazawa had a considerably better understanding of world problems than their predecessors. But there was still a long way to go before we could be satisfied that the Japanese were dealing fairly with their trade partners. The Prime Minister complained at the perennial tendency of other Heads of Government to be nice to Japan at Economic Summit meetings. It always ended with her being the only one prepared to criticise the Japanese.

There was a brief discussion of drug and other problems in Latin America and the Caribbean. Mr. Rockefeller expressed particular concern about Jamaica.

Commenting on the prospects for the United States' Presidential elections, Mr. Rockefeller thought that Gary Hart was well ahead among the Democratic contenders. His own preference would have been for Sam Nunn but he did not really have a national political base. He thought that Vice-President Bush still had a reasonable chance of securing the Republican nomination.

Mr. Rockefeller reminded the Prime Minister that she had an open invitation to address the Council on Foreign

Relations in New York. He would be happy to organise a lunch or dinner when she was able to do so. The Prime Minister said that she would keep the invitation in mind.

The Prime Minister would regard this as a private conversation. I should be grateful if my note of it could be given only a very limited circulation.

I am copying this letter to Tony Galsworthy (Foreign and Commonwealth Office).

Yours sincerely,

Charles Powell

CHARLES POWELL

Alex Allan, Esq.,
H.M. Treasury.

1315/3

FROM: MRS R LOMAX
DATE: 2 March 1987

CHANCELLOR

cc: Economic Secretary
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Hall
Mr Ilett
Mr Board

GROUP OF REGULATORS ("CAINES GROUP"): SECOND REPORT

I attach a copy of the Second Report of the Caines Group, which is being submitted simultaneously to DTI Ministers and the Governor.

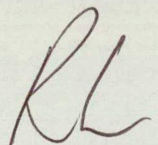
2. The Group's main achievement over the year since its first report has been to allocate lead regulators to 160 conglomerates, according to a set of rather vague criteria set out in paragraph 8. Not surprisingly, the Bank of England emerges as lead regulator for all groups where banking is predominant - 88 in all - while DTI takes the lead for the 47 conglomerates in which an insurance company is predominant; the remaining 25 will be allocated to one or other of the investment business SROs. The full list is shown in Annex D. The routine procedures for ensuring adequate liaison between different regulators are summarised at Annex C.

3. While the blueprint is nearly - but not quite - complete, the practical work of setting up colleges of regulators, under a lead regulator, is only just beginning. Things will move ahead much faster once SIB becomes the designated agency - probably in May. While legislative barriers to the exchange of information between existing regulators have already been removed, it will not be possible to pass restricted information to the SIB until the Delegation Order is laid.

4. All this is very important but essentially bread and butter stuff. The Group's future work plans - shown in paragraph 21 -

look rather more exciting. In practice, however, I see this Group remaining a rather workaday forum for ensuring that the lead regulator arrangements are kept up to date, and work properly. For different reasons, neither the Bank nor the DTI have shown much inclination to discuss general policy issues such as the harmonisation of capital adequacy requirements, and improved international co-operation between securities regulators. Equally, the Group has not played much part in discussing the need for special investigations into financial firms, including the banks, in the aftermath of the Guinness affair.

5. There is, of course, an urgent need for close inter-departmental co-operation on these issues. But more regular meetings of Sir Peter Middleton's Group and ad hoc meetings on particular issues are probably sufficient, for the time being. Certainly we have no great enthusiasm for constructing an edifice of inter-departmental committees, especially with DTI in the Chair.



RACHEL LOMAX

JOINT CONSULTATIVE GROUP OF REGULATORS: SECOND REPORT TO MINISTERS

Introduction

The Joint Consultative Group of Regulators ("the Group") meets under DTI Chairmanship, and includes representatives of HM Treasury, the Bank of England and the Securities and Investments Board. Its terms of reference are:

> "To provide an informal forum at senior level in which the DTI, the Treasury, the Securities and Investments Board and the Bank can consider together issues in the regulation of financial services which arise across or outside existing boundaries, and can:
>
> (a) discuss them with other financial regulators as appropriate;
>
> (b) promote discussion and regular exchanges of information across regulatory boundaries at working level;
>
> (c) review lessons to be learned from any individual cases of particular difficulty in conglomerate supervision;
>
> (d) offer guidance;
>
> (e) draw matters of concern to the attention of the Permanent Secretaries to the Treasury and DTI, and the Deputy Governor."

2. In January 1986 the Group submitted its first Report to Ministers and the Governor of the Bank of England. Its conclusions and recommendations (reproduced at Annex A) were endorsed. The implementation of the Financial Services Act and the Banking Bill will assist in carrying out these recommendations, for example by ensuring that there is comprehensive coverage of financial sector activities, with clear lines of demarcation between the responsibilities of the different regulators and by removing the obstacles to free exchanges of information.

3. The remainder of this report is concerned with measures designed to promote co-operation between regulators, both at home and overseas.

Co-operation between UK regulators

4. The first Report recommended adopting the concept of a "lead regulator", designed to facilitate co-operation between UK regulators of financial conglomerates. Where a conglomerate is operating under more than one UK regime (Bank of England, financial services, insurance) the regulators concerned will form a "college of regulators" under the chairmanship of the "lead regulator" appointed for that conglomerate.

5. These arrangements were outlined on 21 January 1986 in a Parliamentary Answer given by Mr Howard, Parliamentary Under-Secretary of State for Corporate and Consumer Affairs (see Annex B).

6. Detailed arrangements for pooling information, filling gaps in that information and co-ordinating action have now been devised (see Annex C). These arrangements are designed to be compatible with the statutory responsibilities of each regulator and require no separate statutory backing.

7. The Group has identified 160 conglomerates, listed at Annex D, which are expected to require this treatment.

8. Annex D also indicates the lead regulator for each conglomerate. The appointments have been agreed by the Group, based on the following criteria:

(i) who regulates the ultimate holding company

(ii) whether the group's exposure risk is predominantly related to insurance, securities or banking/wholesale money markets, taking in account the concentrations, large exposures and other intra-group aggregations of specific risk which are likely to arise

(iii) the management/control structure

(iv) the risks for regulated entities of contagion by other entities

(v) the degree of overall financial supervision already conducted by regulators for their own purposes

(vi) which regulator needs to obtain for his own purposes the most information about the conglomerate.

The DTI will be the lead regulator for the 47 conglomerates in which an insurance company is predominant and the Bank of England will lead for the 88 where banking is predominant. The remaining 25 will fall to a regulator of investment business: for the time being this role has been allocated to the Securities and Investments Board, but it is expected that in most cases this role will be carried out by a recognised self-regulating organisation (SRO) - such as The Securities Association.

9. The evolving structure of a particular conglomerate may require the substitution of a new lead regulator in accordance with the selection criteria. Moreover, as the relationship develops between a conglomerate and SIB, or the Securities Association, it may become possible for the lead regulator role to pass to it from the Bank.

10. There are three areas which the Group has not yet examined:

(a) foreign banks where there is no UK incorporated deposit taking institution in the group, but where there is a UK branch (so far the list at Annex D only includes such foreign banks where there is already a positive indication that the group is likely to be a significant player in the UK securities markets);

(b) certain single entities which are subject to regulation both by the Bank and under the Financial Services regime;

(c) certain conglomerates which are subject to Bank supervision because they include major participants in the wholesale money markets, as well as including entities subject to the financial services or insurance regimes. (Possibilities here may include Salomons, Morgan Stanley, EF Hutton, Drexel Burnham Lambert, Yamaichi and Daiwa, and also groups involved in money broking activities through for example MAI, International City Holdings and RP Martin. The question of lead regulator treatment cannot be resolved until it emerges whether these groups will apply to the Bank for listing as wholesale money market institutions.)

The Group will need to consider whether there are any conglomerates in these categories which merit lead regulator treatment.

