PO-CH NL|0138

PART A

Alex
Lawson

PART A

SECRET

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PO -CH /NL/0138
PART A

CHANCELLOR'S 1986 PAPERS
ON BANKING LEGISLATION

Begins: 17/1/86
Ends: 22/9/86 (CONTINUED)

DD: 25 years

5/9/95

1783/001

17 JAN 1986

RESTRICTED

FROM: M A HALL

17 January 1986

1. ECONOMIC SECRETARY

2. CHANCELLOR

c c Sir P Middleton
Mr Cassell
Mr Kemp
Mr Peretz
Miss J Kelley
Mr Board
Mr D Jones
Mr Saunders
Mr Watts

Mr Bridgeman)
Mr Davies) RFS

Mr Nicolle Bank

Mr Brummell T. Sol

APPEALS UNDER THE NEW BUILDING SOCIETIES AND BANKING LEGISLATION

In October you (Chancellor) agreed to end your role as arbiter of appeals, leaving the final decision to a tribunal. This submission makes further detailed proposals which, if you approve, will form the basis of instructions to Parliamentary Counsel for building societies and, on a provisional basis, for banks. The key features would be:-

(a) Tribunals to comprise three members:-

(i) A legal chairman of a number of years standing appointed by the Lord Chancellor;

(ii) One accountant, appointed by you;

(iii) One bank or building society practitioner, also appointed by you.

(b) Right of appeal against failure to authorise, revocation of authorisation, conditions imposed on authorisation or, (including, in the case of building societies,

individuals named as not fit and proper) in the case of banks, statutory directions given by the supervisors, or refusal to approve a potential controller.

(c) Revocation of authorisation would be stayed during appeal. Conditions or statutory directions would however continue to apply during proceedings unless tribunal directed otherwise - presumably at a preliminary hearing for the purpose.

(d) Tribunal restricted to considering whether the supervisory body was justified on the facts before it at the time, or in law, in reaching its decision, and had followed the proper procedures. Where appropriate it would be required to consider separately whether the supervisor was justified in his decision that the institution was not suitable for "unconditional authorisation" and whether he was justified in his decision on the action required. It would not conduct a hearing "de novo" or substitute its judgment on the balance of argument for that of the supervisor.

(e) Tribunal empowered to quash the supervisor's decision if it decides his finding that the institution was not suitable for "unconditional authorisation" was not justified.

(f) If tribunal finds that conclusion was justified, but the remedy proposed was not, it conveys its decision and reasons to both parties, invites the supervisor to suggest different conditions, hears representations from societies and then decides what conditions should be substituted.

(g) Tribunal to operate expeditiously. This to be encouraged by:-

(i) Having sufficiently large panels of members and chairmen as to speed appointment of a tribunal and fixing of date; and

(ii) Empowering the Chairman, sitting alone, to discover documents and agree evidence;

(h) Basic procedure to be determined by secondary legislation as under the Banking Act 1979. On matters not affected by the proposals above, the existing Banking Act Regulations to be used as a model, subject to review by officials of experience to date. Within this framework the tribunal itself to have discretion to determine procedure.

(i) Existing presumption of a public hearing to continue. But tribunal to have discretion to accept representations from either party for a private hearing, as now. (For confidence reasons, especially for building societies we would expect some, if not most, hearings to have to be heard in private).

(j) Both parties to have the right to withdraw their appeal/decision at any point before or during the hearing (to avoid the need to hold a hearing to enable them to withdraw, as now).

(k) Treasury to provide the secretariat for the tribunals, but the staff involved not to be drawn from a division in regular contact with the supervisors concerned.

(l) Further appeals to the Courts against the decision of a tribunal to be permitted only on matters of law (- but on other matters applications for judicial review would of course lie where appropriate).

2. These proposals are described more fully in the attached note for which I am indebted to Mr Evershed. They apply to both Banking Act and Building Society Act appeals - though the degree to which

it is acceptable for these to be treated differently is for political judgement. There is a strong presumption for treatment to be as close as possible, given likely future developments. You will wish to see how the Clauses go in the Building Societies Bill, where they will be a wholly new provision, before deciding whether or how far to amend the existing banking legislation. But the prudent course for the moment seems to be to instruct Counsel for both Bills.

3. These proposals are the fruit of many hours of discussion, and reflect the agreed views of HF, the Bank and the Registry. We have benefited from the advice of the Council for Tribunals and the Lord Chancellor's Department. The scheme represents a delicate compromise between conflicting objectives. On the one hand, there is the need to give the individual institution a reasonable and fair hearing and, more important, to reassure institutions prospectively that they will be reasonably and fairly dealt with. On the other hand, there is the need to avoid the risk of the appeal process being used to frustrate effective supervision, and so the provisions in the two Bills to that end. The Chief Registrar has been concerned that this could arise in particular in relation to the Commission's need to secure sufficient standards of capital adequacy, as societies diversify, with a low capital base. He considers that there would be a substantive risk of this if appeals were allowed against the imposition of conditions, and if the tribunal were then free to hear the matter de novo, and to substitute its own judgment, notwithstanding that it considered that the decision of the Commission was justified. HF have accepted Mr Bridgeman's view that this danger is best met by restricting the scope for the Tribunal in very much the same way as the Secretary of State has restricted the scope of appeals against decisions of the Civil Aviation Authority. He in turn has accepted the need to allow appeals against conditions.

4. We commend these proposals to you.

M A HALL

ANNEX : BACKGROUND AND PROPOSALS IN DETAIL

Background

1. For banks, the Banking Act 1979 provides a comprehensive framework for appeals, and, although there has been a steady stream of appeals (15 cases in 5 years), only rarely have they been pursued to a full hearing (2 cases in the same period). The Act itself provides for appeal to the Chancellor, with a hearing by persons appointed by the Chancellor. Most of the procedural detail is left to secondary legislation. (The relevant clauses of the 1979 Act are attached at annex A).

2. For building societies the Building Societies Act 1962 provides that the powers of the registrar to prohibit the raising of funds are exercisable only with the consent of the Treasury. This consent provision provides some safeguard against patent abuse, though in practice the Treasury frequently finds it virtually impossible to second guess the supervisor. But the provision has enabled, for instance, the Treasury to influence the approach which the Chief Registrar was taking to a class of cases, on which he consulted the Economic Secretary in advance some 18 months ago. In practice the effective check on the Chief Registrar has been judicial review. Major cases, such as the New Cross have gone to that, and, as important, the existence of the possibility of judicial review has imposed a discipline on the way in which the Registry has conducted cases. With the introduction in new legislation and given the existing Banking Act provisions of a more comprehensive system of authorisation you have decided to introduce a formal system of appeals.

3. Under the Financial Services Bill, the Secretary of State's or designated agency's decisions to revoke or suspend authorisation, to use powers of intervention against the business or to disqualify individuals may be referred to the Financial Services Tribunal. This tribunal would be composed of a legal chairman and two other members, one of whom would normally have recent practical experience in business relevant to the case. The function of the tribunal is to investigate the case and to make a report to the Secretary of State or designated agency who will be bound to take whatever

action is recommended. The tribunal's report will be able to choose between a number of different courses of action that are available to the Secretary of State or designated agency concerned. Where institutions or persons are authorised by virtue of their membership of a recognised SRO then it is intended that each organisation's rules should provide for an appeals process in the event of disqualification. Since the FS Bill tribunal is investigative, its foundation will be fundamentally different from our proposals for building societies and banks. (We have argued strongly but unsuccessfully that the FS Bill should follow our approach.)

Proposals

4. These proposals are consistent with earlier decisions except on appeals against conditions imposed on authorisation by the Building Societies Commission where it was recommended and agreed that such appeals should not be permitted (except where an individual was named as not fit and proper).

(a) Composition of the Tribunal

5. The normal practice for an independent tribunal is for the Chairman to be appointed from the legal profession by the Lord Chancellor. The Chairman could be an advocate, barrister or solicitor. To avoid delays in forming a tribunal we recommend that new legislation should not restrict the Chairman to any particular class of lawyer - but should specify simply that he be an Advocate, barrister or solicitor of a number of years standing. The Lord Chancellor's Department advise that 7 years would be an appropriate figure.

6. Although the Act need not specify the administrative details for selection of a Chairman we would expect the Lord Chancellor to create a panel of Chairmen willing to participate. The alternative would be to have a permanent Chairman available - but the paucity of hearings to date suggests that this would be inappropriate.

7. The other members could be any number from two upwards. An accountant and a building society or bank practitioner (for example a retired or non-executive director) would be sufficient. These

would be appointed by Chancellor. The Treasury would have to maintain a panel of people willing to serve.

(b) Subject of Appeals

8. Following the precedent of the 1979 Banking Act, the tribunals would be able to hear appeals against decisions by the supervisor to:-

(i) Refuse to grant authorisation

(ii) Revoke authorisation

(iii) Give statutory directions

(iv) Impose conditions on authorisation.

At an earlier stage we recommended that because the imposition of conditions was a less severe and more technical decision than revocation there need not be a right of appeal against it, since judicial review is always available. In discussion with the Lord Chancellor's Department and the Council on Tribunals, however, we are persuaded that, since a supervisor could impose conditions which could severely affect the business of the institution, the natural justice argument for allowing appeals is likely to be irresistible. Moreover, the tribunal will inevitably have to consider whether conditions would not be an adequate alternative to revocation in particular cases, so it would be most odd to exclude appeals against conditions from its remit. Furthermore, unless we removed the right of appeal against conditions for banks, we would have to justify the difference for building societies where, unlike under the Banking Act 1979, conditions could be imposed without prior revocation.

(c) Scope of Hearing

9. One aspect of the Banking Act 1979 appeals system that has been particularly criticised by the Bank, and by the Registry as a model for building societies, is that it hears the appeal 'de-novo' (ie it considers the whole question of the supervisor's decision

afresh, taking new evidence from the appellant and eventually reaching its own judgement of the case, which it may substitute for that of the supervisor). It is argued that this encroaches on the duty of the supervisor to supervise by setting up another body which may form policy (either directly by challenging the supervisor's judgement on matters of principle, or indirectly by handing down a series of decisions making the supervisor's policy untenable). On the application of policy in individual cases it is further argued that the 'de novo' approach encourages the tribunal to set aside the supervisor's advice too lightly, especially on technical matters, given the relative inexperience of the tribunal in supervisory matters, the lack of continuity in its composition, and its lack of "feel" for the institution. There could be a very real risk of the system of supervision of capital adequacy being frustrated. (See para 3 of Mr Hall's covering submission.)

10. The Council on Tribunals have adivsed us that the greater the expertise of the Tribunal when compared with the decision maker, the more likely it is that the tribunal is to reconsider the whole case. Conversely, where the tribunal were felt to be relatively inexperienced it would follow that their discretion should be limited. We therefore propose that the tribunal should be asked to address itself to the questions of whether the supervisor was justified on the facts before it at the time, or in law, in reaching its decision and had followed the proper procedures. There is no precise precedent for this formula but there are for the elements of it. In particular it is close to the way in which the tribunal under the Civil Aviation Act works.

11. The Treasury Solicitor's preference would still be for de novo hearing on the merits (with the possibility of fresh evidence being admitted). However, he accepts that the present proposals represent a significant improvement over reliance on judicial review alone. The tribunal would be more expert than a court on judicial review and more accessible to the appellant (who would have an automatic right of appeal). Moreover the proposed criterion of whether the supervisor was justified in reaching his decision is a less limited test than that applied on judicial review. The tribunal would be asked to consider the supervisor's decision as

such, and not whether the decision was one that no reasonable supervisor would have reached. It would nevertheless fall short of a full de novo hearing, which would attract the problems identified above.

(d) Powers of Tribunal

12. If the tribunal found that the supervisor's conclusion that the institution was not suitable for "unconditional authorisation" was not justified it could strike down the supervisor's order. There is a choice as to what the tribunal should be empowered to do if, on the other hand, it found that the supervisor was justified on that point, but was not justified in his decision on the appropriate statutory action. One possibility would be to require it to remit the matter back to the supervisor to consider an alternative course in the light of the tribunal's findings. While that would be simple, it runs the risk of protracted delay because the supervisor would have to go through proceedings for hearings again, there would be a further right of appeal and that appeal might be heard by a different panel who knew nothing about the case. We therefore recommend a procedure under which the same tribunal would decide the alternative course, subject to it proving practicable to work out the details of the way this is to be achieved with the lawyers. Where the tribunal finds that the supervisor was justified on the first count but not the second, it should notify him and the society, giving its reasons for both conclusions. If it wishes it could itself suggest a particular alternative course (for example the conditions to be attached to the authorisation instead of its outright revocation). The supervisor would then be invited to respond, either accepting the panel's suggestion if it had made one, or himself suggesting particular conditions. The tribunal would hear representations from both the institution and the supervisor, if the former were not satisfied. The tribunal would itself then decide the conditions. At this stage of the process it would be reasonable to allow either the institution or the supervisor to introduce fresh evidence since, what would then be at issue was not whether the supervisor's original decision was justified, but what were the appropriate conditions for current circumstances. This process would need to be carried out at arms length to avoid any suggestion of collusion between the tribunal

and the supervisor.

(e) Expedition

13. It is important in the interests of depositors for any appeal to be determined quickly. Experience with the two appeals so far under the present banking legislation suggests that additional steps need to be taken to help achieve this (the St Martin le Grand Securities' appeal for example took 10 months). This is not easy. The worst problem has been that of assembling the tribunal, since competent members are usually busy elsewhere. We shall need sufficiently large panels of chairmen and members to increase the chances of assembling a tribunal at an early date. We also propose to empower the Chairman to undertake preliminary actions (this may avoid having to wait for other tribunal members to become available). We would encourage the tribunal to adopt simple, flexible procedural rules. We doubt whether a specific, statutory exhortation to make haste would look like more than a pious hope. Delay will nevertheless continue to be a problem.

(f) Other Procedural Matters

14. Under the present Banking Act, procedural matters are determined by secondary legislation. There is no reason to change that. If you are content we will review the present regulations with a view to using them as a model for regulations under the new Building Societies and Banking legislation. The intention would be to give the tribunal as much discretion to determine its own procedure as possible, so that it could move quickly.

(g) Public/Private Hearings

15. An important aspect of the procedural rules that we think important and worth deciding now is the choice of public or private hearings. The principle that Justice must not only be done but be seen to be done is of vital importance. But deposit-taking businesses depend crucially on confidence and a public hearing could easily force an institution to chose - even if the tribunal found in its favour. In practice the decision by the present tribunal to hear a case in public often results in withdrawal of the appeal. (This is a useful device when the tribunal consider an appeal to be frivolous, but is clearly undesirable when there

is genuine ground for complaint). We therefore recommend that the present presumption in favour of a public hearing is retained, with continued discretion for the tribunal (or its chairman) to accept representations from either party that it be held in private.

(h) Withdrawal of Decision

16. We have also identified one anomaly in than once an appeal has been lodged the Bank of England can neither withdraw their decision nor can the appeal be withdrawn without a formal hearing. We propose that this be rectified.

(i) Secretariat

17. The usual practice is for the 'sponsor' department to provide the secretariat. However, the present position where a single division provides both liaison with the Bank and the secretariat for appeals against the Bank is uncomfortable. To avoid suspicion of prejudice we recommend that in future officials from a division in regular contact with the supervisor concerned should not be used. This would mean that the secretariat would no longer be drawn from HF1 division. The infrequency of cases means that the work need take only a small proportion of the time of somebody engaged primarily on other duties. We are in touch with EOG about this.

(j) Further Appeals

18. The institution is in any case able to apply for judicial review, of the supervisor's or the tribunal's decisions, whatever we put in the Bill. An applicant for judicial review needs to demonstrate that the supervisor had:-

(i) not acted lawfully or in accordance with its statutory powers

or (ii) had failed to observe the requirements of natural justice

or (iii) had taken into account irrelevant considerations

or (iv) had failed to take into account relevant considerations

or (v) that its decision was so unreasonable that no reasonable tribunal on the basis of the facts before it could have taken the decision it did.