11. The Group will keep changes in corporate ownership under review so as to identify additional conglomerates which merit the lead regulator treatment and to agree upon a lead regulator. It will update the list as necessary to reflect these and other changes.

12. Legislative obstacles to the exchange of restricted information between existing UK regulators have been removed, (Details are at Annex E.) but it will not become possible to share this information with the Securities and Investments Board until SIB becomes the designated agency under the Financial Services Act. This is planned for Spring 1987, subject to Parliamentary approval. Information can already be given to The Stock Exchange for certain purposes, and when the Securities Association and other self-regulating organisations become recognised in the Summer of 1987, they too will be able to receive it.

13. In order to keep the burden of work within manageable proportions the conglomerates have been divided into three categories. Preliminary work will shortly begin on the 43 conglomerates in the first category, with a view to setting up all these colleges of regulators between the designation of SIB and the Appointed Day, later this year, when the Financial Services Act comes fully into force. The Group also hopes that, despite the magnitude of the task, it will be possible to set up the 88 colleges of regulators in the second category

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by the Appointed Day. Finally work will begin on the 29 conglomerates in the third category, which do not appear to require the same degree of co-operation bewteen regulators.

14. The Group does not intend to publish the list of conglomerates in Annex D. Instead each lead regulator will make contact with his individual conglomerates, starting with those in the first category.

15. The lead regulator arrangements, described in Annex C for the conglomerates listed in Annex D, represent only a first step in developing co-operation between regulators. Each regulator is obliged to operate under the requirements of his statute and no regulator has the power to veto another's actions. It is not possible to predict how well the arrangements will work in practice and much will depend upon the regulators, both in the public and private sectors, developing the habit of working closely together. Nevertheless the arrangements represent a useful initial response to the growingconvergence of financial sectors. The Group firmly believes that a step by step approach to building co-operation between regulators is likely to be the best approach, particularly at a time when the primary task for each regulator is to implement the regulatory changes in his own area.

16. SIB is developing with SROs separate and distinct lead regulator arrangements for application within the area of investment business covered by the Financial Services Act. These arrangements will apply where the business is wholly within the Act's scope, but is regulated by more than one SRO, or authorised by both SIB and an SRO. Because only one statute is involved, and it is possible for monitoring to be delegated, these arrangements will need to be worked out in more detail than the lead regulator arrangements for a conglomerate regulated under two or more statutes. A statement by SIB summarising these two sets of arrangements for the area covered by the Financial Services Act is at Annex F.

17. The Group is ready, if it becomes appropriate, to involve in its work other UK financial regulators, such as the Building Societies Commission, the Chief Registrar of friendly societies and Lloyds. The position of the Take-Over Panel will fall to be considered in the context of the current review of its functions.

International co-operation

18. Work has continued in developing international co-operation between regulators. Good co-operation already occurs between banking supervisors. In December 1986 the DTI hosted a meeting of securities regulators which explored methods for promoting similar co-operation between them. A follow up meeting is planned for Summer 1987. In September 1986 DTI signed a Memorandum of Understanding with the US Securities and Exchange Commission and the Commodity Futures Trading Commission, which is working efecitively. This will be followed by other bilateral agreements with securities

regulators in the leading financial centres: negotiations with the Japanese are already under way. There are signs that the EC Commission will want to take a growing interest in this topic.

19. There is formal machinery to promote co-operation between insurance regulators within the EC, and informal contact by the UK with US and other insurance regulators.

20. The Financial Services and Banking Acts enable the UK to exchange regulatory information with overseas regulatory authorities.

Future Work

21. The future work of the Group is expected to cover:

(a) general oversight of the "college of regulator" arrangements so as to promote effective regulation while minimising compliance costs;

(b) updating the list of conglomerates and their lead regulators, in the light of developments in the balance of their activities or in the relationship between them and their regulators;

(c) exploring the scope for harmonisation of the capital adequacy requirements of the various statutory regimes;

(d) identifying themes or problems common to the various statutory regimes, such as the role of the auditor;

(e) international co-operation between securities regulators;

(f) keeping under review the membership of the Group, to reflect changing needs for co-operation between financial and Companies Act regulators.

ANNEX A

EXTRACT FROM FIRST REPORT OF THE GROUP

X CONCLUSION AND RECOMMENDATIONS

It is inevitable that practical experience of regulating conglomerates will reveal deficiencies in the arrangements described in this paper. Nevertheless our recommendations aim to provide a solid foundation upon which to build.

We recommend:

(a) against the idea of a single regulatory authority for all financial conglomerates (paragraph 2.6).

(b) that as far as possible every financial sector activity should be capable of coverage by one statute or another (paragraph 2.8).

(c) that the Securities and Investments Board should adopt suitable lead regulator arrangements for conglomerates whose financial sector business falls entirely within the Financial Services Bill regime (paragraph 3.6).

(d) for each conglomerate where more than one regulatory regime is involved, the regulators should agree to designate one as a lead regulator, who should have the functions described in paragraphs 3.14 to 3.21 above (paragraph 3.13);

(e) all arrangements for information collection should as far as possible be designed to minimise the compliance cost to the conglomerate (paragraph 3.17);

(f) statutory obstacles should be removed to enable regulators to disclose information to each other (paragraph 4.7);

(g) that the lead regulator should ensure that such relevant information as can be obtained about the unregulated parts of the conglomerate is obtained and shared between all the regulators concerned (paragraph 5.4);

(h) regulators should continue to develop their contacts with overseas regulators with a view to establishing in the long term comprehensive arrangements for exchanging information (paragraph 5.8);

(i) against a statutory provision allowing one regulator to override the obligations or requirements of another (paragraph 8.3);

(j) the boundaries of the various compensation schemes should be drawn up to ensure that there is clear and appropriate coverage for customers (paragraph 9.3).

ANNEX B

Financial Conglomerates

Mr. Tim Smith asked the Secretary of State for Trade and Industry what proposals the Government have for regulating financial conglomerates; and if he will make a statement.

Mr. Howard: The growth of financial conglomerates poses particular problems for regulators. But these new financial supermarkets provide benefits for their customers and for investors. It is for the regulators to find ways of ensuring that these new entities are operating prudently, without erecting barriers which would prevent them from operating efficiently and competitively. Regulation must be clear enough to guide but not cramp structural change in the industry.

The needs of the different regulators are not identical. Investor protection, policy holder protection and depositor protection each call for different rules and different regulatory arrangements. The answer to the financial conglomerates is not necessarily the creation of an extra regulator specifically for them. That would mean duplication and inefficiency. The answer lies in facilitating co-operation between regulators. That involves three things — clear regulatory boundaries, shared information about the different aspects of the financial conglomerate in which one or more regulator has an interest and mechanisms for co-ordinating regulatory action with a view to resolving, conflicts of regulatory interest where possible.

Both the Financial Services Bill and the proposed new Banking Bill will lay down the boundaries of the two regulatory systems and provide powers to enable these boundaries to be swiftly adjusted to meet the needs arising from the creation of new financial products.

The Building Societies Bill and the Financial Services Bill contain powers to enable information to be disclosed to other regulators. The Government intend to enlarge the scope of the powers in the Financial Services Bill to enable information obtained under the Banking, Companies and Insurance Companies Acts to be disclosed to other regulators in appropriate circumstances.

Co-operation between regulators will be achieved by extra-statutory arrangements to nominate one of the regulators with an interest in a conglomerate to act as lead regulator. It will be for the regulators concerned to agree which of them should assume this role for each conglomerate. Essentially this role will be to ensure that all relevant information is obtained and shared, including information about potential difficulties, and to co-ordinate action by individual regulators. Each regulator will continue to have his own statutory duties and responsibilities. The task of the lead regulator is to promote an agreed solution which adequately takes account of the interersts of all the regulators.

The Department of Trade and Industry has established interdepartmental machinery to promote and monitor the new arrangements.