The Banking Act 1979 provides for further appeal against the tribunal on points of law. Having provided a specialist forum to hear appeals we see no need to empower the courts to intervene on matters other than of law in the case of building societies either and so recommend that the Banking Act 1979 precedent be followed.

18. On judicial review of the supervisor's decision, in many cases leave for judicial review might not be granted, if the institution had not first exhausted the appeal provisions available to it under the Act. But that would be for the Court to decide and it would be open to it to decide in a particular case that the circumstances were such that it should hear it, without it going to appeal first.

19. If the matter went for appeal first, any judicial review would then be of the tribunal's decision, not of the supervisor's. Either the institution or the supervisor could seek judicial review of the tribunal's decision, if for example it had failed to follow its own procedure, and so not observed the principles of natural justice, or, for example, if it had gone too wide and insisted on taking a de novo hearing.

20. An appeal by either party on a point of law against the tribunal could be dealt with through judicial review. The practical effect of specifically providing for appeal to the High Court on a point of law is that the appeal would then be heard by a Chancery judge, rather than the point being taken on judicial review by a Queens Bench judge : the former might be better suited to the task.

Outstanding Issues

21. We are considering separately how far individuals rather than institutions should have rights on appeal and whether the Bank needs new powers to prevent the taking of new deposits while a appeal is being determined. We will refer these matters, together with new model procedural rules to you in due course.

Appeals

Appeals from decisions of the Bank.

11.—(1) Any institution which is aggrieved by a decision of the Bank—

(*a*) to refuse to grant recognition or a licence to it, or

(*b*) to grant a licence to it on an application for recognition, or

(*c*) to revoke its recognition or licence, or

(*d*) to give it a direction under section 8 above,

may appeal against the decision to the Chancellor of the Exchequer who, in accordance with regulations under section 12 below, shall refer the matter for a hearing before persons appointed for the purpose.

(2) If the Bank revokes recognition or a licence in the exercise of its powers under section 7(1)(*b*) above, then, on an appeal against the decision to revoke, the appellant institution may challenge any of the conditions of the conditional licence granted to it, whether or not it also challenges the decision itself.

(3) On the determination of an appeal under this section, the Chancellor of the Exchequer may confirm, vary or reverse the decision appealed against, and may—

(*a*) take any action which the Bank could have taken at the time it took the decision appealed against; and

(*b*) give such directions as he thinks just for the payment of costs or expenses by any party to the appeal.

(4) Notice of the Chancellor of the Exchequer's decision on the appeal together with a statement of his reasons for the decision shall be given to the appellant and to the Bank and, unless the Chancellor otherwise directs, the decision shall come into operation on such notice being given to the appellant.

(5) Where an institution is successful in an appeal to the Chancellor of the Exchequer against a decision of the Bank to revoke all authority of the institution to carry on a deposit-taking business and, prior to that decision, the Bank gave such a notice as is referred to in subsection (1)(*a*) of section 8 above, then, on the Chancellor's decision coming into operation,—

(*a*) any directions previously given to the institution under that section shall cease to have effect; and

(*b*) no further direction may be given to the institution under that section in reliance on that notice having been given.

Regulations with respect to appeals.

12.—(1) Provision may be made by regulations with respect to appeals under section 11 above—

(*a*) as to the period within which and the manner in which such appeals are to be brought;

(*b*) as to the persons (in this subsection referred to as "appointed persons") by whom such appeals are to be heard on behalf of the Chancellor of the Exchequer;

(*c*) as to the manner in which such appeals are to be conducted, including provision for any hearing before appointed persons to be held in private;

(*d*) for requiring any person, on tender of the necessary expenses of his attendance, to attend and give evidence or produce documents in his custody or under his control;

(*e*) for taxing or otherwise settling any costs or expenses directed to be paid under section 11(3)(*b*) above and for the enforcement of any such direction; and

(*f*) as to any other matter connected with such appeals.

(2) Subject to subsection (3) below, regulations under this section shall be made by the Treasury after consultation with the Council on Tribunals and shall be made by statutory instrument which shall be subject to annulment in pursuance of a resolution of either House of Parliament.

PART I

(3) Regulations under this section with respect to Scottish appeals, that is to say, appeals where the institution concerned—

(*a*) is a company registered in Scotland, or

(*b*) has its principal or prospective principal place of business in the United Kingdom in Scotland,

shall be made by the Lord Advocate after consultation with the Council on Tribunals which shall consult with its Scottish Committee.

(4) A person who, having been required in accordance with regulations under this section to attend and give evidence, fails without reasonable excuse to attend or give evidence shall be liable on summary conviction to a fine not exceeding £1,000.

(5) A person who intentionally alters, suppresses, conceals, destroys or refuses to produce any document which he has been required to produce in accordance with regulations under this section, or which he is liable to be so required to produce, shall be liable—

(*a*) on summary conviction to a fine not exceeding the statutory maximum ; and

(*b*) on conviction on indictment to imprisonment for a term not exceeding two years or to a fine or both.

(6) The Treasury may, out of money provided by Parliament, pay to any persons appointed as mentioned in paragraph (*b*) of subsection (1) above such fees and make good to them such expenses as the Treasury may determine.

Further appeal on points of law.

13.—(1) An appeal shall lie to the Court at the instance of the institution concerned or of the Bank on any question of law arising from any decision of the Chancellor of the Exchequer on an appeal under section 11 above ; and if the Court is of opinion that the decision appealed against was erroneous in point of law, it shall remit the matter to the Chancellor with the opinion of the Court for re-hearing and determination by him.

(2) In subsection (1) above " the Court " means the High Court, the Court of Session or a judge of the High Court in Northern Ireland according to whether,—

(*a*) if the institution concerned is a company registered in the United Kingdom, it is registered in England and Wales, Scotland or Northern Ireland ; and

(*b*) in the case of any other institution, its principal or prospective principal place of business in the United Kingdom is situated in England and Wales, Scotland or Northern Ireland.

(3) No appeal to the Court of Appeal or to the Court of Appeal in Northern Ireland shall be brought from a decision under subsection (1) above except with the leave of that court or of the court or judge from whose decision the appeal is brought.

(4) An appeal shall lie, with the leave of the Court of Session or the House of Lords, from any decision of the Court of Session under this section, and such leave may be given on such terms as to costs, expenses or otherwise as the Court of Session or the House of Lords may determine.

2388/008

RESTRICTED

FROM: ECONOMIC SECRETARY
DATE: 30 January 1986

CHANCELLOR

cc: Sir P Middleton
Mr Cassell
Mr Kemp
Mr Peretz
Miss J Kelley
Mr Board
Mr D Jones
Mr Saunders
Mr Watts

Mr Bridgeman - RFS
Mr Davis - RFS

Mr Nicolle - BoE

Mr Brummell - T.Sol.

C

Important change suggested by EST in para 3 of this note. But he agrees with rest of large submission below. Note tricky position on banks.

Also need to decide whether to consult (para 6 of this note) the Ld Chancellor.

Howard

Ro 31/1

Agreed. NL.

... I can recommend to you the attached proposals on appeals for building societies and banks, subject to one change.

2. The aim of these proposals, which are acceptable both to the Registry and Bank of England, and to the legal Departments concerned, is to set up a tribunal which provides a genuine appeal, and so goes beyond judicial review, and yet which does not go so far as to substitute its judgment for that of the supervisor. This formula is in section (d) of Mr Hall's covering minute - the tribunal is "restricted to considering whether the supervisory body was justified on the facts before it at the time, or in law, in reaching its decision, and had followed the proper procedures." It is clear that a degree of substitution of judgement is inevitable, even though new facts are not to be admitted. My interpretation of "justified" implies that on the facts available, the tribunal would regard the supervisor's decision as within the range of those which it might itself have considered taking. The formula goes further than that for judicial review, where the basic test is whether the decision being reviewed was one which no reasonable supervisor would have taken.

3. Bearing in mind that although a degree of substitution of

opinion is inevitable, but that our intention is to narrow rather than extend the tribunal's ability to second-guess the supervisor, I think that the proposal at (f) of Mr Hall's minute needs to be modified. For the tribunal itself to propose specific conditions as a substitute for a decision to revoke authorisation by the supervisor goes beyond second-guessing and constitutes a direct act of regulation. In my view, the power of the tribunal should be restricted to upholding or quashing the supervisor's original decision, to revoke. If it rejects the supervisor's decision, but thinks the imposition of conditions a more appropriate remedy, it should make this clear as part of its judgement, without specifying what those conditions should be. It would then be up to the supervisor to decide what the appropriate conditions would be and to apply them. We should rely on the supervisor's professionalism to apply the right conditions.

4. If we take this route the right of appeal against the conditions imposed will have to be available to the institution involved. But it would be cumbersome and time consuming to start the whole appeal procedure all over again. I would propose introducing an accelerated form of appeal in these cases, such that an appeal against conditions would be heard immediately by the same tribunal that had granted the original revocation.

5. Such a scheme would have a number of advantages. It would minimise delay. It would ensure that it is the supervisor who determines the conditions. And it would allow the tribunal the ultimate decision in those cases where the institution involved wished to contest them. But in the majority of cases, where the conditions imposed by the supervisor are clearly in the spirit of the tribunal's findings, there would be no need to refer back to the tribunal on the specification of the conditions.

Procedure

6. If you are content with this scheme, subject to the change outlined above, you will wish to consider whether to clear the scheme with the Lord Chancellor. His Department have been closely involved in policy discussions and have agreed the draft submission. They take the view that it is up to us whether we raise this with him - they do not insist. I am not aware of any difficulties of legal policy or natural justice, and therefore think it would be perfectly proper to proceed direct to instructing Counsel, given both the need for haste and LCD's previous involvment.

7. The position for banks is somewhat different. For building societies, these procedures are new. But for banks, there is an existing procedure, set out in the Banking Act and in regulations. Whilst in principle I should like to introduce parallel provisions for banks, and am content for Parliamentary Counsel to be so instructed in the context of the Banking Bill, what we can achieve when that Bill comes forward will depend on the political climate at the time, and on reactions to the proposals for building societies.

IAN STEWART

RP6.73

RESTRICTED

FROM: P WYNN OWEN
DATE: 3 February 1986

cc Sir P Middleton
Mr Cassell
Mr Kemp
Mr Peretz
Miss J Kelley
Mr Board
Mr D Jones
Mr Saunders
Mr Watts
Mr Bridgeman - RFS
Mr Davis - RFS
Mr Nicolle - BoE
Mr Brummell - T. Sol.

PS/ECONOMIC SECRETARY

APPEALS UNDER THE NEW BUILDING SOCIETIES AND BANKING LEGISLATION

The Chancellor has seen the Economic Secretary's minute of 30 January and Mr Hall's submission of 17 January. He agrees with the Economic Secretary's recommendations.

P WYNN OWEN

1864/12

FROM: M EVERSHED
DATE: 27 February 1986

1. MR HALL
2. ECONOMIC SECRETARY

cc PPS
PS/Sir P Middleton
Mr Cassell
Mr Peretz
Mr Monger
Mr Board
Mr Grinlinton
Mr Brummell (T.Sol)
Mr Bridgeman (RFS)

(without attachments)

BANKING AND BUILDING SOCIETIES BILL: DISCLOSURE OF INFORMATION

1. Mr Jones' submission of 16 October 1985 (copy attached) set out the background and broad approach proposed for disclosure of supervisory information by the Bank of England. Mr Neilson's minute of 22 October (also attached) recorded your agreement to the immediate question of disclosure to other supervisors - subject to two qualifications discussed below. We now need to clear with you detailed proposals for a scheme of confidentiality for supervisory information on the basis of which instructions will be drafted for Counsel. A complete description of the proposals is at Annex A. This covering note considers only the main issues.

2. Although the submission is drafted in terms of the Banking Bill and the duties and responsibilities of the Bank of England we are also proposing a virtually identical regime for information given to the Building Societies Commission. We are therefore also seeking your agreement to apply the policy set out in this submission to the Building Societies Bill.

3. The two conditions which you attached to disclosure of supervisory information by the Bank to other supervisors were that it should be used by them only for supervisory purposes and that when disclosed it should be subject to at least an equivalent degree of protection from further disclosure as is provided by

Section 19 of the Banking Act. We have been discussing these conditions with officials from the Bank, the Registry of Friendly Societies and the Department of Trade and Industry, and have agreed with them the following broad approach:-

(a) Banking Act information to be protected at all times by the Banking Act.

(b) Disclosure to other supervisors to be always for the purposes of their supervisory functions or the Bank's supervisory functions.

(c) Further disclosure other than for criminal proceedings to be permitted only with the consent of the Bank of England and only for supervisory purposes.

The present Banking Act permits disclosure by any holder of Banking Act information for the purpose of criminal prosecutions. But in discussion with the DTI, Bank and Registry it has become clear that it is desirable that when one supervisor obtains information from another, that he should normally be able to use it to take effective supervisory action - even though this might reveal the existence, source or content of the information. However, under some circumstances the benefit from effective supervisory action by the recipient may be outweighed by the damage caused elsewhere from the resulting breach of confidentiality. Our proposals therefore make further disclosure possible for supervisory purposes but subject to the consent of the providing supervisory authority.

4. In our discussions with DTI we have tried to include in our package of disclosures to be permitted under the Banking Bill as many as possible of the circumstances in which they would wish to use information for supervisory purposes. But the range of DTI supervisory action goes very wide and we have agreed with the Bank to exclude at present:-

(a) liquidators and receivers (other than those responsible for winding up authorised institutions)

(b) The Director General of Fair Trading.

and

(c) Civil proceedings arising out of the FS Bill (where DTI envisage giving information to investors to mount their own civil actions).

We consider these to go wider than 'financial supervision' and therefore that it is inappropriate for the Bank to disclose confidential banking information for these purposes. (DTI are in the difficult position of having to weigh internal pressures from their other responsibilities for insolvency, independent pricing policies and consumer protection). It has also been pointed out in the case of civil actions, liquidators and receivers that a discretion for the Bank to disclose supervisory information might undermine a public interest immunity defence against court orders requesting information for non-supervisory purposes - the court being bound to note that Parliament had thought it in the public interest to allow disclosure beyond the supervisory fence in certain circumstances. (The reason for wider disclosure in civil cases under the Financial Services Bill arises from the functions of the Self Regulatory Organisations (SROs) in policing codes of practise - where it is government policy that the SRO's should give information to investors sueing an institution for breach of the code. By contrast the Bank and the Commission are applying a discretionary prudential regime. They are also concerned to preserve "banking confidentiality" as far as customers are concerned and, as important, confidence in the deposit-taking institutions).

5. The FS Bill is most forthcoming in providing information to the Bank and in particular will not require consent to be given before the Bank can use it. (In part this reflects the narrower range of supervisory activity of the Bank). Nevertheless DTI are prepared to accept the introduction of a consent clause for Banking Act information.

6. Representation from the British Bankers Association and the Committee of Scottish Clearing Bankers explicitly or tacitly accept the need for disclosure between supervisors. We therefore

anticipate little difficulty in principle on this issue though as you will see from the annex , the list of 'supervisors' is quite long and while each may be defensible in detail, together they may give a sense of insecurity. Of course, in practice much will depend on how the Bank use their discretion to disclose.

5. But these same bodies are emphatically not content with our proposals for disclosure to other government departments. Reasons given include fears that a future government might try to obtain information for non supervisory purposes or that London will come to be seen by overseas customers as an unattractive place to do business. In particular the BBA feel that permitting such disclosure in the 'public interest' is too vague. They would prefer something more explicit - for example 'to protect life and property' or 'the security of the state'. The Bank have suggested that there might be an order making power to specify the purposes for which information would be disclosed. We will need to look at this again. But for the present we seek your agreement to prepare instructions on the basis of the full gateway for disclosure to the Secretary of State 'in the interest of depositors or the public interest'. This is the approach to be taken in both the Building Societies and Financial Services Bills.