PROCEDURES FOR THE INTER-REGIME LEAD REGULATOR

This note summarises the procedures for ensuring adequate liaison between regulators in monitoring the position of financial organisations which fall within the ambit of two or more regulatory regimes whether these be for banking, insurance, investment business or wholesalemarket-making. The same basic arrangements can apply, in general, whether the organisation being supervised is a single entity or a financial conglomerate, although the regulators of a single entity will need to maintain a closer and more frequent dialogue.

2. The responsibility for calling meetings will lie with the designated lead regulator. Meetings should be called whenever the chairman becomes aware through his organisation that a meeting is desirable or is asked to do so by one of the other members of the college. Where it is possible to arrange for one group of supervisors to cover several institutions at a meeting, it is suggested that this will be more efficient.

3. The lead regulators may like to appoint as the Chairman of the meetings of the college of supervisors for each organisation a senior member of their staff who is not the "expert" on that institution. The "expert" would then be free to contribute to the meeting with the representatives from the other supervisory bodies. It is felt that this arrangement may lead to a smoother conduct of the meetings.

4. An initial meeting should be held to exchange information about the organisation, so that the lead regulator may establish whether there are any gaps in the available information, and how these can be filled, and to agree the extent of any delegation of monitoring where appropriate.

5. Prior to subsequent meetings, each of the members of the college should circulate briefing, normally of a factual or statistical nature, regarding the parts of the relevant organisation known to them. The lead regulator would have the responsibility to provide a synthesis or basic "information pack" based on these briefings; and may also have to contribute some information on parts of a financial conglomerate if they do not fall within the ambit of any of the regulators.

6. Regulators should use all best endeavours to minimise inconsistencies and overlaps in their information requirements, so that minor differences in definitions, reporting dates etc did not cause unnecessary burdens for the conglomerates. This might have to be tackled case by case.

7. The routine meeting should generally cover:

(i) Developments of which each individual supervisory authority is aware (eg changes in control, management and financial position, shortfalls from conduct of business standards etc).

(ii) Such information as the individual member may possess about the future plans or strategy of the organisation.

8. Regulators should also be prepared to exchange information on an ad hoc basis between meeting as circumstances warrant. Where one regulator has delegated monitoring of an organisation to another regulator some regular exchange of information between meetings may be required.

9. Routine enforcement action should be reported to other members of the college. Events might prove to be more significant than they at first appeared, and it would be desirable to err on the side of informing other regulators. Although it might not be necessary to inform at the stage when a firm was subjected to informal pressure, other regulators should be informed when the possibility was under exploration of using formal powers. The outcome of investigations or visits should also be passed on if likely to be of relevance.

10. The overseas activities of groups based overseas might be particularly difficult to explore, although pooling the information obtainable through powers, persuasion and public sources would help. Where an information gap remained the college would have to decide whether that mattered and if so whether further information should be sought from overseas regulators, or whether it should be assumed that the particular overseas regulators were doing an adequate job. Gaps in the information may also arise in relation to non-financial UK activities of the conglomerate.

11. It was agreed that tighter arrangements were necessary for monitoring a single entity than for monitoring a group of companies. Each college should develop its own procedures within the overall framework described in this note.

12. It will be necessary to recommend whether action needs to be taken with regard to the organisation and what form any such action should take and how it can be co-ordinated. Responsibility for taking any action will of course remain with each regulator in respect of those activities of the financial organisation which fall within its area of responsibility. If any regulator considers between meetings that action needs to be taken, the lead regulator should be informed and so far as the urgency of the situation permits, the action to be taken should be discussed and co-ordinated within the college.

13. Where a college is set up, the conglomerate should be informed of its existence, but it is most unlikely that the college would meet collectively with representatives of the conglomerate.

14. Each college of regulators should take a decision once a year whether or not it is necessary to meet to review its conglomerate. It should also reach a conclusion on whether the college was working satisfactorily and if not should take steps to improve liaison. The Group would exercise general oversight over the colleges, but there would be no formal requirement for individual colleges to satisfy the Group as to their effectiveness.

ANNEX D

CONGLOMERATES AND LEAD REGULATORS

FIRST CATEGORY

(a) DTI LEAD REGULATOR

	OTHER REGULATORS
BAT Industries	Bank,SIB
Legal & General	Bank,SIB
Municipal Mutual Insurance	Bank,SIB
Norwich Union	Bank,SIB
Provincial Insurance	Bank,SIB
Scottish Amicable Life	Bank,SIB

(b) BANK LEAD REGULATOR

	OTHER REGULATORS
BAII	SIB
BankAmerica Corp	SIB
Bankers Trust New York Corp	SIB
Bank of Scotland	DTI,SIB
Barclays Bank	DTI,SIB
Baring Bros & Co	SIB
Britannia Arrow (Singer & Friedlander Ltd)	DTI,SIB
Brown Shipley	DTI,SIB
Citicorp	DTI,SIB
Guinness Peat	DTI,SIB
Hambros	SIB
Hill Samuel	DTI,SIB
Hong Kong & Shanghai Banking Corporation	SIB
Kleinwort Benson Lonsdale	DTI,SIB
Lazard Bros	SIB
Lloyds Bank	DTI,SIB
Mercantile House (Alexanders Discount plc)	DTI,SIB
Mercury International (S G Warburg & Co Ltd)	SIB
Midland Bank	SIB
Morgan Grenfell	DTI,SIB
National Westminster Bank	SIB
N M Rothschild	SIB
Prudential Insurance Co of America (Clive Discount Co Ltd)	DTI,SIB
Rea Bros	SIB
Robert Fleming	DTI,SIB
Royal Bank of Scotland	DTI,SIB
Schroders	DTI,SIB
Security Pacific Group	DTI,SIB
Standard Chartered Bank	SIB

FIRST CATEGORY CONTINUED	OTHER REGULATORS
(c) SIB LEAD REGULATOR	
Aitken Hume International plc	DTI, Bank
Financiere Credit Suisse First Boston	Bank
Goldman Sachs & Co	Bank
Merrill Lynch & Co	Bank
Nomura Securities Company	Bank
Quayle Munro Ltd (McNeill Pearson)	DTI, Bank
Smith & Williamson	DTI, Bank
Societe Centrale de Groupe des Assurances Nationales (Minster Trust Ltd)	DTI, Bank

SECOND CATEGORY

OTHER REGULATORS

(a) DTI LEAD REGULATOR

Company	Other Regulators
Aetna Life & Casualty Co (USA)	SIB
AMEX NV (Netherlands)	SIB
Canada Life Assurance Co (Canada)	SIB
Confederation Life Assurance Co (Canada)	SIB
Co-operative Wholesale Society	Bank
Laurentian Group (Canada)	Bank,SIB
Lincoln National Corporation (USA)	SIB
Manufacturers Life Assurance Co (Canada)	SIB
National Nederlanden NV (Netherlands)	SIB
Prudential Corporation	SIB
Refuge Group	Bank,SIB
Scottish Equitable Life Assurance Society	Bank,SIB
Scottish Mutual Assurance Society	Bank,SIB
Standard Life Assurance	Bank,SIB
Sun Alliance & London Insurance	SIB
Swiss Life Insurance & Pension Co (Switzerland)	SIB
Vesta Group (Norway)	SIB

(b) BANK LEAD REGULATOR

Company	Other Regulators
American Express Co	SIB
Amsterdam Rotterdam Bank	SIB
ANZ Banking Group	SIB
Argyle Trust plc	DTI,SIB
Associates Capital Group	DTI
Bank Leumi le-Israel	SIB
Bank of Tokyo Ltd	SIB
Banque Nationale de Paris	SIB
Beneficial Corporation	DTI,SIB
Burns Anderson plc	SIB
Business Mortgages Trust plc	SIB
Cater Allen	SIB
Chancery Securities	SIB
Chase Manhattan Corp	SIB
Chemical New York Corp	SIB
Close Bros Group plc	SIB
Fairmount Trust	SIB
Financial and General Securities Ltd	SIB
First Interstate Bancorp	SIB
First Chicago Corp	SIB
Gerrard & National	SIB
Henry Ansbacher	SIB
Irving Bank Corp	SIB
J P Morgan & Co Inc	SIB
King & Shaxson	SIB
Knowsley & Co	SIB