7. It is intended that those changes necessary for the functioning of the Building Societies and Financial Services Bills will be introduced into the existing Banking Act by those Bills. But all the proposals discussed here, and in the annex, will need to be included in our instructions for new banking legislation. For the Building Societies Bill the remaining amendments necessary to give effect to an equivalent policy to that set out in the submission would be brought forward for you to table at Report Stage. We would be grateful to know whether you are content with these proposals.

M.EVERSHED

Copy also to Mr Nicolle (Bank of England).

ANNEX A

SUMMARY OF PROPOSALS FOR DISCLOSURE OF SUPERVISORY INFORMATION IN THE NEW BANKING LEGISLATION

(1) DEFINITION OF INFORMATION TO BE PROTECTED

The Banking Act 1979 has:-

> 'Information obtained under or for the purposes of this Act'

The Building Societies Bill has

> 'Information obtained by or furnished to the Commission under or for the purposes of this Act ...'

This makes clear that information provided voluntarily is also protected. We propose that new banking legislation should have the same effect and in addition that it should protect the identity of the provider.

(2) BOUNDARY BEYOND WHICH DISCLOSURE COMES UNDER PROTECTION

The Banking Act 1979 has:-

> 'no information ... may be disclosed (otherwise than to an officer or employee of the Bank) ...'

This will need to be extended to the members of the Board of Banking Supervision who will be neither the Bank's officers nor its employees. It should also make clear that the restrictions in the banking legislation apply to any holders of that information.

(3) EXCEPTIONS

The Banking Act 1979 has three exceptions to the prohibition on disclosure of supervisory information in circumstances in which the obligation of confidence does not arise. These are:-

> 'no information ... may be disclosed ... except -
>
> (a) with the consent of the person to whom it relates; or
>
> (b) to the extent that it is information which is at the time of the disclosure, or has previously been, available to the public from other sources; or

(c) in the form of a summary or collection of information so framed as not to enable information relating to any particular person to be ascertained from it.'

The only change proposed to these exceptions is to tighten the requirement for consent from the person to whom the information relates to include, if different, the provider of the information. This should help reassure providers of information, such as banks, that information about their counterparties and customers is protected. Similar requirements will appear in the Financial Services (FS) and Building Societies (BS) Bills.

(4) **EXISTING SPECIFIC DISCLOSURE 'GATEWAYS'**

In addition to the exceptions listed above the Banking Act 1979 also includes a list of circumstances in which information which should otherwise be kept confidential may be disclosed because wider policy interests override the need for confidence.

These are:-

(a) 'With a view to the institution of, or otherwise for the purposes of, any criminal proceedings, whether under this Act or otherwise'

We are content with this gateway for offences generally but there are new proposals below to deal with offences subject to the new search and seizure powers of the Bank.

(b) 'In connection with any other proceedings arising out of this Act'

This gateway deals with civil actions but concern has been expressed that this existing formulation might not permit the Bank or the Deposit Protection Board to use supervisory information defensively if it were sued. We therefore propose adopting the clearer Building Societies Bill approach:-

'with a view to the institution of, or otherwise for the purposes of, any civil proceedings <u>by or at the relation of or against</u> the Commission or by the Investor Protection Board ...'

The new formulation will need also to cover appeals proceedings. The exact wording would of course be a matter for Counsel.

(c) 'In order to enable the Bank to comply with any obligation under this Act'

We propose to retain this provision.

NOTE Gateways (a) to (c) above are available to any holder of Banking Act information. Gateways (d) onwards are for the Bank only.

(d) 'Disclosure to [a professional adviser] of such information as may appear to the Bank to be necessary to ensure that he is properly informed with respect to the matters on which his advice is sought'

We doubt whether this formulation is adequate to cover investigators appointed by the Bank or by an authorised institution at the request of the Bank, as well as 'advisers' as such. We therefore propose asking Counsel to extend this.

(e) 'To the Treasury in circumstances where, in the opinion of the Bank, it is desirable or expedient that the information should be so disclosed in the interest of depositors or in the public interest'

We propose retaining this gateway.

(f) 'To the Deposit Protection Board ... to enable that Board to perform any of their functions ...'

No change is proposed here.

(g) 'To the Secretary of State where it appears to the Bank ... that the Secretary of State might wish to appoint inspectors under ... section 432 [of the Companies Act 1985] (investigation of cases of fraud etc) or ... section 442 [of the Companies Act 1985] (investigation of ownership of a company etc)'

This gateway covers disclosure to the Secretary of State in some of his specific capacities under the Companies Act, and is different in principle from the general public interest disclosure gateway

for other government departments considered later. It has been pointed out that disclosure 'where he might wish' to appoint investigators does not cover the situation after they have been appointed and we recommend remedying this. (This will include permitting disclosure to the inspectors themselves as well as to the Secretary of State.) DTI have also asked that we include disclosure to the Secretary of State under all the circumstances in which an investigation may be mounted or papers demanded under Part XIV of the Companies Act. This would mean adding:-

(i) Investigations at the request of the members of a company (S 431 of the Act)

(ii) The requesting of information from any person holding or able to obtain information about share ownership (S 444 of the Act)

(iii) The investigation of share dealings (S 446 of the Act)

(iv) The production of papers and documents (S 447 of the Act).

The Bank have difficulty with the last case, where they consider the powers to go very wide (for example, between 1980 and 1984 there have been 453 such enquiries compared to 17 for the other categories combined), and have argued that disclosure in these circumstances must be at the Bank of England's absolute discretion. Otherwise they fear that they could be required to produce banks books and papers that they hold. We have considered this but on balance recommend that the singling out of one Companies Act provision as somehow second-rate could be presentationally awkward. And that would be for little gain since we may expect the Secretary of State to use his discretion sensibly. (If necessary the Chancellor in support of the Bank could persuade him not to require information which for wider reasons should remain confidential.) We therefore recommend that the new banking legislation should follow the Building Societies Bill and permit disclosure in all the circumstances where the Secretary of State exercises supervisory powers in Part XIV of the Companies Act. Equivalent provisions will be needed for the relevant Northern Irish regulators.

(h) 'To the authorities which exercise in a country or territory outside the United Kingdom functions corresponding to those of the Bank ... information relating to [an authorised institution which carries on a deposit taking business abroad or is a subsidiary or associate of an institution established abroad].'

In discussion with DTI, the Registry of Friendly Societies and the Bank we have jointly proposed a system of disclosure between supervisors here and abroad which works on a like to like basis. That is, the Bank will talk to banking supervisors, the Savings and Investment Board (SIB) to investment supervisors etc. This will build on established relationships, but it will need to be implemented in such a way as to permit information to be exchanged between UK supervisors and dissimilar overseas supervisors in order to achieve adequate international consolidated supervision. Disclosure will also need to be possible either to fulfil the Bank's function or, at the Bank's discretion, the overseas supervisor's functions. The new banking legislation will therefore need to permit (but not oblige) Banking Act information to be given to overseas regulators of securities and insurance (either via the corresponding UK regulator or via the overseas banking regulator).

It will also need to ensure that where the FS Bill and BS Bills permit information to be given to the Bank for onward transmission to overseas banking regulators, nothing in the banking legislation prevents this happening. Our approach may need to be modified when the result of the Hillegom v. Hellenius European Court case is digested. But for the purposes of the first draft legislation we recommend proceeding on the basis above. The Treasury Solicitor is content.

(5) **NEW SPECIFIC DISCLOSURE 'GATEWAYS'**

In addition to the modifications to the existing gateways proposed above a number of new gateways are recommended. They are:-

(a) <u>To other supervisors</u>

As part of the policy to ensure that supervisors are able to communicate adequately with each other and in particular to help them deal with financial conglomerates. It has been agreed that

The various regulatory Bills should permit supervisors to pass information one to another. We propose that the following supervisors should be included in the new banking legislation 'gateways':-

(i) The Building Societies Commission

(ii) The Registrar of Friendly Societies

(iii) The Registrar of Friendly Societies for Northern Ireland

(iv) The Investor Protection Board

(These four items to be added to the Banking Act 1979 by the Building Societies Bill as an interim measure.)

(v) The Designated Agency and Transfer body under the FS Bill (ie the Securities and Investment Board)

(vi) Self Regulating Organisations under the Financial Services Bill

(vii) Recognised investment exchanges and recognised clearing houses under the Financial Services Bill

(viii) Investigators appointed under the Financial Services Bill

(ix) The Secretary of State in the exercise of his functions under the Financial Services Bill

(x) Professional bodies recognised under the FS Bill

(x) The competent authority for listing purposes under the FS Bill

(Items (v) - (x) to be added to the Banking Act 1979 by the FS Bill as an interim measure.)

(xi) The Secretary of State in the exercise of his supervisory functions under the Insurance Acts

(xii) The Industrial Assurance Commissioner

(xiii) The Industrial Assurance Commissioner for Northern Ireland

(If the scope of the FS Bill permits it may be used to add items (xi) - (xiii) to the Banking Act 1979 as an interim measure.)

The DTI have requested that we include the Director General of Fair Trading. We have suggested including him in the exercise of his supervisory functions with relation to the Consumer Credit Act (but

not his wider competition policy functions which are not supervisory in the narrow sense of financial services) and we propose including this in the Building Societies Bill. But the Bank of England are not yet convinced of the desirability of this for their information and we will need to discuss this further before adding it to the Banking Bill provisions.

The DTI have also requested that we add liquidators and receivers generally to the list of other 'supervisors'. At present information may be disclosed to the liquidators and receivers of authorised institutions because they stand in place of the directors of the institution. However because of concern expressed by the Registry of Friendly Societies in the context of the Building Societies Bill we have agreed with the Bank not to recommend adding to this until concerns over vulnerability to discovery of documents in litigation involving liquidators of companies unrelated to authorised institutions are resolved.

(b) To the Secretary of State in the interests of depositors or in the public interest

This provision is proposed to permit disclosure to other government departments as recommended by the Review Committee and proposed in the White Paper. The formulation 'to the Secretary of State' would not include the Revenue departments. This proposal in the White Paper has been subject to intense lobbying and it may need to be restricted further to avoid problems from bank sponsored amendments. However, for the purposes of instructions for the first draft of the Bill we recommend including it in its complete form.

(c) In pursuance of any Community obligation on the holder of the information

Because the new banking legislation cannot overturn European law this provision simply makes clear the true position. (Similar provisions appear in the FS and BS Bills.) However, it is formulated to avoid any ability on the part of the holder of the information to gratuitously provide it to help someone else fulfil a Community obligation.

(d) To the auditors of an authorised institution

This proposal enables the supervisor to participate in the new auditor-supervisor dialogue.

(e) To an accountancy professional body for the purposes of disciplinary action against members employed as auditors of an authorised institution or appointed pursuant to powers to obtain information from an authorised institution

This proposal is essential to ensure that auditors and other accountants employed by the institution or by the Bank for investigatory purposes or on whom the Bank relies for information can be disciplined if they perform badly or act improperly.

(f) Disclosure in connection with search and seizure powers

When investigating offences subject to the new search and seizure powers (currently unauthorised deposit-taking) the Bank wish to be able to disclose information to a magistrate or a constable for the purposes of obtaining and executing a warrant and subsequently to disclose to the DPP or police (or their territorial equivalents) information obtained from unauthorised persons by use of the search and seizure powers or the associated right to demand information.

(g) To shareholder/controllers of authorised institutions

There are circumstances in which the Bank would wish to be able to express their concern over the conduct of an institution to its controlling shareholders. This seems eminently sensible and we propose that this is added.

(6) **ORDER MAKING POWER**

Under the Building Societies Bill an order making power (by affirmative resolution) exists, primarily to enable FS Bill supervisors to be added later when the relevant legislation is passed. But there will also be a residual problem in that the financial sector is developing and changing so quickly that new supervisory bodies may emerge (or currently proposed bodies disappear). We therefore recommend inclusion of an order making power in the new banking legislation either to add new supervisory persons to the list of disclosure gateways or to remove supervisory persons from the list (by negative resolution).

(7) **ONWARD DISCLOSURE**

In order to enable recipient supervisors to use information provided to them when it is necessary to do so it is proposed to explicitly permit further disclosure by them subject to two contraints:-

(a) Disclosure must be for their supervisory purposes only. (This will be done by reference to their functions under the relevant Act of Parliament.)

(b) And only with the Bank of England's consent.

This proposal is intended to ensure that supervisors can act effectively on information provided while ensuring that they cannot overweigh their own supervisory interests in comparison with the Bank of England's need to maintain confidence and the flow of information.

(8) **INWARD DISCLOSURE**

There is a potential problem under the Banking Act 1979 where information unrelated to banking supervision provided to the Bank by an overseas central bank/supervisor might be covered by the prohibition on disclosure. This could prevent the Bank passing on useful economic intelligence. This is clearly undesirable and we recommend that the problem be eliminated in new legislation.

1776/032

From: **M A HALL**
Date: 28 February 1986

ECONOMIC SECRETARY

cc PS/Chancellor
Sir P Middleton
Mr Cassell
Mr Peretz
Mr Board
Mr Saunders
Mr P Hall

Mr Bridgeman, RFS

Mr Brummell, T. Sol

THIRD PARTIES' RIGHTS OF APPEAL UNDER NEW BANKS AND BUILDING SOCIETY LEGISLATION

The Annex to my submission of 17 January on appeals noted that we were considering further how far individuals, as distinct from institutions, should have rights of appeal. This has inevitably widened to include the questions of third parties' rights generally in the face of supervisory action, and rights of representation short of full appeal. We now propose that:-

(i) Whenever the supervisor takes or proposes to take an action under statutory powers requiring the removal of a director or employee from a post in an authorised institution, or when he refuses or revokes authorisation on the grounds of a person's unfitness, then that person should have a separate right to be notified, and to make representations to the supervisor on the matter that directly affects him;

(For consistency, wherever an institution's rights of representation to the supervisor are less than this they should be brought up to the same level;)

(ii) The third party should also have the right to appeal on his own behalf to the appropriate tribunal should he remain dissatisfied;

(iii) For banks, the same rights should extend to shareholder-controllers prevented from gaining or required to relinquish control, or who are formally identified as unfit in grounds for revocation or in reasons for refusing authorisation;

but (iv) His appeal should be solely on the matter or matters that affect him directly and should not be against any wider decision by the supervisor against the institution. (In particular, if his appeal results in the overturning of a sole ground for revocation it should not result in the automatic restoration of authorisation. This should continue to depend on an appeal - or a reapplication - from the institution itself);

and (v) If more than one person appeals against a given supervisory decision then all the appeals should be heard by one tribunal.

2. Further background is at Annex A.

3. Wherever possible the supervisor will attempt to persuade an institution to remove an unfit officer, director or controller, or to take some other action against a third party, voluntarily. In the interests of natural justice the supervisors make every effort to ensure that the institution gives the person concerned a hearing and genuinely accepts the supervisor's view before taking action. This will continue to be the case under new legislation; and to that extent these proposals will deal only with the exceptional cases where formal powers are invoked.

4. You should be aware that the proposals above stop short of the Financial Services Bill formula which confers rights of appeal on third parties where the reasons given for formal supervisory action are, in the opinion of the Secretary of State, 'prejudicial to them in any office or employment'. DTI tell us that this is intended primarily to cover the position of employees. But it has been drawn up in a way that could include a wider range of persons, for example business associates described as dishonest or professional advisers identified as incompetent. The Bank and Registry are deeply uneasy about having a similarly wide provision in Banking and Building Society legislation.