SECOND CATEGORY (CONTINUED)	OTHER REGULATORS
Liechtenstein UK Ltd	SIB
London Investment & Trustee Co Ltd (N H Woolley & Co Ltd)	SIB
Manchester Exchange Group Ltd	SIB
Manufacturers Hanover Corp	SIB
Mellon National Corp	SIB
Minories Finance Ltd	SIB
Monte dei Paschi di Siena Group (Italian International Bank plc)	SIB
Moorgate Mercantile Holdings plc	DTI,SIB
NCNB Corp (National Bank of North Carolina)	SIB
P K Banken (English Trust plc)	DTI,SIB
Provident Financial Group of Bradford plc (Peoples Trust & Savings;H T Greenwood)	DTI
Rathbone Bros	SIB
Robert Fraser & Partners	SIB
Royal Bank of Canada Group	SIB
Royal Trust Co of Canada	SIB
Saudi International Bank	SIB
Second Poore Ltd (Federated Trust Corp Ltd)	SIB
Swinton (Holdings) Ltd (Munshul Trust Ltd)	SIB
Swiss Bank Corporation	SIB
TSB	DTI,SIB
Tullett and Tokyo Forex International Ltd	SIB
Union Bank of Switzerland	SIB
Union Discount Company of London plc	SIB
United Bank of Kuwait (The)	SIB
Wallace Smith Group Ltd	SIB
Walter Duncan & Goodricke plc (Duncan Lawrie Ltd)	SIB
Westpac Banking Corp	DTI,SIB
Worms & Co Ltd (The Heritable & General Trust Ltd)	SIB

(c) SIB LEAD REGULATOR

The Bestwood plc (Barrie Vanger & Co Ltd)	Bank
Brint Investments plc	Bank
British and Commonwealth Shipping (Cayzer Ltd)	Bank
Burnbank Trust Ltd (The)	Bank
Charter Consolidated plc	Bank
Cue & Co	Bank
Dartington Hall Trust	Bank
Foreign & Colonial Investment Trust plc	Bank

SECOND CATEGORY CONTINUED	OTHER REGULATORS
Frizzell Group Ltd (Shawlands Securities Ltd)	Bank
Goode Durrant & Murray Group plc	Bank
Granville & Co Ltd	Bank
Hanover Acceptances Ltd (Chesterfield Street Trust Ltd)	Bank
Industrial Finance & Investment Corporation plc	Bank
James Finlay Corporation	Bank
London Law International Ltd	Bank
Matheson & Co Ltd	Bank
Pointon York Group Ltd	Bank

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THIRD CATEGORY	OTHER REGULATOR
(a) DTI LEAD REGULATOR	
Abbey Life Assurance plc	SIB
Alexander and Alexander Services Inc (USA)	SIB
Clerical, Medical & General Life Assurance Society	SIB
Electrical Contractors' Insurance Co Ltd	SIB
Equitable Life Assurance Society	SIB
Equity & Law Life Assurance Society	SIB
Friends Provident Life Office	SIB
FS Assurance Ltd	SIB
General Accident Fire & Life Assurance Corp plc	SIB
Guardian Royal Exchange Assurance plc	SIB
London & Manchester Group	SIB
Marine & General Mutual Life Assurance Society	SIB
National Farmers Union Mutual Insurance Society Ltd	SIB
National Provincial Institution	SIB
Pearl Assurance plc	SIB
Providence Capitol Life Assurance Ltd	SIB
Provident Mutual Life Assurance Society	SIB
Reliance Mutual Insurance Society Ltd	SIB
Royal Insurance plc	SIB
Royal London Mutual Insurance Society Ltd	SIB
Scottish Life Assurance Co	SIB
Scottish Provident Institution	SIB
Scottish Widows Fund and Life Assurance Society	SIB
Sun Life Assurance Society plc	SIB
(b) BANK LEAD REGULATOR	
Al Baraka Int Ltd	SIB
First National Finance Corporation (First National Securities Ltd;TCB Ltd)	DTI,SIB
Great Universal Stores	DTI,SIB
House of Fraser (Harrods Trust Ltd)	SIB
Household International Inc (HFC Trust & Savings Ltd)	DTI,SIB
(c) SIB LEAD REGULATOR	
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ANNEX E

DISCLOSURE OF INFORMATION

The Financial Services Act 1986 provides for the modification of statutory obstacles to the disclosure of restricted information obtained under that Act or under banking, insurance companies or companies legislation. All these modifications have now been brought into force, so that this information can be disclosed to assist the Secretary of State or the Bank of England to discharge their functions. The information can also be given to The Stock Exchange in connection with its functions as competent authority for listing (or its existing functions under the Prevention of Fraud (Investments) Act 1958).

Restricted information cannot normally be given to SIB at this stage, but when it becomes the designated agency in the Spring of 1987, it will be fully integrated into the system for sharing information. Similarly once the self-regulating organisations receive recognition from SIB, in the Summer of 1987, they will be able to receive information in connection with their functions as recognised SROs.

These provisions do not apply to information which is not subject to statutory restrictions, such as that obtained under insolvency legislation, or supplied under the Insurance Companies Act where the formal investigation powers have not been invoked. Such information can be given to other regulators where relevant to their functions if there is no specific impropriety involved in doing so.

ANNEX F

EXTRACT FROM "SIB'S APPROACH TO ITS REGULATORY RESPONSIBILITIES"

CO-OPERATION WITH OTHER REGULATORS, AND THE "LEAD REGULATOR" ARRANGEMENTS

1 SIB is able and willing to co-operate, by sharing of information and otherwise, with the Secretary of State and other authorities, bodies and persons having responsibility for the supervision or regulation of investment business and other financial services. As far as concerns the sharing of information it will, of course, comply with the restrictions on disclosure in section 179 of the Act.

2 SIB expects to have close relations with other UK investment business supervisors and regulators. It proposes to enter into a Memorandum of Understanding on mutual co-operation and exchange of information with the SROs and other bodies it recognises, and expects to have close relations with the Secretary of State. It has already established relations with the other main UK supervisors and regulators. It also welcomes the initiatives taken by the Government in promoting international co-operation in this area and has itself begun to establish contacts overseas.

The "Lead Regulator" Arrangements

3 SIB recognises that for lead regulator arrangements to operate successfully it is important to develop common standards of financial resources requirements in relation to investment businesses, both within the financial services sector and, where possible, across other regulatory regimes.

4 There will be two distinct and separate types of "lead regulator" arrangements which SIB will promote to cater for situations where businesses are subject to supervision by more than one regulator. Both types might occur either where businesses are members of more than one SRO and/or authorised by SIB or where businesses which are authorised under the Financial Services Act are also supervised under a separate regulatory regime, such as those governing banks, building societies and insurance companies. The two types of arrangements are as set out below:-

A Arrangements for the consultation and sharing of information between regulators with a regulatory interest in the same group or firm

5 The purpose of these arrangements is to ensure adequate and effective liaison between regulators in monitoring a supervised group or firm. The consultation and sharing of information will principally relate to matters of financial supervision, although information concerning business conduct and other matters will also be shared where appropriate. The sharing of information and of matters of concern, and the identification of gaps in the regulators' combined information about the organisation concerned, will enhance the quality of the regulators' perspective of the supervised group or firm. This work will also include an assessment of the implications of the exposure of regulated entities to difficulties arising from unregulated parts of the group. These arrangements will ensure that regulators have oversight of groups where an individual regulator is responsible for the day to day supervision of only a part.