5. There is a genuine problem here. When action is taken by the supervisor (and direct reasons given for that action) the ripples can spread pretty wide and a line has to be drawn somewhere. We recommend the approach above because:

(a) It will be clear in each case who has and does not have rights of representation and appeal;

and

(b) It will reassure the Bank and Commission that they can act quickly and robustly without facing a large number of second order objections.

6. The proposals would nevertheless provide an important safeguard for those immediately affected by the exercise of the supervisor's statutory powers. And, especially in comparison with the Banking Act 1979 (which gives rights only to the authorised institution), we think the proposals are acceptable.

7. There will also be two small differences between the Banking and Building Societies legislation. The first is that the Banking legislation will need to provide for shareholder-controllers who are named as unfit (this is not relevant for building societies). The second is that under the Building Societies Bill rights of representation to the supervisor would include hearings (this is already in the Bill and would be presentationally difficult to withdraw) while for reasons of timing under Banking legislation there would only be a right to less formal oral representations.

8. We have consulted the Council on Tribunals and the Lord Chancellor's Department who have indicated that they do not envisage objecting to the proposals. The Bank of England and the Registry of Friendly Societies are prepared to accept them.

M A HALL

Copy also to Mr Nicolle (Bank of England)

ANNEX A

Background and Proposals in Detail

(a) Background

1. Under the Banking Act 1979 the Bank of England can suggest formally in writing that a person is not fit and proper in giving reasons:-

(a) in a notice of refusal to authorise (S5(4));

or, (b) in a 'minded to revoke' letter (S7(3));

or, (c) in an immediate revocation notice (S7(4) and schedule 4, part II para 3).

In addition the Bank may implicitly deem someone unfit when requiring their dismissal in the terms of a proposed conditional licence or in varying the terms of an existing or proposed conditional licence. Under most of these circumstances the institution concerned may make representations in writing but it does not always have a right to oral representations before the supervisor as well. In all cases except the varying of the terms of a conditional licence by agreement it may also appeal to the Chancellor. But in no case does a person named as unfit have separate rights - though in practice the Bank do permit informal representations to be made.

2. In two special cases the institution itself has no right of representation to the supervisor. One is where the Bank give notice of their intention to revoke outright and then after receiving representations impose a conditional licence instead. (There is no right of representations on the conditions.) The second is where the Bank give notice of their intention to impose a conditional licence and then, after representations, vary the terms of that licence. (There is no right to representations on the varied conditions.)

3. Under the Building Societies Bill officers of building societies have the same rights as the society concerned to make representations to the Commission if a condition is imposed requiring their dismissal

or if their unfitness is a ground for revocation of authorisation. These rights include both written representation and the right to be heard. There is however a lacuna under the Bill as presently drafted where an individual named as the reason for refusal to authorise has no such separate rights.

4. For building societies the persons named as unfit can only be individuals, but for banks they can include corporate shareholder controllers.

5. In the absence of rights of appeal to a special tribunal, the persons affected could attempt to obtain redress from the courts. But while the possibility of Judicial Review cannot be ignored (eg where the Bank had unreasonably failed to take into account representations by an individual) it would be very unlikely to succeed. (He might have a chance to obtain compensation - for example in a suit for damages or before an industrial tribunal - but this would not necessarily address the underlying question of his 'fitness'.)

(b) Proposals

(i) Separate right of representation to the supervisor

6. Whenever a person is dismissed from his employment, formally named as unfit or - in the case of a shareholder controller - deprived of the benefits of ownership, and especially where this is under circumstances that may prevent him from achieving future employment or ownership in a similar business, there is a strong argument on the ground of natural justice for him to be able to make representations to the authority that is acting against his interest. Since it is by no means certain that the institution's interests will coincide with those of the third party concerned (they may for example be prepared to acquiesce in a dismissal to avoid trouble), natural justice would also argue that his right of representation should be separate from that of the institution concerned. And, on issues of this importance to the person concerned it is commonly considered that his rights should include a hearing as well as written representations.

7. The changes required to the policy already in the Building Societies Bill to implement our proposals would not be extensive. (The rights of representation already given to officials would need to be extended to cover the lacuna already identified where a third party has no separate rights if an application for authorisation is refused on the grounds of his unfitness.) But to be consistent the Banking Act provisions for written representations would need to be extended throughout the new legislation and made to include equivalent rights for the relevant third parties and give a right to a hearing. But the 14 day representation period presently is considered insufficient to organise formal hearings. (By comparison the Building Society legislation gives the supervisor discretion to set any period for representation, subject only to a 14 day minimum). The Bank of England have advised against lengthening the process because it leads to the risk of delaying tactics and/or greater risks to depositors. This would mean having rights to a hearing in the Building Societies Bill only - creating the presentational difficulty of a minor gap opening up between the two sets of new legislation. But provided the gap is minimised by allowing oral representations in the Banking Bill short of a formal hearing, we do not think the difference will cause significant problems.

(ii) Third party's right to raise an appeal in his own behalf

8. Since the interests of the person deemed unfit and those of the institution are not identical, there is also a case on grounds of natural justice to permit the person affected to raise an appeal on his own behalf.

9. But it is not considered necessary to grant third parties a right of appeal in the special circumstances in S10(2)(c) of the Banking Act 1979 where conditions are changed by agreement between the supervisor and the institution. This is a special case of the institution's response to informal pressure and since the dismissal results from a voluntary act on the part of the institution any complaint by the person affected rests primarily against the institution, not the supervisor. Moreover, the institution itself has no right of appeal in these circumstances.

(iii) Corporate Shareholder Controllers

10. It can be argued that because corporate shareholder controllers will usually have greater resources than individuals they do not need the same protection under statute. But corporate shareholder controllers may be no less displeased at being deemed unfit and disadvantaged than individuals and it may be wise to grant an outlet for them other than for example, judicial review. And we have already proposed and it has been agreed that where a proposed shareholder controller is prevented from acquiring control on prudential grounds he should have access to the appeals tribunal. We therefore recommend that they be given the same rights as individuals throughout. (This will only affect the Banking legislation).

(iv) Object of Third Party's Appeal

11. But there are practical problems with a separate right of appeal. One arises where the supervisor is attempting to revoke or refuse authorisation on the ground that a named person is unfit. Allowing a separate right of appeal to an individual against the supervisor's decision in these circumstances could lead to the bizarre result that, if the separate appeal succeeded, there would be implication that the institution should be given or retain authorisation even though it had not thought fit to appeal itself. This problem arises because the individual's appeal ('I am fit') is different from the institution's ('I should be authorised') while any overturning of the decision bites on both. Therefore we recommend that the individual should have a separate right of appeal only against the matter that directly affects him (eg the finding of unfitness or a condition requiring his dismissal).

(v) Organisation of Appeal Hearings

12. Another practical problem arises from the fact that notwithstanding the limitation proposed above, appeals from individuals and an institution against any one supervisory action will be closely related. If they were heard by two separate tribunals they would be bound to cover some of the same ground and contradictions could emerge. We therefore recommend that where more than one person appeals against a given supervisory action one tribunal should determine all the appeals together.

Net Effect

13. The net effect of these proposals when a supervisor uses his statutory powers would be as follows:-

(1) Supervisor formally notifies the authorised institution and any third parties which are formally found unfit or whose removal from a post in the authorised institution is demanded, of his proposed action simultaneously and with the same opportunity to make representations.

(2) Supervisor takes and considers representations.

(3) If he decides to proceed the supervisor again notifies all parties concerned.

(4) The institution and the third parties now have the same deadline in which to appeal to the tribunal.

(5) On expiry of the deadline arrangements are made by the secretariat for a single tribunal to hear any appeals that have been made.

(6) After hearing the appeals together the tribunal then specifically determines each one in its judgement.

(7) If a third party has appealed against a sole ground for revocation and wins, then in the absence of an appeal by the institution the revocation remains in force. (But it would be open to the institution to reapply for authorisation in the normal way - in which case the supervisor will be bound to take into account the tribunal's decision.)

2389/016

FROM: M NEILSON
DATE: 4 March 1986

MR HALL

cc: PS/Chancellor
Sir P Middleton
Mr Cassell
Mr Peretz
Mr Board
Mr Saunders
Mr P Hall
Mr Jones
Mr Evershed
Mr Bridgeman - RFS
Mr Brummell -T.Sol

C. To note, especially paras 4 and 7 of Martin's minute below.

RO 7/3

THIRD PARTIES' RIGHTS OF APPEAL UNDER NEW BANKS AND BUILDING SOCIETY LEGISLATION

The Economic Secretary was grateful for your minute of 28 February setting out proposals for third parties rights of appeal under the new Banks and Building Societies legislation. You confirmed that you saw no problems with allowing hearings under the rights of representation to the supervisor for building societies, but not for banks, and on this basis he is content with the proposals.

M NEILSON

b/f 20/3 pl b/f 14/2 pl

From: M A HALL
Date: 12 March 1986

ECONOMIC SECRETARY

cc Financial Secretary
PS/Chancellor
Sir P Middleton
Mr Cassell
Mr Peretz
Mr Monger
Mr Hall
Miss Sinclair
Mr Walsh
Mr Board
Mr Haigh
Mr D Jones
Dr G I Webb
Mr Wood
Mr Tarkowski
Mr Brummell (T/Sol)
Mr Munro (IR)
Mr Gray (IR)
Mr Bridgeman (RFS)

BANKING BILL : TAX TREATMENT OF BANKS

Under present legislation the definition of a bank for tax purposes and the Banking Act 1979 authorisation criteria differ. About $^2/_3$ of licensed deposit-takers are not recognised by the Revenue as 'banks'. The attached note by the Inland Revenue considers whether the tax purposes definition should be changed in the light of the proposed banking legislation. It concludes that nothing should be done now because the proposals for banking legislation do not require a change and because there is no clear policy reason for alignment. The Revenue suggest a further look after the banking legislation is passed. They consider that any future change could be made, more appropriately, in a Finance Act. But the Bank of England see good policy reasons for early alignment of the definitions.

2. The issue is important to the institutions affected. Without recognition by the Revenue as a bank they have to pay interest to non-retail customers net of tax on deposits of one year maturity or more. On one calculation, assuming general interest rates of 10 per cent, this would cost a corporate customer the equivalent of a ½ per cent margin when compared with Revenue recognised banks. The effect is to direct corporate deposits towards Revenue-recognised "banks", and to oblige non-recognised institutions to have deposit bases with a high proportion of short term deposits.

3. The reasons for moving to the same definition would be, in increasing order of importance:-

(a) administrative elegance and simplicity, and the removal of an anomaly;

(b) "level playing fields". It looks unfair to differentiate within the class of authorised institutions.

(c) better balanced liabilities for those institutions not now recognised by the Revenue as banks, thus reducing the risk of failures.

4. The counter-arguments are:-

(a) A once off increase in the PSBR as tax revenues are delayed through customer tax accounts;

(b) A once off increase in £M3 if the new terms attract funds from outside the £M3 monetary sector;

(c) The use by some institutions of their new status to participate in tax avoidance schemes;

(d) The risk of encouraging applications for Banking Act authorisation by institutions which are not really deposit-takers, solely for favourable tax treatment.

5. Although the arguments against harmonisation appear to touch on wide policy issues HF3 advise that, though they cannot be easily quantified, both the PSBR and monetary effects would be very small.

6. It will be genuinely difficult to sustain arguments for a tax distinction drawn by reference to a wide range of 'banking' services when the equivalent test is dropped from new banking legislation. (In effect we would be retaining a two-tier system for tax purposes.)

7. Against this, the present discretion available to the Revenue is a useful safeguard against abuse, though it might well be possible to design an aligned system which left a degree of discretion to exclude institutions they consider to be abusing, or likely to abuse, their positions.

8. Finally, a change would almost certainly mean that we should have to look again at the arrangements for building societies. Corporate shares and deposits are generally outside the composite rule arrangements, and interest is payable net with a few exceptions such as interest on CDs and Eurobonds, or interest paid to exempt pension funds and friendly societies and to charities. Bringing all authorised banks into line would leave the position on company deposits with building societies looking very anomalous.

Conclusion

9. No decisions are needed at present. A Finance Bill (not this one!) would be more suitable than the banking legislation next session, on grounds both of time available and scope.

10. We therefore seek your agreement to our telling Counsel that no change in the tax definition is proposed in the Banking Bill. We would however welcome your preliminary views.

MAH

M A HALL

cc Mr Nicolle (Bank of England)

THE BANKING BILL

NOTE BY INLAND REVENUE ON POSSIBLE IMPLICATIONS ON "BANKING" PROVISIONS IN THE TAXES ACTS

1. There are a considerable number of particular provisions and references to "banks" and "banking" in tax legislation. These generally contain no definition of the terms but rely on the common law meaning as interpreted in the Courts. Most of them pre-date the 1979 Banking Act and that Act in any case specifically provides that its definitions shall not affect the determination of what constitutes a bank for non-Banking Act purposes.

2. The most important tax provisions on banks are those concerning interest, in particular section 54 of the Taxes Act. Section 54 provides that tax has to be deducted from annual interest paid by companies or local authorities, or whenever it is paid to someone whose normal place of abode is outside to UK. But section 54(2) allows interest payable in the UK to a bank on a bank advance, or by a bank in the ordinary course of its banking business, to be paid gross, provided the bank is carrying on a bona fide banking business in the UK. Other provisions enable interest paid to a bank by companies to be deductible in a wider range of circumstances than if paid to anyone else.

3. The Taxes Acts do not define a "bona fide banking business". This is therefore decided on the facts about the company's activities in the light of what the Courts have decided is a banking business. If a company is not authorised to take deposits it cannot anyway pretend to banking status. Companies with full bank status under the Banking Act should have little difficulty in meeting section 54 banking criteria, but possession of licensed deposit-taker status does not mean automatic recognition as a bank for tax purposes. Case law on the subject (notably the 1966 Court of Appeal decision in United Dominions Trust v Kirkwood) indicates that a banking business generally involves the carrying out of a range of normal banking activities, including retail - cheque book and current account - facilities.

4. While there is no requirement to do so, a newly established LDT which seeks section 54 recognition, will generally apply to us for prior approval, since otherwise its entitlement to receive and pay interest gross is uncertain. These approval arrangements have operated satisfactorily and without significant controversy. Reputable companies carrying on a range of banking activities have generally been able to meet the established and well-known section 54 criteria. We have had to make few refusals, and any company which feels itself aggrieved at being turned down has of course full rights of appeal against the Revenue's decision. In recent years no appeal against our decision has been successfully pursued. And one aspect of tax treatment for banking purposes not being automatically linked to Banking Act recognition is our ability to fight instances where we suspect that LDTs are seeking the ability to pay and receive interest gross essentially for tax avoidance purposes. We have indeed refused section 54 recognition in these circumstances.

New Banking Bill proposals

5. From the proposals to go into the new Banking Bill it is not evident that changes will necessarily be required in the tax legislation concerning banks. Those proposals will create a single tier of "authorised banking institutions" in place of the present two tier full bank and LDT structure. Also some tightening up is planned as regards minimum asset and capital backing, and in the fitness and qualification criteria required of those running such an institution. But overall, bodies which would at present qualify as LDTs will generally meet the revised criteria; and there is any way provision for all existing LDTs to be allowed to continue as authorised institutions (about one-third of licenced deposit takers have been accepted as banks for tax purposes). We also understand that, as with the existing Act, this Bill will not seek to define "banking" or "a banking business"; so the existing common/case law criteria on the subject, which the Revenue adhere to for tax purposes, will not be superceded. This points to the conclusion that a number of institutions which will be authorised under the new Bill will, as at present, not be carrying on a bona fide banking business, so it would not be appropriate to treat them as if they were.

6. A further aspect is that the Inland Revenue are specifically excluded from the proposals to allow the Bank to exchange information about particular institutions with other Government departments. It will not therefore be in the Bank's powers, even if they felt this appropriate, to supply us with information they might obtain about tax avoidance activities. It will therefore continue to be helpful, in tackling suspected avoidance by non-bank deposit takers, to be able to refuse/withdraw section 54 recognition in certain circumstances.

Conclusion

7. The present proposals for the Banking Bill seem to require no automatic consequental change in tax legislation. Nor is it clear that as a matter of policy, the taxlaw in this area ought to be changed. However this can be reviewed more thoroughly after the passage of the Banking Bill, once its final details are clear. Until then it would be premature to propose or enact any such changes and we recommend that no reference to taxation be made in the coming White Paper. Such amendment would anyway be appropriate to a Finance Bill, and this would not be before 1987 (assuming the Banking Bill is passed by then). By then, we should also know the real extent of any pressure from outside for change in this area, which should emerge in representations on the White Paper or during the passing of the Banking Bill.

2389/053

FROM: M NEILSON
DATE: 14 March 1986

MR EVERSHED

cc: PPS
PS/Sir P Middleton
Mr Cassell
Mr Peretz
Mr Hall
Mr Monger
Mr Board
Mr Grinlinton
Mr Brummell - T.Sol
Mr Bridgeman - RFS

C/To be quite.
RO 21/3

BANKING AND BUILDING BILL: DISCLOSURE OF INFORMATION

The Economic Secretary was grateful for your minute of 27 February setting out detailed proposals for a scheme of confidentiality for supervisory information. I have discussed with you the Economic Secretary's suggestion that disclosure should be by the Bank rather than simply with its consent, but you pointed out the potential difficulties in cases involving the proper supervisory functions of other supervisors. The Economic Secretary accepts these arguments, and is content with all the proposals set out in your minute, which can now form the basis for instructions to counsel.

M NEILSON

2389/068

FROM: M NEILSON
DATE: 17 March 1986

MR HALL

cc: Financial secretary
PS/Chancellor
Sir P Middleton
Mr Cassell
Mr Peretz
Mr Monger
Mr Hall
Miss Sinclair
Mr Walsh
Mr Baord
Mr Haigh
Mr D Jones
Dr G I Webb
Mr Wood
Mr Tarkowski

Mr Brummell - T.Sol.
Mr Munro - IR
Mr Gray - IR
Mr Bridgeman - RFS

C/10 note.

R 21/3

BANKING BILL: TAX TREATMENT OF BANKS

The Economic Secretary has seen your minute of 12 March about the tax treatment of banks. He agrees that this should not be included in the Banking Bill he would prefer to deal with this question as part of the general sweep up of composite rate tax matters etc in the 1987 Finance Bill. You also asked for his preliminary views on how the abolition of the two tier system should be dealt with in taxation terms. The Economic Secretary considers that it would be difficult to have separate definitions after the Banking Act, but this can be judged better when it is all looked at again this Winter.

M NEILSON

1785/012

FROM: **M A HALL**

11 April 1986

EST agrees
-PS/EST to minute c c

ECONOMIC SECRETARY

PPS ← 12/2
PS/Sir P Middleton
Mr Cassell
Mr Peretz
Mr D Jones
Mr P Hall
Mr Evershed
Mr Guy

Mr Brummell T.Sol

(You may feel that it would be preferable for the Chancellor to write)

BANKING BILL: AMENDMENTS TO THE CONSUMER CREDIT ACT

DTI have drawn our attention to the attached correspondence between Lord Young and Mr Howard. We think you should intervene in this correspondence to prevent the idea that the Banking Bill will be available for substantial amendments to the Consumer Credit Act (CCA) from gaining further currency.

2. We have agreed to use the Bill to make a minor, technical amendment to the CCA to remove a possible obstacle to the development of EFT-POS. The amendment does not affect any existing rights or obligations under consumer legislation. We are also committed to the corollary of the provision in the Building Societies Bill bringing CCA treatment of first and second mortgages into line.

3. Lord Young's letter of 27 March presses on Mr Howard the merits of early legislation to remove from the CCA's requirements lending to unincorporated businesses (incorporated businesses are already out). We have no objections to this policy, but Lord Young goes on to suggest that if an early decision can be reached and the proposal incorporated in the White Paper on deregulation due in May, then it might be possible to include the necessary amendments in the Banking Bill. We see major objections to that course, and it would therefore be best if Lord Young and Mr Howard were made aware of them as soon as possible.

4. First, there is a timing problem. The Banking Bill has to be ready for early introduction. The bulk of Instructions have already been sent. It is late to be considering a completely new initiative which will still be at the policy formulation/consultation stage during the summer. We do not know how complicated the necessary amendments would be, nor how long it would take to prepare them. Even if they were to be straightforward, and so ease the timing contraints, there are more substantial difficulties.

5. We are already beginning to regret the minor amendments to which we have agreed. Limited as they are, in dealing with CCA rather than strictly supervisory matters, they widen the scope of the Bill and threaten to attract proposals for further CCA amendments. We have recently received proposals from both sides of the consumer protection 'fence' - from the banks and from the National Consumer Council - which have made it clear that any concessions to banks will produce pressure for counterbalancing measures for more consumer protection, drawn from the NCC's shopping list of CCA amendments. DTI will in due course need to weigh these competing claims in its review of the CCA. But we cannot hope to do this in the context of the Banking Bill's schedule.

6. We hope to be able to control matters if CCA points do not extend beyond the present proposed simple amendments. But if the Bill takes in more substantial matters - as suggested by Lord Young - we believe it would be perceived as an early opportunity for wholesale lobbying on consumer affairs, as they affect banks and otherwise. At least the two amendments we have accepted do relate to banks, which should help on scope.

7. The removal of unincorporated business lending would not only affect banks. Small loans are also made by non-bank lenders. So it would be difficult to limit the scope of the Bill to banking matters, or even to consumer matters as they affect bank lending.

8. Our case is not as strong as it might be, especially in rejecting a politically attractive change. But it is worth sounding a warning note. A draft letter to Lord Young is attached.

MAS

M A HALL

c c Mr Nicolle BoE

1785/013

~~DRAFT~~

Pl type

The Rt Hon Lord Young of Graffham
Secretary of State for Employment
Department of Employment
Caxton House
Tothill Street
LONDON
SW1H 9NP

much in sympathise with your policy objective,

CONSUMER CREDIT ACT (CCA)

I have seen a copy of your letter to Michael Howard of 27 March. I am writing to let you know at this early stage that, I cannot forsee the Banking Bill being available as a vehicle for (the substantial amendments ~~of~~ (you seek to the Consumer Credit Act.

The amendment that we hope to deal with on EFT-POS has been planned for some time and is a minor, technical one. Apart from one other small change consequential on the Building Societies Bill, we do not envisage being able to deal with any further consumer credit matters, both because of the timetable for early introduction of the Bill and because of the need for its scope to extend as little as possible beyond banking supervisory matters. Even the EFT-POS amendment represents a calculated risk, which we have taken on the basis that it was required urgently and was a technical and non-controversial matter, unlikely to open up the Bill to wholesale CCA amendments. Even so, it has been necessary to impress on both the banks and the National Consumer Council that we are unable to consider any other items on the lengthy 'shopping lists' of CCA amendments they are respectively seeking.

It is for Michael Howard to comment on any problems opening up the CCA in this way might cause for the DTI's line and legal resources. I should have thought it was better to reach a considered view on the CCA as the culmination of the monitoring process which has just begun. This is not to say that I do not support the amendments you are seeking. But I fear that the risk they pose to the scope and timing of the Banking Bill do not permit their inclusion.

I am sending a copy of this letter to Michael Howard.

IAN STEWART

Caxton House Tothill Street London SW1H 9NF
Telephone Direct Line 01-213 6460
Switchboard 01-213 3000

MR JONES
FOR ADVICE AND
DRAFT REPLY IF
APPROPRIATE
PLEASE BY: 16/4

Copies cc
MR CAINE
MR NEWTON
MR BURR
MS ST JOHN
BROOK

Michael Howard Esq QC MP
Parliamentary Under Secretary of State
Department of Trade and Industry
1 Victoria Street
LONDON SW1H 0ET

27 March 1986

Dear Michael,

CONSUMER CREDIT ACT (CCA)

Thank you for your letter of 7 March.

I welcome your positive approach to considering whether business lending might be excluded from the provisions of the CCA. I have to say that the messages I am receiving from the banks is that they do regard this as a top priority and I feel they have a strong case.

I agree with you that we must take the views of the customers through small business organisations, not least because small loans are often made by lenders other than banks. The customer may regard CCA protection as valuable in some cases. However, my officials would be pleased to help yours complete the necessary consultation wtihin weeks so that any early decision can be made.

My concern to bring a decision forward is that this issue has been consistently raised as a priority for amendment since I took on the deregulation initiative and I have as yet heard no convincing arguments against. It is not unreasonable for the banks and others to look for our conclusions in the forthcoming deregulation White Paper.

I apprecaite your points on timing. However, would not an early decision help in that we could explore whether the Banking Bill could be used to amend the CCA (as with your EFT/POS proposal). Alternatively, the amendment should prove attractive as a Private Member's Bill in the next session.

Yours,

Norman

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215 4417
GTN 215)
(Switchboard) 215 7877

From the Parliamentary Under Secretary of State for Corporate and Consumer Affairs

Michael Howard QC MP

File No.

Copies to:
PS/Mr Morrison
Mr Caines
Mr Burbridge - CA
Mr Burke - Inf
Ms St John-Brooks - GP
Mr Jones - CA1 (on file)

The Rt Hon Lord Young of Graffham
Secretary of State for Employment
Department of Employment
Caxton House
Tothill Street
LONDON
SW1H 9NF

7th March 1986

Dear David

CONSUMER CREDIT ACT (CCA)

Thank you for your letter of 21 February. I welcome your support for our proposed action on EFT/POS.

I have seen the paper by Mr Wheatley to which you refer and indeed Leon Brittan and I [redacted] discussed with him a range of CCA issues, including lending to small unincorporated businesses, when we met him on 21 January.

As you know, the banks are represented on the Monitoring Group which we have set up to keep the working of the Act under review and all the points raised in Mr Wheatley's letter will have been taken on board by the Group by the time it reports to Ministers in July. The question of lending to unincorporated businesses was covered by the Group at its most recent meeting on 18 February.

The existing CCA provisions in this area were decided on for two reasons: first because it was considered by Crowther that some small traders should enjoy the protection of the Act but also because it was felt that a "purpose of loan" test could present lenders with serious difficulties. At the 18 February meeting, however, the banks argued, with some support from the finance houses, that this approach would be greatly preferable from their own point of view. We still need to look at the issue from the point of view of the potential borrowers, however, and my officials will shortly be consulting organisations representing small firms, in consultation with your own Small Firms Division, to ascertain their views.

LT3ADW

If this consultation reveals no strong arguments in favour of the existing provisions then I would agree that there would be a strong case for making changes on the lines that the banks seek. On timing, however, we need to bear in mind that this would require primary legislation and I believe that the banks themselves would not regard this as their priority for amendment of the CCA. I do not therefore think that we should single out this point for special mention in the forthcoming White Paper. However, I believe that, as our MISC 121 paper indicates, we will nevertheless have a reasonable story to tell, in that the Monitoring Group is examining the whole range of issues that give rise to concern. The report of the Group will give us a clear idea of those matters on which action may be desirable, together with an indication of their relative priority. This of course is in addition to those amendments which we have already made to deal with specific business difficulties.

Yours ever
Michael

MICHAEL HOWARD

LT3ADW

TB

C.C.B.

SECRETARY OF STATE FOR EMPLOYMENT

RECEIVED 24 FEB 1986 PARLIAMENTARY UNDER SECRETARY OF STATES OFFICE (CCA)

Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-213 6460

Switchboard 01-213 3000

Michael Howard QC, MP
Parliamentary Under Secretary of State
Department of Trade and Industry
1-19 Victoria Street
LONDON SW1

21 February 1986

Dear Michael,

CONSUMER CREDIT ACT

You will have seen the letter of 15 January from Mr D P F Wheatley of Lloyds Bank, enclosing a paper by the Midland Bank, about difficulties caused by the Consumer Credit Act. Mr Wheatley wrote to me with a copy to you, following a lunch meeting at Lloyds at which I invited feedback on business burdens.

I was very pleased to see your written answer to the House on 28 January confirming the intention to amend the Act in the forthcoming Banking Bill to facilitate the development of EFT-POS. This is welcome indeed.

I should be grateful to know whether you have plans to deal with the other difficulties Lloyds and Midland raise, particularly in respect of small loans to unincorporated businesses. I know you are familiar with the issues through your monitoring group on the Act and, as I have already indicated to Peter Morrison in correspondence about MISC 121, I believe we should aim to have progress to show in our deregulation White Paper, due in May.

Love,

David

ADVICE AND REPLY IF [APPROPRIATE] PLEASE BY: 3/3 extended to 4/3

Copies to

2931/042

ECONOMIC SECRETARY TO THE TREASURY

FROM: M NEILSON
DATE: 14 April 1986

PS/CHANCELLOR

BANKING BILL : AMENDMENTS TO THE CONSUMER CREDIT ACT

The Economic Secretary has seen Mr Hall's minute of 11 April and thinks the Chancellor should both see it and sign it himself. The Economic Secretary is content with the draft.

M NEILSON

Ch/ The Ld Young proposal is another [illegible] of how he has [illegible] on [illegible]. Much groaning from [illegible] & Bank today about the idea of putting any more CCA stuff into the Banking Bill.

Content to write as suggested?

KC
15/4

OK [illegible]

LR1.73

cc EST
PS/Sir P Middleton
Mr Cassell
Mr Peretz
Mr M A Hall
Mr D Jones
Mr P Hall
Mr Eversheld
Mr Guy
Mr Brummel (T.Sol)

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

16 April 1986

The Rt Hon Lord Young of Graffham
Secretary of State for Employment
Department of Employment
Caxton House
Tothill Street
LONDON SW1H 9NP

CONSUMER CREDIT ACT (CCA)

I have seen a copy of your letter to Michael Howard of 27 March. I am writing to let you know at this early stage that, much as I sympathise with your policy objective, I cannot foresee the Banking Bill being available as a vehicle for the substantial amendments you seek to the Consumer Credit Act.

The amendment that we hope to deal with on EFT-POS has been planned for some time and is a minor, technical one. Apart from one other small change consequential on the Building Societies Bill, we do not envisage being able to deal with any further consumer credit matters, both because of the timetable for early introduction of the Bill and because of the need for its scope to extend as little as possible beyond banking supervisory matters. Even the EFT-POS amendment represents a calculated risk, which we have taken on the basis that it was required urgently and was a technical and non-controversial matter, unlikely to open up the Bill to wholesale CCA amendments. Even so, it has been necessary to impress on both the banks and the National Consumer Council that we are unable to consider any other items on the lengthy 'shopping lists' of CCA amendments they are respectively seeking.

It is for Michael Howard to comment on any problems that opening up the CCA in this way might cause for the DTI's line management and legal resources. But I should have thought it was better to reach a considered view on the CCA when the Monitoring Group has reported, as Michael suggests. This is not to say that I am not in sympathy with the amendments you are seeking. But I am afraid that they would pose an unacceptable risk to the scope and timing of the Banking Bill.

I am copying this letter to Michael Howard.

NIGEL LAWSON

0082f 12.5.86

From: D M SUTHERLAND

MR QUINN 12/5
THE DGPS

Copies to: Mr Galpin
Mr Cooke
Mr Barnes
Mr Nicolle
Mr Beverly

ANNUAL REPORT UNDER THE BANKING ACT

I attach a draft of the covering letter from the Deputy Governor to the Chancellor. I understand that the first printed copies of the Report should become available tomorrow.