6 Meetings for the sharing of information will normally be called by the designated lead regulator and will take place on a regular (probably annual) basis as well as on an ad hoc basis. Where groups of firms are subject to more than one regulatory regime, the selection of the inter-regime lead regulator will be done in consultation with and agreed with the appropriate regulatory authorities, eg Bank of England, Department of Trade and Industry. (In those cases where it is agreed the lead regulator should come from the Financial Services sector, it should be noted that which SRO, or SIB itself, performs this function will only be clarified when firms finally decide what corporate structures they wish to adopt, and which SROs they wish to join.)

7 These arrangements for meetings should also enable each regulator to consult and, where appropriate, co-ordinate action with other regulators when it is considering taking, or has decided to take, disciplinary measures or other enforcement action. Each regulator will remain responsible for discharging his responsibilities under the relevant legislation. It is expected that the lead regulator will also have a responsibility to keep under review the effectiveness of the arrangements on a case by case basis.

B Arrangements for the delegation of financial monitoring by an SRO or by SIB

8 Where more than one regulator has responsibility for supervising the financial position of a single firm (or of the firms within a group), the Act permits an SRO or SIB to make arrangements whereby the task of day to day financial monitoring can be delegated by one regulator to another, provided that the recognising body is satisfied as to the adequacy of the arrangements to be applied by the body to which monitoring has been delegated. SIB will encourage the use of these arrangements provided that the monitoring arrangements to be applied are commensurate with those of SIB or the SRO. They are designed to avoid imposing unnecessary duplication or conflict of financial reporting requirements upon the supervised firm, and also to avoid overlap of supervisory effort and resource on the part of the regulators. However, SIB recognises that these arrangements are voluntary and that under the law it must be entirely at the option and judgement of the individual regulators whether such arrangements should be made, since any delegation will not reduce the ultimate responsibility of the regulator who so delegates. The nature of the arrangements made by an SRO for the delegation of monitoring will be subject to approval by SIB on the recognition of the SRO and will be kept under review thereafter.

9 Differences between the areas of expertise, supervisory methods and financial resources rules of SROs and, in the case of other regulators (non-financial services), differences of regulatory objective are such that in some cases it may be difficult to formulate arrangements which do not weaken the rigour of SIB's or SROs' financial supervision of authorised firms.

10 The arrangements made are likely to differ from case to case depending on the nature and preponderance of firms' business activities and on the degree of similarity and compatibility between the regulators' rules and methods.

1315/4

APPOINTMENTS IN CONFIDENCE

FROM: MRS R LOMAX
DATE: 2 March 1987

PRINCIPAL PRIVATE SECRETARY

cc: PS/Economic Secretary
Sir P Middleton
Mr Cassell

NOMINATED MEMBERS FOR LLOYD'S

One of the key recommendations of the Neill Committee was the addition of four new nominated members to the Council of Lloyd's, matched by a reduction in the number of working members. Four of the present working members offered their resignation at the beginning of February, and the Chairman of Lloyd's has now put forward four names for the Governor's approval as nominated members. I understand that the Governor is minded to approve these recommendations but, before doing so, would like to know that the Chancellor has no objection to any of them.

2. They are:-

Sir Philip Shelbourne	- Chairman, Britoil
Sir Maurice Hodgson	- Chairman, British Home Stores, formerly Chairman, ICI
Brian Pomeroy	- Touche Ross, Member of the Neill Committee
Elizabeth Freeman	- Fellow, Clare College, Cambridge; Lecturer in Law cv attached

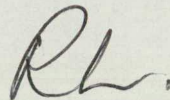
3. The Chancellor will know the first two. There is no reason why Sir Philip Shelbourne should not take on other City responsibilities eg Chairman of the Takeover Panel, in addition to serving on the Council of Lloyd's, if that seemed a good idea. As for Sir Maurice Hodgson, I suspect the connection is Dunlop: he was a senior non-executive director during Alan Lord's time. Brian Pomeroy is 40ish, and pretty bright: known to me, and no doubt others here, and, in my view, a good

choice. As far as the Bank are aware, Mrs Freeman has no previous connection with Lloyd's: she is a token woman (much needed, in the case of Lloyd's), who apparently has the merit of being young, bright, "personable" and legally trained. I am not sure where the name came from: nor do I know her.

4. For the record, the existing nominated members are:-

Alan Lord CB
Sir Kenneth Berrill KCB
Edward Walker-Arnott
Alan Hardcastle.

5. Could you please let me know if the Chancellor takes violent exception to any of Peter Miller's suggestions? (No doubt the approach via me rather than you reflects the Bank's assessment of the constitutional niceties!)



RACHEL LOMAX

cv

FREEMAN, Mrs. Elizabeth

Born : 1949
Married : 3 Children
Educated: Grove Park Grammar School, Wrexham, North Wales;

Girton College, Cambridge;
Exhibitioner for 2 years; followed by Scholar.
First Class Honours - Law Tripods;
First Class Honours - LLB.

Harvard Law School;
Kennedy Scholarship.
LLM.

Institue d'Etude Europeennes, Brussels.
Licence en Droit Europeenne.

Barrister - Middle Temple

Pupil to: Oliver Weaver
24, Old Buildings,
Lincoln's Inn.
and
Anthony Hollgarten,
3, Essex Court.

1973 - 1976 - Lecturer, University College, London;

1976 - present - Fellow, Clare College, Cambridge; Lecturer in Law.

- 1978 - present - Member, College Finance Committee;
- 1979 - 1985 - College Admissions Tutor.

Trustee, Oakham School.

Recreations: Music

HOME ADDRESS: 21, Clarkson Road,
CAMBRIDGE.
CB3 OEH

MR 9/65

APPOINTMENTS IN CONFIDENCE

pmp

FROM: A C S ALLAN
DATE: 3 March 1987

MRS LOMAX

cc: PS/EST
Sir P Middleton
Mr Cassell

NOMINATED MEMBERS FOR LLOYD'S

The Chancellor has no objection to the proposed new nominated members to the Council of Lloyds.

ACSA

A C S ALLAN

Ch

PS/Gov tells me that Gov is still canvassing names for Take Over Panel (and for BBS, SIB & SE @ same time!). Phillip Shelbourne is one of the possible names, & the Gov will be seeing him on Wednesday week. (The Gov – and others – had taken Lord Shawcross's description @ X to encompass many of his qualities).

Review of powers & functions of TO panel proceeding separately – John Cairns hopes to finish it before he goes to ODA in April.

AA

From: Sir G.Littler
Date: 5 March 1987

Thanks, Eric

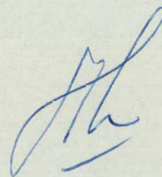
MR ALEX ALLAN

NIKKEI CONFERENCE ON TOKYO FINANCIAL MARKET

The Japanese newspaper, Nihon Keizai Shimbun, is running this conference in London on 12-13 March. I attach the programme. I agreed some time ago, after consulting Sir Peter Middleton, to be one of the opening speakers, alongside Toyoo Gyohten, and to speak on "Developing the Global Financial Market".

2. The Chancellor might like to be aware of this in advance, although I doubt whether it will attract much publicity. He may also like to glance at the attached text I have prepared - which contains nothing really new, but takes the opportunity of urging more liberalisation in Tokyo.

3. I understand that Mr Howard will be attending the closing dinner, and I am sending a copy of my text to his secretary.



(Geoffrey Littler)

Ch
Speech looks OK.

AA

DEVELOPING THE GLOBAL MARKET

Speech by Geoffrey Littler, H.M.Treasury

- - - - - - - - - - -

I am delighted that Nikkei have decided to hold this - their first conference of its kind - in London. I congratulate them too - because their choice of London is of course entirely appropriate and shows their sound knowledge and judgment.

London has had a particularly important role over many years in the development of international financing and has shown a remarkable ability to adapt to dramatic changes which might in prospect have seemed likely to threaten its position.