Banking Supervision Division HO-2
12 May 1986

D M Sutherland (5021)

0081f

BANK OF ENGLAND

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
London
SW1P 3AG

BANKING ACT 1979

Section 4 of the Banking Act provides for the Bank of England to report each year to the Chancellor of the Exchequer on its activities in the exercise of the functions conferred on it by the Act; and for the Chancellor to lay the Report before each House of Parliament. In the Governor's absence abroad, ~~of the Governor~~, I enclose the Bank's seventh such Report, covering the year ended 28 February 1986. We ~~It is~~ intended to publish the Report on 19 May.

As in previous years
The Governor will, on his return, be sending you ~~the usual~~ a memorandum providing some background to developments affecting UK banks over the year. Since the report itself is fuller this year than usual, this covering memorandum will be somewhat briefer than in previous years.

We have told HMT it will be shorter this year.

BANK OF ENGLAND
LONDON EC2R 8AH

THE DEPUTY GOVERNOR

13 May 1986

*ADVICE BY 15/5 PLEASE

CH/EXCHEQUER

REC.	14 MAY 1986
ACTION	Mr Hall *
COPIES TO	PS/Est
	Sir P. Middleton
	Sir T. Burns
	Mr Cassell
	Mr Peretz
	Mr D. Jones

14/5

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London
SW1P 3AG

Dear Chancellor

BANKING ACT 1979

Section 4 of the Banking Act provides for the Bank of England to report each year to the Chancellor of the Exchequer on its activities in the exercise of the functions conferred on it by the Act; and for the Chancellor to lay the Report before each House of Parliament. In the Governor's absence abroad, I enclose the Bank's seventh such Report, covering the year ended 28 February 1986. We intend to publish the Report on 19 May.

As in previous years the Governor will, on his return, be sending you a memorandum providing some background to developments affecting UK banks over the year. Since the Report itself is fuller than usual, this covering memorandum will be somewhat briefer than in previous years.

Yours sincerely

George Blunden

2934/061

Confidential

FROM: M NEILSON
DATE: 14 May 1986

MR JONES

cc: Mr Peretz
Mr Hall
Mr Evershed
Mr Brummell T.Sol.

BANKING BILL : CONDITIONAL AUTHORISATION

The Economic Secretary has seen your minute of 9 May on this subject. He is still not convinced by the Bank's arguments against a power to impose conditions on authorisation in cases where revocation is not justified. It seems to him that the Bank's argument is based on the false premise that giving them a power to make such conditions imposes a duty on them to do so. It is only if this is the case that the Bank's argument that a power to impose conditions would involve a major increase in legalistic supervisory interference would hold water. The Economic Secretary would like to know whether Treasury/Treasury Solicitors think it would be possible to draft a reserve power for the Bank to impose conditions in these cases without any presumption that they would necessarily use it except in the most exceptional cases. Though the Bank argue that this power would be superfluous the Economic Secretary thinks it might well turn out to be a useful part of their armoury at a future stage, since it is difficult to anticipate now how the nature of supervisory problems will develop as markets change.

2. He would also like an explanation of the difference between restrictions and conditions referred to in your paragraph 3; is this purely a legalistic distinction or does it have operational consequences?

M NEILSON

36/3067

S E C R E T

FROM: DAVID PERETZ
15 May 1986

CHANCELLOR

cc Economic Secretary
Sir P Middleton
Mr Cassell
Mr Sedgwick
Mr Walsh
Mr Richardson
Mr Ross Goobey

INDEX LINKED STOCK

You asked last Friday (Mrs Lomax's minute of 9 May) for a short paper about options for new index linked issues - the alternatives to the Bank's proposal (subsequently withdrawn) for a new 2024 IG.

3. The Bank have written the attached paper at our request. It summarises the main options, and the conditions in which they would be appropriate. It also describes how conditions in the IG market have developed since a week ago. You will see that the Bank would like contingent authority - if conditions are right - to bring £300m of IG tranchettes tomorrow, at a range of maturities up to 2013.

4. Paragraph 4 of the attached note sets out the other options. There are at least two not included in the list:-

(a) A new stock in the 1995-2020 maturity range. There are strong arguments for filling in the many gaps that exist at present in the range of available IG maturities.

(b) The idea we identified some time ago for a conventional short, with a double conversion option, one leg into a long conventional, the other into a long IG. This can perhaps be regarded as a variant of (iv) on the Bank of England's list, and is subject to similar considerations.

5. I do not quite agree with the Bank's analysis of the pros and cons of index linked convertibles (paragraph 4(iv) of their note). First, it should not in principle be taken as a sign

that we are uncertain about the course of future inflation. It would be a sign that we acknowledged that the market was uncertain, not that we were uncertain ourselves. The option, after all, is one to be exercised against us. If we were uncertain, we would want to issue a convertible where the option was exercisable by ourselves, not by the holder. Second, I do not see anything intrinsically wrong with accepting that the market knows there will be a General Election within the next two years or so.

6. The more important point, it seems to me, is that on the whole we have tended not to get a great deal of benefit in terms of a better price from offering options in the past. The benefit we have usually achieved is to get the market going again, when it is stuck. The market is not stuck at present. We have been meeting our funding targets well so far this year, and have a good deal of funding tied up for the future. So we are not in any difficulty, and would not want to give the market any cause to think that we were. So I would agree with the conclusion that we should stick to something more conventional for now; but would like to discuss further with the Bank the kind of conditions where this kind of innovation might be appropriate.

7. Of the other options in the Bank's list, I should be perfectly happy to go for a new longer stock, as the Bank proposed last week, if that is where a demand is. The 2020 IG was issued three years ago, and 2024 would be a natural extension. But demand at the long end has dropped off.

8. I would also be keen to fill in some of the gaps in the spectrum of IG issues. We should, I think, try to adopt this as a strategy. The more complete the range of maturities the easier it will be for insurance companies and pension funds to tailor their IG holdings to meet their particular portfolio needs.

9. That said, I would not object to the Bank's proposal to issue a small package of IG tranchettes tomorrow, if conditions are right: and suggest we give them the contingent authority they request. But I would hope that the next move (in the IG market) might be to take an opportunity to fill in one of the missing maturity dates with a new issue.

DLCP

D L C PERETZ

THE GILT-EDGED MARKET: INDEX-LINKED STOCK
(Note by the Bank of England)

1 Our proposal last week for contingent authority to bring a new 2024 index-linked stock reflected the steady improvement that sector has experienced in the past few weeks: yields at the long end have fallen from 3 3/4% in mid-January to just over 3% now, and at the short end from 5% to 3 1/4%. In the process we have been able to sell some £400 mn of index-linked stock, much of which we had bought earlier in bouts of market weakness.

2 We suggested last week a new stock with a long-dated maturity because it was in that area that buying interest was at that stage most evident. Moreover, in terms of the broader development of the index-linked market, a number of pension funds have indicated to us that longer-dated index-linked gilts, even beyond the existing range of maturities, might help to match their pension liabilities, and there might therefore be demand for stock beyond 2020. This is corroborated by the fact that the index-linked curve is downward sloping at the long end. We also think that it is helpful, where possible, to widen the range of available maturities so as to provide more scope for switching among the various maturities and thus help to develop the liquidity of the market.

3 Since the weekend, however, demand for the IGs has become somewhat more fitful, and the focus of interest has shifted to the mid-range maturities in the early 2000s. The rally has also begun to show signs of becoming ragged, in the face of expectation that we will bring new stock but uncertainty as to what our move will be. On this basis we would want to try again to bring stock this coming Friday, 16 May, but our proposal now would be for a small package of tranchettes totalling around £300 mn - probably £100 mn each of 2003, 2009 and 2013, though the precise size and components may need to be fine-tuned at the last moment.

4 There are a number of other possible approaches to the index-linked sector which we keep under review, but we do not think any of them would be appropriate in the present market situation. The main alternatives are:

(i) A new longer stock, beyond the existing longest maturity of 2020, as discussed in paragraph 2 above. We would want to revert to this proposal when the tone of the IG sector is more robust.

(ii) A new short maturity. As it approaches maturity, the 1988 stock is increasingly trading as a conventional, and there is a case for replacing it with a stock maturing in the early 1990s. However, demand at present is clearly focused somewhat further up the maturity range in the early 2000s.

(iii) Either of the above options could be made with FOTRA provision, as an experiment to test whether there is latent foreign demand for index-linked gilts. However, we cannot introduce the FOTRA provision for tranchettes, which have to conform with the features of their parent stocks.

(iv) An index-linked convertible (ie an index-linked stock convertible into a conventional), which we understand the Chancellor has suggested. The natural opportunity for an index-linked convertible would arise when the market was being affected by a particular uncertainty about the outlook for inflation, which could be expected to be resolved before the buyer of the stock would have to decide whether to convert. It was in circumstances of this kind that we brought the 1999 index-linked stock shortly before the 1983 general election. But to issue a stock of this kind in present circumstances would run the risk of giving the market quite the wrong signal, by implying that we may have doubts whether the present improvement in inflation will be sustained. The same instrument in reverse, ie, a

conventional convertible into index-linked, carries essentially the same implication, but is presentationally worse in that it might be taken as offering a hedge against a change of government.

5 We would therefore like to seek contingent authority to be able to proceed with a package of tranchettes on the lines indicated above if conditions in the index-linked market are appropriate on Friday. Conditions in this area can however, change quickly: we may have to revert if we see the need to alter our recommendation before then, or we may need to defer bringing any stock at all.

Bank of England
14 May 1986

LR2.35

SECRET

FROM: MRS R LOMAX
DATE: 16 May 1986

MR PERETZ

cc Economic Secretary
Sir P Middleton
Mr Cassell
Mr Sedgwick
Mr Walsh
Mr Richardson
Mr Ross Goobey

INDEX LINKED STOCK

The Chancellor was grateful for your minute of 15 May. He is content to give the Bank contigent authority to issue a package of IG tranchettes today, at a range of maturities up to 2013 - if that is what they really believe a 3 per cent RPI calls for!

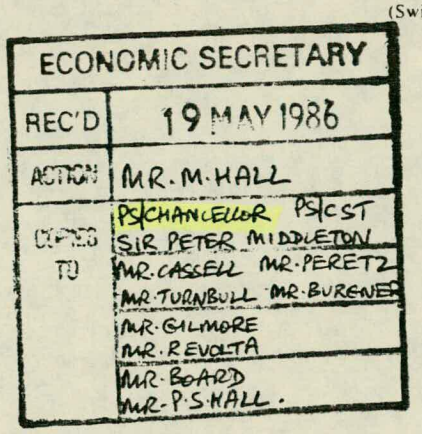
2. The Chancellor will be reflecting further on the wider issues raised in your note and the Bank's paper.

RACHEL LOMAX

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215 4417
GTN 215
(Switchboard) 215 7877

From the Parliamentary Under Secretary of State for Corporate and Consumer Affairs

Michael Howard QC MP



bf 20/5

Ian Stewart Esq MP
Economic Secretary
H M Treasury
Treasury Chambers
Parliament Street
LONDON SW1

16th May 1986

Dear Ian

DISCLOSURE OF INFORMATION OBTAINED UNDER THE BANKING ACT 1979

The White Paper on Banking Supervision stated that the new legislation on Financial Services would secure amendments to the Banking Act so that information obtained by the Bank of England could be disclosed to other supervisory authorities. My concern is that a regulator who has received such information should be able to disclose it in order to discharge his functions. There would be scope for embarrassing criticism if he were prevented from acting on information he had received.

It is agreed that the Bank should have complete discretion whether to disclose information to a financial services regulator. When it does so the regulator may himself need to disclose the information in order to discharge his own functions. The information may be the vital piece of the jig-saw which enables necessary action to be taken against an investment business to protect investors. The designated Agency, for example, is required to state its reasons when serving notice on the business of its intention to act. Including the Bank's information in the notice, or providing it to the tribunal, would constitute disclosure.

I understand that the Bank wishes to have an absolute veto over disclosure by a regulator to which it has provided information. If that veto were exercised the regulator could be placed in the extremely difficult position of knowing that action should be taken, but being prevented from taking it. It would be improper for the regulator to rely upon information which could not be disclosed as a basis for acting.

J03AJF

The regulator, once alerted by the Bank, will sometimes be able to avoid the problem by obtaining other information to justify the action required. But my concern here is with the hard case where this is impossible.

I recognise the sensitivity of much banking information, and I appreciate that there may be cases where that consideration should be allowed to prevail over the needs of investor protection. But there will be other cases where the threat to investors should be the predominant consideration. I cannot accept that the Bank should be the sole judge of where the balance of advantage lies.

I therefore propose that the financial services regulator should be able to diclose Banking Act information given to him, provided that two conditions are both met. The first is that such disclosure will enable or assist him to discharge his own functions. The second is that he should first consult the Bank and have regard to its views.

In order to facilitate co-operation between the Bank and the financial services regulators, it might help if there were to be an agreement between them on the factors to be taken into account before a decision is made. I am sure this possibility could be explored if you thought it would help.

In the meantime, however, we need to decide quickly what provisions should be included in the Financial Services Bill. We are already well-advanced in drafting amendments to the disclosure provisions in the Insurance Companies Act and Companies Act and we will be tabling these for Commons Report Stage. There would be considerable advantage in covering the Banking Act at the same time. I would therefore appreciate your views early next week.

I am copying this letter to the Governor of the Bank of England and to Sir Kenneth Berrill.

Yours ever

Michael

MICHAEL HOWARD

J03AJF

2934/067

FROM: M NEILSON
DATE: 16 May 1986

PPS

cc: Sir P Middleton
Mr Cassell
Mr Peretz
Mr Sedgwick
Mr Walsh
Mr Richardson
Mr Ross Goobey

INDEX LINKED STOCK

The Economic Secretary has seen Mr Peretz's minute of 15 May to the Chancellor. Like the Chancellor he sees no reason to object to the Bank's proposal and has commented that it is always worth considering innovative funding methods, but in the near future both the market situation and the current funding position seem suitable for an uncomplicated approach, including some gap filling in both indexed and conventional gilts (where suitable stock for subsequent tranchettes are often lacking because of historically high coupons).

M NEILSON

LR2.42 SECRET

FROM: MRS R LOMAX
DATE: 19 May 1986

PS/ECONOMIC SECRETARY

cc Sir P Middleton
Mr Cassell
Mr Peretz
Mr Sedgwick
Mr Walsh
Mr Richardson
Mr Ross Goobey

INDEX LINKED STOCK

The Chancellor has now looked again at Mr Peretz' submission of 15 May, and its attachment. He has reached the following conclusions:-

- He is strongly in favour of trying FOTRA IG at the earliest opportunity.

- He also favours returning to the attack on an IG convertible: he has commented that the market will increasingly be overshadowed by fears of an adverse General Election result, and will want to hedge against it. But the conversion option should not be too generous.

- In general, the Chancellor would like IGs of one kind or another to constitute a higher proportion of total funding than has hitherto been the case.

2. The Chancellor would be grateful for a brief note on options for conversion offers of existing convertibles into IGs (he is aware that this has already been touched on recently - as well as in the past).

RACHEL LOMAX

36/7

RNP

FROM: R N G BLOWER
DATE: 19 MAY 1986

1. MR WALSH

2. PARLIAMENTARY CLERK

cc: PS/Chancellor
PS/Economic Secretary
Mr Richardson
Mr Brummell - T.Sol

THE BANKING ACT 1979 (EXEMPT TRANSACTIONS) (AMENDMENT) REGULATIONS 1986 NO.769

As I mentioned to you last week three words were erroneously left out of the typescript version of the Explanatory Note which was laid, second paragraph, second sentence, that materially alters the sense of the sentence. Where it says ".....the company issuing the commercial paper (or its guarantor parent) are not less than £50 million...." the words "not less than" were added at proof stage. We agreed that it might be courteous to point this out to the Clerk of the Joint Committee on Statutory Instruments.

2. I attach a draft reply.

R N G BLOWER

DRAFT LETTER TO:

The Clerk
Joint Committee on Statutory Instruments
House of Commons
London SW1 0AA

You may wish to be aware that amongst other corrections three words have been added to the Explanatory Note of The Banking Act 1979 (Exempt Transactions) (Amendment) Regulations 1986 S.I. No.769. These words "...not less than..." were erroneously omitted from the typescript version in the second sentence of paragraph 2 which read "...the company issuing the commercial paper (or its guarantor parent) are £50 million...". In view of the fact that the material accuracy of the Explanatory Note was inhibited by this omission the Note has been amended to read "...are not less than £50 million...".

(BOD)

RA/090

cc PS/EST
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Hall
Mr Peretz
Mr D Jones

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

George Blunden Esq
Deputy Governor
Bank of England
London
EC2R 8AH

19 May 1986

Dear Deputy Governor,

BANKING ACT 1979

The Chancellor was grateful for your letter of 13 May, attaching a copy of the Bank's seventh Annual Report, for the year ended 28 February 1986. He looks forward to seeing the Governor's usual memorandum.

Yours sincerely
Rachel Lomax

RACHEL LOMAX

Rachel
D. Board is dealing
He will be submitting
advice in a couple of
days time.
[illegible] 20/5

bf with advice
(by 28/5 pm)

The Governor

Bank of England
London EC2R 8AH

19 May 1986

bf 30/5

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London
SW1P 3AG

CH/EXCHEQUER
REC. 19 MAY 1986
ACTION MR HALL
COPIES TO PS/EST
SIR P. MIDDLETON
SIR T. BURNS
MR CASSELL
MR PEEFTZ
MR D. JONES

V 19/5

Dear Nigel,

BANKING ACT 1979

The Deputy Governor wrote to you on 13 May enclosing copies of the Bank's seventh report under the Banking Act, which is being published today. He mentioned that I would be sending you, on my return from abroad, a memorandum providing some further background to developments affecting UK banks over the past year, and this is now enclosed.

Yours ever,

Robin

SECRET UNDER SECTION 19 BANKING ACT

PRUDENTIAL SUPERVISION OF BRITISH BANKS*

1. This paper develops a number of the points raised in the formal report on the exercise of the Bank of England's responsibilities under the Banking Act, and comments on the supervisory aspects of some of the more significant developments in the banking system during the last year not covered in the report.

I Capital Adequacy

2. This year's annual report gives a fuller account than published hitherto on trends in capital adequacy of UK banks. This subject has also been covered at the regular six-monthly discussions on prudential issues held between Bank and Treasury officials.

3. As mentioned in the report, UK banks made significant progress in strengthening the quantity and quality of their capital during the year, which was especially needed given the fall in capital ratios which had taken place over the period 1980-84. A large part of this improvement was achieved through the issue of primary perpetual subordinated debt and by a higher level of retained earnings.

4. The some £4 1/2 bn primary perpetual subordinated debt which was raised during the year represented an entirely new form of capital for UK banks. The Bank believes that such debt can, inter alia, absorb losses while allowing the bank to continue to trade - unlike term subordinated loan capital - and therefore represents high quality capital. It is often issued in foreign currency, which gives a measure of protection against the effects of fluctuations in exchange rates on capital ratios.

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* For simplicity, the term "banks" is often used in this paper to cover both recognised banks and licensed deposit-takers.

5. Following a profitable year in which the pretax profits of the four major clearing banks rose at a higher rate than in the previous year, averaging a rise of 35% (14% in 1984), the retentions of the four major clearers last year totalled £1060 mn, almost double that of 1984.

6. The following table shows the average of the risk asset and gearing ratios for the four major clearing bank groups since 1980 and shows the marked improvement in ratios in 1985.

	1980	1981	1982	1983	1984	1985
Risk asset ratio	8.5	7.9	7.4	7.9	7.2	9.4
Gearing ratio	4.5	4.2	4.2	4.8	4.5	6.5

British banks are now fairly well capitalised by international standards. Much of the enhanced level of capital adequacy achieved at end-1985 is due to the particular contribution of primary perpetual subordinated debt. As banks have already used up a significant part of their capacity to issue such stock within supervisory limits, there will not be the same scope for further issues in future years. The Bank also recognises that many banks have built up their capital resources ahead of "Big Bang". These factors suggest that capital ratios in the current year may not show a further significant improvement.

7. The performance of British banks last year must also be considered against the increased risks inherent in banks' business as regards both domestic and international activity. On the domestic side, the total charge for domestic specific provisions of the four major clearing bank groups has continued to rise, up 20% on 1984. From a supervisory perspective this is a point to watch but it is not yet a matter for concern. We might have expected domestic bad debt experience to have bottomed out by now; however, the last recession was unusually severe. The banks themselves have not indicated any particular area of difficulty. The general picture is of losses arising mainly among small and medium sized businesses and personal borrowers, but we shall of course be watching developments closely.

II Provisions for international debt

8. The last year has been a period of mixed fortunes for banks with international lending. On the one hand, the lowering of US interest rates, lower oil prices (for oil importing countries) and a steady, if unspectacular, growth in world trade have all been broadly helpful factors which might have restored a better sense of balance in the market. On the other hand, however, it is clear that the financial position of some of the major problem country debtors, particularly those which are oil exporting countries, is more serious than a year ago and their difficulties continue to dominate the outlook for banks with significant lending to these areas. The moratorium on payments imposed by South Africa has had a further effect on the outlook for certain banks.

9. Against this background the Bank viewed with disappointment the rather modest level of provisions set aside against international lending during the period. There can be an important trade off between additions to retained earnings and to general provisions, and in some cases retentions have been at the expense of general provisions. As a result of the greater emphasis given to retentions, UK banks have generally provided somewhat less against their international exposures than some of their European counterparts. European banks have generally made provisions averaging 20% of their exposures to the principal problem debtor countries, but those from Japan, US, and Belgium, have made significantly lower percentage provisions. UK banks fall in between these two groups. The tax treatment of banks' provisions against international debt also varies widely from country to country and in some cases is related to the provisions required to be made by the national supervisory authority.

10. The Bank will be pressing banks hard to build up their provisions for sovereign debt, at the same time as expecting them to sustain the improvement in their capital ratios. In the course of the current year, our officials may need to look again at the tax treatment of provisions set aside against sovereign risk, if this is an issue to which the banks return in their discussions with the Bank.

III Competitiveness

11. Although the banking community's approach to the principal issues currently the subject of consultation has been positive and constructive the banks have, perhaps inevitably, serious concerns about the effects supervisory action may have on their competitive position internationally and vis-a-vis non-banks. These concerns embrace, for example, the Bank's treatment of off balance sheet risks, and large exposures, especially when considered in the context of the new financial groupings currently being formed. They will also need to be met if, and when, the Bank's proposals for a primary liquid assets requirement, referred to in paragraph 14, are accepted. The Bank is sensitive to these concerns and has, for example, been urging other supervisors to adopt a similar approach to off balance sheet business. (In this context, the Annual Report refers to the work of the Basle Supervisors Committee in this and other supervisory areas.)

12. Competitive forces will be one factor that the Bank will take into consideration in its deliberations, but it will have to be balanced against the need for prudence and cannot be the overriding factor.

Off Balance Sheet Risk

13. The Bank's consultative paper on the off balance sheet business of banks appears to have been well received. The banks generally accept the analysis of the risks involved and are content with the broad framework of risk assessment proposed. However, there remain a number of issues on which further work will be required, particularly in relation to the degree to which a lending bank is committed both legally and in practice under various types of agreed credit lines and facilities; the formulae to be used for estimating the credit risk involved in interest rate and foreign exchange rate instruments; and the allocation of conventional contingent exposures among the three risk categories proposed. This work is in hand and once progress has been made on these issues we will be in a position to discuss numerical weightings in the risk asset ratio. The banks have suggested that some instruments might be excluded on de minimis grounds and the Bank is prepared to consider this.

Liquidity

14. The Bank has been in discussion with Treasury officials about the proposed introduction of a primary liquid assets requirement for all authorised institutions, following withdrawal by the end of October of the arrangements under which all eligible institutions undertake to maintain balances of secured money with members of the LDMA and with Stock Exchange money brokers and gilt-edged jobbers.

15. The withdrawal of this arrangement would remove the obligation on a significant part of the banking system to hold a substantial quantity of prime quality sterling assets. The Bank is concerned to ensure that a certain level of such assets should exist within the system at all times. To achieve this it has therefore been proposed that a primary liquid assets requirement in sterling should be introduced for all institutions authorised under the Banking Act. The precise details of this new arrangement, including how the liquidity should be dispersed amongst institutions within the system and how the requirement is to be calculated, would be developed in discussion with the banking community.

Large Exposures

16. Since the publication of a consultative paper in July 1985 the Bank has held discussions with the banking community on its proposed policy on banks' large exposures. Much of these discussions has concerned the detailed implementation of the policy rather than the general principles, although there has been resistance from some banks whose business will be significantly affected to the idea of generally restricting individual exposures to 25% of a bank's capital base. The results of these discussions will be reflected in a further consultative paper which should be issued shortly. A number of the revised proposals are likely to cause strong protests from some banks, and particularly from members of the Accepting Houses Committee in relation to their traditional underwriting business; we will need to listen carefully to their representations in this area. Although comments on the paper will be invited, the Bank will however make it clear that it does not in general

expect the finally agreed policy to differ substantially from the revised proposals.

Group relationships

17. The changes presently in progress in the City leading to the formation of financial services groups have had to be taken into account in framing a large exposures policy for banks. In particular the Bank, as the banking supervisor, has had to give consideration to banks which propose to offer treasury services to other group companies which are supervised by other UK supervisory authorities. Restricting a bank's exposures to such companies risks damage to the underlying rationale for the formation of groups designed to compete in the new securities markets. Nevertheless, an overconcentration of exposure to other group companies conflicts with the general principle that banks should diversify their risk taking. It is difficult to judge how far the principle is compromised by allowing banks to lend to group companies even though such companies will be closely supervised by other supervisors. The Bank will, therefore, continue to examine closely banks' policies for lending to group companies and will in particular discourage strongly exposures to other group companies which are not made on arm's length terms or are otherwise disguised capital injections.

IV Branches of overseas banks

18. In the last year problems affecting a number of existing branches of overseas banks, together with proposals from banks from some countries to establish branches here, have led us to look more closely at our approach to branch supervision. The latter rests on the Basle Concordat and recognises that as the host supervisor we have to rely on the parent supervisory authority for reassurance about the overall financial soundness and managment of an institution. Concerns may arise where the home supervisory authority adopts different standards or lacks the resources to carry out supervision beyond its national boundaries.

19. An application to open a branch here means that we have to look most carefully at the standard of supervision applied by the

bank's parent authority and if this is found wanting apply pressure for its improvement. How this is done depends on whether or not the country concerned already has any other of its banks represented here. If not, the position is relatively straight-forward; if we cannot get the assurances we would like about improvements in the supervision of the parent authority, we would not grant the bank a licence. If, however, there is already representation here the situation is less simple but essentially we seek to get the standard of supervision improved and, if necessary, to restrict the branch activities carried out here while those improvements are forthcoming.

20. In the last year or so there have been a number of cases where we have encountered problems and developed doubts about the home supervision of branches already in London - mainly from banks in the Indian sub-continent and the Middle East. In these cases we have discussed the issues with the parent supervisory authority and the head office of the bank concerned so as to ensure that depositors' interests were protected, a programme of remedial action is in place and that the parent authority understood and accepted its responsibility for the supervision of the branch. Given the wide representation in London of branches from many different countries such dialogue with the head offices of banks and their parent supervisors seems likely to continue as an important part of our supervisory approach.

21. In the last year, however, probably the most conspicuous problem concerning branches was caused by the South African debt moratorium which embraced the activities of their banks not only in South Africa but also, in the case of Nedbank, of the bank abroad, including its London branch. This led to extensive discussions with the South African authorities to see how depositors' interests might be best served and the situation remedied. The conclusion reached was that revocation of Nedbank's licence might be counter productive to the interests of depositors and, given the South African Reserve Bank's undertaking to stand behind the institution, it was decided to watch carefully the progress of discussions between the creditors and the South Africans. Meanwhile, steps are being taken by the South Africans to tighten the supervision of their banks' overseas branches and

we continue to monitor closely developments in them. So far as Nedbank is concerned events have so far justified the decision not to revoke.

V Banks' auditors

22. Since the publication of the White Paper we have continued to develop the proposals for a closer relationship with banks' auditors. It has been necessary to clarify the legal basis of the relationship, on which there have been differences between the lawyers, and to refine, and where possible remove, differences between the regimes proposed under the Banking, Financial Services and Building Societies Bills. The auditors' request for a measure of immunity has added a further complication to the legal debate.

23. We intend to publish shortly a consultative document on the proposed regime for branches of overseas banks, to be followed by further papers setting out the Bank's views on what constitutes adequate accounting records and internal controls, and the content of the reports we will require on these and the statistical returns made to the Bank. These proposals will have to be discussed with the accountancy bodies and banking associations, as a result of which the former will develop guidance for accountants on the work which they will need to do to meet our requirements. It is hoped that by the end of the year we shall be able to initiate a trial run of the system with a small group of banks and their auditors.

24. Some guidance will also be given by the profession on the circumstances in which auditors should provide information to the supervisors and will expand on Annex 4 to the White Paper; this will first be agreed with the Bank, Treasury officials and the BBA.

VI The timeliness and accuracy of statistical returns

25. Our controls and procedures for ensuring the timely submission and accuracy of statistical returns have been strengthened in the last year. Whilst in general the reporting record of banks/ldts has not given the Bank cause for concern,

steps have been taken to ensure that individual lapses in reporting standards are dealt with both consistently and promptly; and to introduce procedures which enable the Bank to focus quickly on inconsistencies, and variations in the manner and standard of reporting revealed in the various forms lodged by banks and ldts.

26. So far as individual lapses are concerned, reporting institutions are now telephoned as soon as the due date has passed for any major form; with good results in raising timeliness standards generally. Where forms remain outstanding after a further period - which varies between two and ten days depending on the time allowed for submission of forms - a letter is sent to the institution requesting immediate submission of the form.

27. So far as the wider review of reporting standards is concerned, the aim has been to identify and improve the standards of those banks which are frequently a few days late sending in forms, but not sufficiently late to cause serious concern. In March this year the Banking Supervision Division in conjunction with the Financial Statistics Division collated the available information for the previous 12 month period, and as a result letters were sent to 37 banks identified as having an unsatisfactory reporting record for two or more form types. We are also writing to 10 of the smaller ldts whose record is unsatisfactory. This exercise is expected to lead to a significant improvement in reporting standards.

28. In order to improve the management information available to the Bank in this area a computer system has been introduced which can collate the data from the areas of the Bank which process the various form types, and prepare reports on individual banks' performance, both on timeliness and on errors found in the completion of the forms.

VII Enforcement

29. While no prosecutions for offences under the Banking Act were initiated by the Bank during the year, there has been a growing workload of investigation of cases of possible contraventions which have come to the Bank's attention. Much of the initial investigatory work has been carried out by a secondee from the Companies Investigation Branch of the DTI. In exchange one member of the Bank's permanent staff has been seconded to the DTI for training in this work.

30. The Bank's lack of investigatory powers continued to present a handicap to successful pursuit of some of these cases, although improved links and co-operation with other agencies (the DTI, the police and DPP) have helped. Several cases have been referred to the DTI, following the Bank's preliminary enquiries, for formal investigation under powers in the Companies Act, with a view to prosecution either under the Banking Act or other legislation or to the DTI taking action to have the company wound up. Some of the cases with which the Bank has been involved are currently being considered by the police or DPP. In view of such developments and the continuing flow of new cases coming to the Bank's attention, we hope to build up our enforcement capacity in advance of the new legislation which is intended to provide the Bank with formal enforcement powers.