The success of the City was for a long period built on one of the most advanced of the newly industrialising economies of the first industrial revolution, on an extensive empire, and on the major part that empire played in opening up world trade. Sterling was for a time the dominant currency in financing world trade.

Empire is no more. Britain has not been the leader of the more recent industrial and technical revolutions. Sterling is no longer the dominant currency in international trade.

Yet London has retained its position in spite of all these changes.

In doing so it has been able to draw on a network of contacts and communications world-wide, and on a wealth of knowledge and experience, all developed in the past but adaptable to the needs of the modern world.

But there has been another advantage - one which has been encouraged for a long time and has made an enormous contribution. That is the way in which London has over many generations welcomed foreign institutions and individuals to come here and pursue their business on equal terms with British institutions and individuals. This has added to the richness and variety, to the contacts and the expertise, and to the competitiveness and effectiveness of the City as a whole in world finance. No other world centre has nearly as many different institutions of different countries operating fully and freely in it as London.

We want to keep it that way - as is amply demonstrated by the major changes which have taken place over the past few months. These changes have been encouraged by the authorities, whether government, central bank, or institutions such as the Stock Exchange whose merger with ISRO now admits foreign houses to membership.

Let Tokyo please take note. (I have said something of the kind several times to Toyoo Gyohten from the opposite side of the negotiating table. It is a special pleasure to say it here and from the same side of the table).

And so I am particularly pleased and honoured that Nikkei have invited me to offer some remarks before you get down to the serious educational parts of your programme. During these two days in London you will be hearing many speakers with extensive and direct experience of different aspects of the global arkets. They are speakers who have indeed individually contributed - and are still contributing - to the development of those markets.

My themes will be more general. First, I should like to make some comments on the evolution of the global market and to explain why I believe that it has been inevitable - and is also irreversible. I then want to talk about its impact - and about the associated roles and responsibilities of governments and others - on the world economy, on national economies, on the soundness of our financial systems, and on standards of business.

That should be enough for a half-hour!

Inevitable and Irreversible Developments

The phrase "global market" is one of those pieces of jargon whose meaning is obvious - until you try to define it. If we stick to the obvious, we are talking of a market which is in actual and regular practice accessible to and used by a large and important part of the world and which is therefore not limited by national frontiers; by national currencies; by national working hours; or by national institutions.

Over the past twenty years or so, we have seen the emergence of markets with some of these characteristics, growing alongside national markets and serving various special purposes. The most developed of them is the foreign exchange market which certainly operates on a global basis, 24 hours a day, and has been estimated to be handling transactions now with an average daily value of some $200 billion. Euro-dollar markets - in deposits, floating rate borrowing and bonds - have some claim to be global, especially now that they have developed in a variety of currencies and an increasingly bewildering range of instruments.

What is very striking now, however, is the linkages which are developing across markets which were previously much more clearly distinct. And typically the major professional operators look for a place in a wide range of types and locations of markets and themselves provide the closest possible linkages between them.

These developments can be traced to a multitude of causes. Examining a few of those causes should help us to judge whether we are dealing with some temporary and reversible phenomenon, or whether what has happened is likely to be consolidated and remain as a permanent feature of world finance.

There have certainly been some features of the development towards global markets which have been accidental: measures taken by governments which had no intention at all of contributing to novel market developments, but nevertheless did so; measures which could perhaps have been avoided and could be - or even have been - removed or reversed:

- there is no doubt that some of the early growth of the Euro-dollar markets was enormously encouraged by United States domestic regulations whose effect was to drive some types of business offshore; but by the time those regulations were changed, the Euro-dollar markets had so thoroughly established themselves that they survived;

- the removal or reduction of exchange controls in many countries has certainly made easier the international freedom of transfer of funds; such controls could in theory be reimposed - but I doubt whether that would at this stage make more than a modest difference;

- the volatility of exchange rates since the abandonment of the old fixed rate system has certainly provided a most important stimulus to cross-currency transactions, and to cross-border transactions generally; but if we were to revert now to a fixed rate system - and I must say that I do not see any early likelihood of that - I suspect that we would still see flourishing swap and other deals to hedge foreign currency risks or exploit marginal benefits of cost and return.

These are good examples of the ratchet principle. Accidental causes may help to foster a good idea. They may make it particularly profitable or attractive for a time. But once the process has developed, it can well survive the removal of those accidental causes. (Every tax authority knows only too well, from bitter experience, that tax avoidance which may originally have been promoted by the prospect of large gains will continue merrily even when the prospective gains have been reduced!)

The real point is surely that there are much deeper and more substantial reasons for developing global markets, reasons which are likely to be permanent. I would highlight three main reasons: technology, professionalism and diversification.

It was growing ease of transport and communications - the steamship and telegraph and telephone systems - which transformed specialised trade-routes into world markets in commodities and manufactures. By a close analogy the revolution of information technology has broken down barriers of time and place and made world-wide instantaneous transmission of information and instructions a commonplace.

(I hope others of this audience share my sense of delight and excitement in this phenomenon of our generation. When I visit Toyoo Gyohten in his office, I can play with his Reuters monitor, using exactly the same codes I have memorized for my own, to track the Bank of England effective rate index, UK money market rates, or the European parity grid).

It is clear that this novelty is here to stay. It offers not only extra choices and opportunities for lenders and borrowers and investors; it offers also finer margins of cost.

Secondly, the professionalism of the world's main financial systems and institutions has developed apace over the last two or three decades. And this professionalism undoubtedly has a global horizon, simply because it has learned to exploit world-wide opportunities and be attentive to world-wide risks. It is very well informed about national conditions and limitations, but it over-rides them because its own interests and the interests of its clients transcend national boundaries.

Again, I can see no likelihood that this development of professional attitudes and ways of working will be reversed.

Finally, the question of diversification. The world becomes continuously more wealthy and an increasing amount of the wealth is held in marketable forms which offer opportunities for good returns combined with effective liquidity or freedom to vary investments. Wealthy individuals are probably only a small part of the total, which includes working capital and other corporate reserves and the accumulated savings of people world-wide. These assets are nowadays increasingly managed by professionals.

One of the most dramatic growth areas of present times is that of the private pension fund. The United Kingdom came into this field comparatively early, with an enormous rate of growth over the last two decades. Its growth in Japan is likely to be a major influence in world finance over the next two decades. And the investment of accumulated assets - of pension funds and other savings - has become a professional job.

But the professional typically cultivates familiarity with the widest possible range of investment opportunities, and seeks widely diversified portfolios. I see this as another pressure towards global markets which simply cannot be reversed.

Impact of Global Markets

I am not going to spend time on the commercial impact of global markets - the fine margins, the variety of choice, the opportunities for hedging and diversification, the ease of mobilisation and transfer of capital. These seem to me to be from the commercial point of view plainly advantages. You will hear of some of them from other speakers during your programme. Many of you already know far more about them in practice than I do!

I want to explore some of the impacts of the global market which are of particular interest to governments - for better or worse - and indeed present governments with problems.

I shall begin with two effects of the global market on the ability of governments to choose and pursue their desired economic policies. They may be called: discipline and disruption. Neither is new. Both are enormously amplified by the global market.

Discipline on Governments

An important part of the growth of the global market is the scale of financial transactions which have nothing directly to do with payments and receipts necessary to international trade or direct international investment. As much as 90% of daily turnover in foreign exchange markets may be in this form. And typically these transactions take place between different instruments and different currencies, and can put significant pressure on prices and rates from day to day.

This is a very different scenario for government policies from what we were used to a few decades ago. Exposure of the national financial economy to international capital movements has often been important in the past - I myself lived close to a long sequence of difficult occasions for sterling over the years. But there is no doubt that the scale and speed of movements now has gone into a higher gear.

There are countries which still seek the protection of government controls to prevent unwanted transactions from taking place. But the sophistication of modern markets is such that these kinds of restrictions cannot work at all well in practice. A highly sophisticated machinery of control may work effectively in insulating a relatively unsophisticated economy and market from the rest of the world. But for the major countries and economies of the world, it will not do.

All of which leaves economies and governments and their policies uncomfortably exposed to the judgments of international markets.

The plight of a currency which forfeits market confidence is certainly difficult. But if there is good reason for the loss of confidence, the market reaction is more than a signal. There is a real discipline in a system which exacts such a severe and inescapable penalty.

That discipline has now reached formidable proportions. Small deviations - or even suspected deviations - from financial rectitude as perceived by markets can now produce an immediate penalty in the form of huge movements of funds out of the currency in question. It is a more compelling and severe discipline than anything devised by governments or by the International Monetary Fund. It is one which governments, individually and even collectively, find it very hard to resist.

And let us not forget that, although the pressure against a weak currency is the most dramatic, the pressures against a strong currency can also be very powerful - remember the impact of the recent very high US dollar on American trade; ask my Japanese colleague about his concern over the impact on their trade and industry and employment of the appreciation of the yen - and about the options and constraints it offers for Japanese policies.

The bad news in this is that markets are not always right. The plain evidence is that markets can and do sometimes overshoot. They do not move solidly, heavily and persistently for or against a currency or country without cause. But that cause may not be simple - it may even with hindsight appear to be perverse (for example levels reached by the US dollar in the period up to February 1985 which have now been so dramatically changed).

How should the dilemma be resolved?

It will be neither politically comfortable nor technically easy, but let me offer three possibilities - ideas which have already begun to be discussed in and among governments of the industrial countries and which could be constructive responses:

- the pressures will oblige governments to give more weight in their overall economic policies to the value of sustained financial rectitude; and as a result they will be wary of policies of demand management and will instead tend increasingly to look for economic progress through structural policies of education and training, research and development, and the cultivation of freer markets for labour and capital and products;

- individual governments will see advantages in developing cooperation with each other - not to fight markets - but to steer with markets in the direction of sustainable and more stable relationships; this surely is how the Plaza and the more recent Paris agreements should be seen;

- and governments will want to seek a better and shared understanding of economic and financial developments, as a basis for more effective cooperation, and probably try also to develop new techniques of concerted action.

If that sounds too hopeful, let me remind you: I prefaced those three points by saying that they would be not be politically comfortable and they would not be technically easy!

Disruption of Monetary Control

Another area of difficulty for the authorities resulting from the global market arises over the interaction between the domestic financial economy and the rest of the world. The ebb and flow of transactions inevitably has effects on monetary conditions. Unfortunately it also frequently seems to make more difficult the task of reading the various signals of monetary conditions.

Nearly all major countries have been going through unhappy experiences in attempting to track their different monetary aggregates. And while international transactions are by no means always to blame, there is no doubt that they have contributed to the problems on many occasions, and do so increasingly.

The scale of the problem will obviously vary in different countries. I and my colleagues are perhaps especially conscious of it because the United Kingdom is more exposed than most other economies to interaction with the global market.

Plainly more homework is needed - and I suspect we shall often find ourselves afflicted by the "Uncertainty Principle" of the physicist Heisenberg who deduced the absolute impossibility of knowing simultaneously both mass and momentum of the electron - how appropriate that both terms should begin with M!

I draw a little comfort from two reflections. The monetary authorities can read the signs at least as well as anyone else, and better than most. And however sceptical commentators choose to be, I believe one can make reasonable judgments of monetary conditions without slavishly following any one magic number.

Volatility versus Stability

Before I leave the subject of macro-economic effects of the global market, I offer two reflections on the conflicting themes of volatility and stability.

Much of what I have just been saying reflects problems - at least for governments - arising from the volatility of movements in global markets, of flows of funds and of prices. But it seems that international financial markets also have the ability to absorb and cushion imbalances between major countries for quite long periods.

There is something of a paradox here. On the one hand, we see an expanded market able to force government policies to respond more quickly; on the other hand that same market can absorb imbalances and allow time for their correction - or even time for the imbalances to grow to a potentially damaging scale.

My second reflection is of a different kind. I make no apology for dragging in the subject of international debt, which must preoccupy many of us a good deal. I imagine that most would agree - with hindsight - that the forms in which debt has been incurred by many of today's problem sovereign debtors were not the most suitable to the condition and needs of those debtors, however attractive they seemed at the time they were incurred.

Are there possibilities that participants in the global market could, for the future, be interested in and capable of developing more appropriate forms of equity and other long-term investments in some of these developing countries and so market them as to leave them widely held?

Regulation of Standards

On a quite different theme the global market presents both the authorities and the market-makers and participants with new challenges to the quality and integrity of financial business. I deliberately bracket together in this both the authorities on the one hand and the market-makers and participants on the other, because it seems to me that they have some common interests, and each will need help from the other.

It has often been remarked that standards - of ethics and of competence - of business in the Euro-dollar markets have been high, and that this has come about without any formal supervision or even jurisdiction over an essentially offshore market on the part of governments and their central banks. These markets have of course been in general built up and operated by a fairly homogeneous and close-knit collection of professionals from the financial communities of the major countries, - much the same professionals who are now building the wider global market.

That example may well show that market professionals can be both aware of the importance to themselves of good reputation and able to foster it by their behaviour. But there have been other and less happy examples which point to the need for some framework of regulation and supervision.

The fact that global markets are bringing together people and institutions from different cultures, accustomed to different practices and different standards, obviously adds to the problem. We cannot afford to rely on the hope that markets will find good answers themselves. And we need to move as fast as possible.

You will be able to listen to Kenneth Berrill tomorrow speaking of the need for international cooperation in market regulation, which has become a high priority for the authorities of the countries mainly concerned. I hope that you will see this as a problem in which authorities and the markets themselves have the same interest, and need to cooperate closely together.

I think the approach we have adopted in London to the task of regulating markets going through major and rapid changes of conditions and practice illustrates the value the authorities in this country place on the knowledge and experience of markets in creating and managing a good system of regulation.

The Role of Tokyo

I end with some remarks about Tokyo and the Japanese place in the global market - on which much of this Conference will be focussing.

Japan earns a key role in the global market - and that market needs full Japanese participation - for several reasons which are fairly recent, but certainly will remain with us for years to come:

- the second largest free-world economy with one of the wealthiest populations;
- the largest owner of net foreign assets, (having a year or so ago displaced the United Kingdom from that top position);

- one of the largest banking systems and one of the largest stock markets in the world;

- a country with a very high savings ratio, a demographic prospect which points to rapidly growing future needs for pension provision, and a growing interest in professional and international management;

- liable to continue to run current account surpluses for some time ahead - even if we hope to see the size lower - which makes the international deployment of domestic savings inevitable.

But for Japan the prospect contains many novelties. The Japanese financial economy has spread out into all parts of the world in recent years, but at home it remains in many ways still locked into its traditional institutional and cultural patterns. The structure of banking at different levels, the limited access to the Stock Exchange, the rigidity of money markets, the role of savings institutions, the control of many interest rates - all these are examples of rigidities which do not fit at all well with the global market; they also make it in many cases difficult for foreign houses to enjoy in Tokyo the genuine competitive freedom which is available to them and to Japanese houses in London.

I warmly welcome the steps towards liberalisation of their markets and the increased willingness to licence foreign houses which my Japanese colleagues have taken and shown over the last two or three years. But there is still a long way to go - by the standards of London certainly - and there are forces of resistance within Japan.

I hope and believe that the process will be carried further and I applaud Conferences of this kind for the contribution they can make to encouraging it.

Thank you.

1315/36

APPOINTMENTS IN CONFIDENCE

FROM: MRS R LOMAX
DATE: 16 March 1987

PRINCIPAL PRIVATE SECRETARY

cc: PS/Economic Secretary
Sir P Middleton
Mr Cassell

NOMINATED MEMBERS FOR LLOYD'S: PART 2

Earlier this month the Bank sounded us out about four names to fill the new nominated members slot to the Council of Lloyd's. The Council have now told Peter Miller that they would like a longer list from which to make their selection. Accordingly, Peter Miller and the Governor have come up with the following additional names:

Lord Limerick	-	Kleinwort Benson
Robin Dent	-	Barings
David Hopkinson	-	M & G
Lord Chorley	-	Coopers & Lybrand.

Both dropped out.
Replacement
Trevor Holdsworth GKN etc
Jeremy Morse

2. All four will be known to the Chancellor - save possibly for Robin Dent, whom he may recall was an earlier suggestion for the Board of Banking Supervision. As before, the Governor would like to be assured that the Chancellor sees no objection to these names, before he gives them his blessing. He would be grateful for an early response: following the article by Christopher Fildes in today's Telegraph, there is a general desire to get a move on before there are any further leaks. (Incidentally, I was interested to see that the name of the token woman did not leak: I will be most surprised if she makes it to the Council of Lloyd's!)

RL

RACHEL LOMAX

3756/005

APPOINTMENTS IN CONFIDENCE

FROM: P D P BARNES
DATE: 18 March 1987

PS/CHANCELLOR

cc: Sir P Middleton
Mr Cassell
Mrs Lomax

I know Chorley well & am content with all 4 @ X in.

NOMINATED MEMBERS FROM LLOYDS: PART 2

The Economic Secretary has seen Mrs Lomax's minute to you of 16 March.

2. The Economic Secretary has commented that he does not know Lord Chorley, but the other suggested names are fine.

PB

P D P BARNES

Ch

I held this back because PS/Gov said names were changing. Latest list of additions is

X
- Dent
- Chorley
- Holdsworth
- Morse

OK? Lloyd's meet Tuesday & would like to know before then. AA

298/19

APPOINTMENTS IN CONFIDENCE

FROM: F CASSELL
18 March 1987

CHANCELLOR

cc Economic Secretary
Sir P Middleton
Mrs Lomax
Mr Ross Goobey

NEW NAMES FOR THE SIB

DTI and the Bank are giving some preliminary thought to possible new members for the SIB. There are likely to be two vacancies. Sir Martin Jacomb is standing down this May and (almost certainly) so also is Stormonth-Darling (of Alexanders, Laing and Cruickshank).

For the deputy chairmanship, the Bank seem to be thinking of Ralph Quartano. He has apparently been an effective and independently-minded member of the SIB, and should have more time to devote to it when he gives up the chairmanship of PosTel later this year. He is a member of the little group of pension fund managers I see from time to time and he certainly is an impressive, if sometimes quirky, performer with an extensive knowledge of markets. But whether he has the personality, or inclination, to provide an adequate counter-weight to Mark Weinberg, is perhaps the question. That seems to have been lacking up to now, and one would hope that the reconstitution of the Board would produce a better balance.

I gather that Rachel Waterhouse still has her supporters for a deputy job, and that the idea of having 3 deputy chairmen is being entertained. It does not seem to me to have much to commend it. DTI and the Bank see it as a possible way of strengthening the lay element on the Board. An alternative, favoured by (some at) DTI but not by the Bank, would be to replace one of the retiring practitioners by a lay person, or to increase the size of the Board to 19 by adding a new lay member. This concern for more lay representation apparently stems from DTI Ministers' wish to meet the strong Parliamentary pressure for a move in that direction.

For the new practitioner member(s), three names are running:-

Simon Garmoyle of Warburgs;

Alex Hammond-Chambers of Ivory & Sime (who has also got useful regulatory experience as a member of the American NASDAQ);

John Craven (formerly a deputy chairman of Warburgs and active dealer in Eurobonds, now running his own - reportedly very successful - consultancy agency: Phoenix Securities).

X

You probably know all three. They look reasonably good candidates, though they may not be easy ones to entice into SIB. If Quartano replaces Jacomb, there could be room for all of them.

Finding suitable names for a new lay member, if there is to be one, is proving more difficult. The current list is:

Alan Peacock

Alan Budd

Heather Brigstocke (High Mistress of St Paul's School)

Peter Mathias (Professor of Economic History at Oxford)

Anne Warburton (Lucy Cavendish College, Cambridge, ex Lazards much earlier)

Mervyn King (LSE and joint author with John Kay of "The British Tax System".)

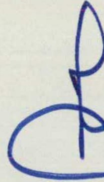
Michael Franklin (retiring later this year from MAFF)

Peacock seems to be emerging as the most favoured candidate (the Governor feels he has a good background), but without much enthusiasm.

It seems to us that Alan Budd or Mervyn King or possibly Professor Mathias would be stronger candidates. The first two have the sort of expertise that should be useful on the SIB. Mathias is known here to Rachel Lomax, and has the

distinction of turning her from history to economics! He has a reputation for pragmatism but is not well known outside academic circles and is rather remote from the securities markets. Peacock's main appeal appears to be that his name is likely to be well known among the MPs pressing for more lay membership.

I understand that the Governor was intending to have a word with you about Peacock's credentials, but that the opportunity did not arise when you last met. It would be very helpful to know if you have any strong views of him or on any of the other possible candidates mentioned above.



F CASSELL

3756/019

APPOINTMENTS IN CONFIDENCE

FROM: P D P BARNES
DATE: 19 March 1987

PS/CHANCELLOR

cc: Sir P Middleton
Mr Cassell
Mrs Lomax
Mr Ross Goobey

NEW NAMES FOR THE SIB

The Economic Secretary has seen Mr Cassell's submission to the Chancellor of 18 March.

2. The Economic Secretary has commented that the list of candidates for the new practitioner member(s) would give Warburgs a chance to put their money where their mouth is. The Economic Secretary thinks that Mr Hammond-Chambers is also sensible.

Guy Westhead.
PP P D P BARNES
Private Secretary

APPOINTMENTS IN CONFIDENCE

FROM: F CASSELL
20 March 1987

CHANCELLOR

cc PS/Economic Secretary
Sir P Middleton
Mrs Lomax
Mr Ross Goobey

NEW NAMES FOR THE SIB

I gather that Sir Ian Fraser, who retired from Lazards in 1985, is getting bored with farming. The Governor is thinking that he might make a good deputy chairman of the Takeover Panel and also strengthen the membership of the SIB. Sounds promising.

F CASSELL

Ian Fraser, I think would be good enough, would be excellent in this dual role. [illegible] would be a better Dep-Chairman of the SIB [illegible] than [illegible] suggestion

NEW NAMES FOR SIB

1255/20

APPOINTMENTS IN CONFIDENCE

FROM: A ROSS GOOBEY
DATE: 24 MARCH 1987

CHANCELLOR

cc Economic Secretary
Sir P Middleton
Mr Cassell
Mrs Lomax

When do I next see Gov?

— Alex

I can't see anything in diary. Do you know?

NEW NAMES FOR THE S.I.B.

I know Garmoyle and Hammond-Chambers well and would agree they are both good candidates.

2. Ralph Quartano seems too quirky to make a satisfactory foil to such a strong proselytiser as Mark Weinberg.

3. Sir Ian Fraser would, on the other hand, not allow himself to be pushed into unreasonable decisions which might favour the MIBOC camp against the original SIB interests.

4. If Mark Weinberg were to resign following an adverse decision on polarisation, an equally able but probably not a single-minded head of a direct sale life company, Michael Hepher of Abbey Life would be a strong candidate.

5. Looking for a countervailing character to balance SIB might lead to considering David Hopkinson (just ex-M&G) who has been a rabid opponent of conflicts of interest (probably going over-the-top in the process).

ARG

A ROSS GOOBEY

APPOINTMENTS IN CONFIDENCE