VIII The number of authorised institutions

31. The number of authorised institutions fell back during the year after having increased in three of the four previous years. A small number of US banks has withdrawn following a reassessment of corporate strategies, which led them to conclude that the business being generated did not justify the high costs of maintaining a London presence. Apart from a number of revocations, the closer examination of banks' businesses resulting from supervisory visits is leading a number of the smaller licensed deposit-takers to reassess the benefits of keeping a licence. These institutions are typically very small locally-based businesses which have difficulty in maintaining the standards of management and control systems appropriate to

companies taking deposits from the public. The managers/owners of such companies are being required to devote greater resources to satisfying our requirements, mainly by improving their systems, leading to increases in their business overheads. It is clearly right that if such companies cannot meet reasonable prudential standards, they should not be taking deposits from the public.

012/2955

FROM: **M A HALL**

22 May 1986

ECONOMIC SECRETARY

c c PPS
Sir Peter Middleton
Mr Cassell o/r
Mr A Wilson
Mr Peretz
Mr D Jones
Mr Eversheds

Mr Bridgeman RFS

DISCLOSURE OF INFORMATION OBTAINED UNDER THE BANKING ACT 1979

I attach a draft reply to Mr Howard's letter of 16 May.

2. The draft, read in conjunction with Mr Howard's letter, is self-explanatory, and covers ground we have discussed amongst ourselves before. To our mind, and in the view of the Chief Registrar and Bank of England, it is essential that deposit-taking institutions should maintain the right of veto, in the last resort, over onward disclosure by either the SIB or an SRO in performance of their own functions. This safeguard seems fundamental the way in which the supervisors of deposit-taking institutions obtain information, and to the relationships they need in order to operate. Besides the reasons set out in the draft letter, it is likely as a matter of practice that, if the Bank or Commission had no control over onward disclosure, they would tend to judge whether or not information should be disclosed by the standards of confidentiality of the weakest SRO. Furthermore, we have no knowledge, or control, of disclosure channels which might be added subsequently to the Financial Services Bill.

3. We have, however, offered one small concession to Mr Howard. This is the offer to make a provision that the Bank be required to have regard to the views of the SIB or relevant SRO, wishing to disclose further, before reaching its decision on its request.

4. The Bank and Chief Registrar are content with this draft. The Governor will be sending a short letter in support.

MMH

M A HALL

c c Mr Nicolle BoE

011/2955

Michael Howard Esq QC MP
Department of Trade & Industry
1-19 Victoria Street
LONDON SW1H OET

May 1986

DISCLOSURE OF INFORMATION OBTAINED UNDER THE BANKING ACT 1979

Thank you for your letter of 16 May.

I know that our officials have found disclosure one of the most complex and troublesome areas of the various regulatory Bills, and I am glad that - apart from the point you raise - such a wide measure of agreement and consistency has been reached.

In all three pieces of legislation, on financial services, building societies and banks, we have had two main objectives in mind - to safeguard information entrusted to the supervisors by institutions about themselves and about their customers; and to enable the supervisors to perform their functions effectively. The provisions are necessarily in places a compromise between these two purposes. In all cases, although it will be open to a supervisor to ask another for information, the second supervisor will have absolute discretion over whether to disclose. The system will rely, in this as in many other respects, on the good sense and co-operative attitude of the respective supervisors.

It seems to me that the embarrassing cases you fear would in practice occur rarely if ever, because the initiating supervisor would have a common interest with the second supervisor in ensuring that he performed his functions effectively. Unless there were overriding reasons, relating perhaps to the privileged source of the information, it is likely that the Bank would agree to onward disclosure by the second supervisor in performance of its functions. But I am afraid I still take the view that, in the interests of securing a continuing flow of confidential information to the banking supervisors, it should remain open to the Bank, at the end of the day, to refuse to agree to onward disclosure.

I am not convinced that any operational inconvenience caused to the financial services supervisors would outweigh the risk to effective banking supervision. Nor would it be likely in practice that the flow of information to the financial services supervisors would be quite so free if the originating supervisor had to consider whether it was disclosable to all the possible gateways under the FS Bill, rather than solely to a trusted and known contact in the first instance. It is, for instance, an important consideration that in the FS Bill, disclosure is permitted in the context of a civil action, as a means of assisting aggrieved customers in cases against financial institutions. This is not proposed for the building

society and bank supervisors.

I also think that even where onward disclosure is not possible, there is considerable value in "tip-offs" between supervisors. All supervisors will from time to time, from the nature of their role, receive valuable information which, for one reason or another, cannot be disclosed or used in evidence.

I cannot therefore, regrettably, agree to your proposal that the Financial Services regulators should be able to disclose further Banking Act information given to them, even if the two conditions you stipulate are met. I am, however, prepared to have included in the amendments to the Banking Act a provision that the Bank be required to have regard to the views of the SIB or relevant SRO, before reaching its decision on a request to disclose further. I am sure that additionally the Bank and the financial services regulators will wish to discuss the factors to be taken into account on these occasions. This is a matter for them.

I regard the Building Societies Commission as being in precisely the same position as the Bank of England, in respect of information protected by the Building Societies Bill.

I am copying this letter to the Governor of the Bank of England and to Sir Kenneth Berrill.

IAN STEWART

1777/19

CONFIDENTIAL

FROM: D R H BOARD
DATE: 28 May 1986

1. MR M HALL
2. CHANCELLOR

cc: PS/Economic Secretary
PS/Sir P Middleton
Mr Cassell
Mr Peretz

BANKING ACT 1979 - PRUDENTIAL SUPERVISION OF BRITISH BANKS

The Governor's letter of 19 May attaches his usual confidential supplement to the published Banking Act annual report. The ground covered differs little from that in Mr Peretz' submission of 15 May and the recent six-monthly prudential meeting. We shall provide separate submissions on, for example, the nature of a new primary liquidity requirement; it is not necessary to pick up these points here. A short draft reply which I hope is self-explanatory is below.

D R H BOARD

CONFIDENTIAL

CONFIDENTIAL

A type

DRAFT LETTER FROM CHANCELLOR TO:

Governor of the Bank of England

BANKING ACT 1979 - PRUDENTIAL SUPERVISION OF BRITISH BANKS

Thank you for your letter of 19 May and for the enclosed memorandum on prudential issues supplementing the Bank's published report, which I read with interest. The wide range of developments summarised in the report and memorandum and discussed between the Bank and the Treasury throughout the year illustrates the daunting pace of change for banks and supervisors alike. I am reinforced in the view that supervisory developments need to keep up with the game on a co-ordinated international scale, both on prudential and on competitive grounds.

2. While the overall economic outlook domestically and internationally remains bright, some parts of the international banking system (for example in North America) are potentially fragile. The strengthened capital position of British banks is welcome but I note that further improvement in the near future may be more limited. The tendency in the past year to relax the build-up of provisions against international exposures

(taking advantage, or so it seems, of the dollar's decline against sterling) is indeed disappointing and I welcome the action which you intend to take to press the banks hard on this. The memorandum comments that it may be worth looking again at the tax treatment of provisions against sovereign risk. I should be content for officials to do this but it seems likely to be the combination of more demanding prudential requirements with more generous fiscal treatment which is influential in producing higher percentage provisions in some other countries.

Nigel Lawson

1777/30

FROM: DEREK JONES
DATE: 29 May 1986

30 MAY 1986

1. MR HALL
2. ECONOMIC SECRETARY

cc: Mr Peretz
Mr Evershed
Mr Brummell T Sol

BANKING BILL: CONDITIONAL AUTHORISATION

We have discussed this again in HF, though not yet with the Bank, in the light of your comments (Mr Neilson's minute of 14 May).

2. A new power to impose conditions or restrictions (the difference is purely terminological - "restrictions" being a new word introduced by Counsel for this Bill) quite separately from any revocation proceedings would, we believe, look much the same as the power now proposed for the Bill - although possibly shorn of the 3-year limit after which revocation takes place automatically.

3. The reason for this is that, even if the power is intended to be kept in reserve, it is still necessary to specify the grounds or circumstances for its use. The grounds for use of the power now proposed are the same as those for revocation. But the grounds for revocation have been made very wide to give the Bank maximum flexibility when revocation is needed. The grounds will be, that it appears to the Bank that:

(a) any of the criteria for authorisation is not or has not been fulfilled, or may not be or may not have been fulfilled;

(b) the interests of depositors or potential depositors of the institution are threatened, whether by the manner in which the institution is conducting or proposes to conduct its affairs or for any other reason;

(c) the institution has failed to comply with any obligation imposed on it under the Act;

(d) a person has become a controller of the institution in contravention of the new takeover rules;

(e) the institution or its directors have furnished the Bank with false, misleading or inaccurate information;

(f) the institution has not accepted any deposits in the UK for over 6 months, or within a year of being authorised.

4. It seems likely that grounds (a), (b), (c) and possibly grounds (d) and (e) would also need to form the basis of a new power to impose formal restrictions regardless of whether or not that power is seen as a prelude to revocation. The distinguishing features are therefore the time limit of 3 years and the way the power is presented. At the moment, it is presented as delayed revocation with an opportunity for rehabilitation. It might be possible to take away this flavour by removing the time limit altogether, or by retaining the provision that a restricted authorisation must expire after 3 years but not that revocation would automatically follow. The end of 3 years would then require a re-assessment, and action of some kind to be taken, but the Bank would have the options of revocation, a further 3 years of restrictions or returning full authorisation.

5. This, however, would only be a minor modification to the power already proposed. The crucial issue is the way the Bank uses its powers in practice. That will not be changed by the leglisation. But if our aim is simply to have a statute on the books that would permit giving conditional licences in situations short of those warranting complete revocation - against the possibility that some day in the future the Bank might be persuaded to operate in that way - then what is proposed already gets us most of the way there. It is just that the Bank of England do not like us presenting it in that way.

6. Unlike the Bank, we do not see any disadvantage in an additional power; or in presenting and if necessary amending the current proposal to make the procedure more independent of revocation, along the lines described above. It might be useful to discuss the various options before we go back to the Bank of England on this.

DEREK JONES

RR7.9

CONFIDENTIAL

cc PS/EST
PS/Sir P Middleton
Mr Cassell
Mr Peretz
Mr Hall
Mr Board

pwp

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

2 June 1986

Robin Leigh-Pemberton Esq
Governor
Bank of England

BANKING ACT 1979 - PRUDENTIAL SUPERVISION OF BRITISH BANKS

Thank you for your letter of 19 May and for the enclosed memorandum on prudential issues supplementing the Bank's published report which I read with interest. The wide range of developments summarised in the report and memorandum and discussed between the Bank and the Treasury throughout the year illustrates the daunting pace of change for banks and supervisors alike. I am reinforced in the view that supervisory developments need to keep up with the game on a co-ordinated international scale, both on prudential and on competitive grounds.

While the overall economic outlook domestically and internationally remains bright, some parts of the international banking system (for example in North America) are potentially fragile. The strengthened capital position of British banks is welcome but I note that further improvement in the near future may be more limited. The tendency in the past year to relax the build-up of provisions against international exposures (taking advantage, or so it seems, of the dollar's decline against sterling) is indeed disappointing and I welcome the action which you intend to take to press the banks hard on this.

NIGEL LAWSON

FROM: M A HALL
DATE: 3 June 1986

1. MR PERETZ
2. SIR PETER MIDDLETON o/r

cc PPS
PS/Economic Secretary
Mr Cassell o/r
Mr Wilson
Mr D Jones
Mr Eversheds

DISCLOSURE OF INFORMATION OBTAINED UNDER THE BANKING ACT 1979

Please refer to Kieran Murphy's minute of 27 May (below)

2. All the supervisors, under their respective legislation, are permitted to disclose information directly to the police and other prosecuting authorities "with a view to the instigation of or otherwise for the purpose of criminal proceedings". In these circumstances the consent of the original supervisor is not needed.

3. New powers will be needed for supervisors and others to pass information to the new Serious Fraud Office and vice versa. It will be for consideration whether the wording of the Banking Act (in previous paragraph) allows early enough disclosure when the supervisor first becomes suspicious.

PS H&CC

ff

M A HALL

especially given that
it has been hoaxed,
+ Bridgeman has something
similar. If I think he is
probably right, though it's
not the biggest issue in
the world.

CSI is having another
meeting to discuss the Book
Fund. Does he have your
support?

RL.
1876

CHANCELLOR OF THE EXCHEQUER

EST has my support. ✓

Ch.

EST would like a general steer from you on conditional authorisation. The Bank don't want this power, because they think it would put them under an obligation to behave in a more interventionist, legalistic way. EST doesn't, though, envisage that it would make much difference in practice: his concern is largely presentational. He thinks it would look a bit feeble not to have such a power, given B.

2935/057

CONFIDENTIAL

FROM: M J NEILSON
DATE: 13 June 1986

MR M HALL

cc: PPS
PS/Sir P Middleton
Mr Cassell
Mr Peretz
Mr Saunders
Mr D Jones
Mr Eversheds
Mr Brummell T.Sol

BANKING BILL: ROUND-UP

You and Mr Jones discussed with the Economic Secretary a number of Banking Bill issues.

Primary Liquidity

It was agreed that the Bank should issue their consultative paper on primary liquidity without further changes; the issues raised in your covering minute of 27 May could be decided at a later stage.

Conditional Authorisation

Mr Jones submission of 9 May refers. The Economic Secretary said that he was not inclined to give way to the Bank on this; he saw a good case for giving the Bank a power to impose conditional authorisations in a situation were there was insufficient ground for revocation. It would be particularly difficult to explain why the proposal had been dropped since it appeared sensible, it was in the Bank's consultative document, no one had objected to it, it paralleled the situation under the Building Societies Bill, and it appeared to give powers to the Bank that they might need in dealing with difficult cases. He will be willing to discuss this with the Bank, and would also seek the views of the Chancellor.

Minimum Net Assets

Mr Jones minute of 29 May refers. There appeared to be no simple

solution to the grandfathering problem. You said that a further linked paper on banking names would soon be submitted, and it was agreed that decisions on the minimum net assets would not be taken until the Economic Secretary had the opportunity to consider the banking names submission.

Deposit Protection

Your minute of 3 June refers. The Economic Secretary confirmed that you were correct in proceeding on the assumption that he had no intention to volunteer any increase in the degree of protection given by the scheme.

M NEILSON

VL/88/1t

FROM: MRS R LOMAX
DATE: 19th June 1986

PS/ECONOMIC SECRETARY

cc Sir P Middleton
Mr Cassell
Mr Peretz
Mr D Jones
Mr Saunders
Mr Brummell T.Sol.

BANKING BILL : CONDITIONAL AUTHORISATION

The Chancellor has seen your minute of 13 June, and has noted that there is some dispute between the Economic Secretary and the Bank on the case for giving the Bank a power to impose conditional authorisations in a situation where there are insufficient grounds for revocation.

The Economic Secretary has the Chancellor's support on this one.

RL

RACHEL LOMAX

bf 4/7 pre

~~bf 1979~~

MORETON PHILLIPS & SON
SOLICITORS
with FRANCIS MILLER & STEELE
(COMMISSIONERS FOR OATHS)

JOHN MORETON PHILLIPS
NEVILL H. PHILLIPS, M.A. (Oxon)
MICHAEL G. CORKILL LL.B. (L'pool)
RICHARD J. I. PARKER, LL.B.(EXON)

5, Charterhouse Square,
London, EC1M 6EE

TELEPHONE 01-251 4931 (7 LINES)
TELEX 261595 MPS
L.D.E. Box No. 171
(OFFICE HOURS 9.15 A.M. TO 5.15 P.M.)

OUR REF: RP/tm/E56

YOUR REF:

2nd July 19 86

The Chancellor of the Exchequer
The Treasury
Parliament Street
London
SW1

Rendel,
Martin Hall has the top of this.
He is discussing it with David Peretz

L 2/7

Dear Sir

Credit Celt International Limited
Banking Act 1979

Pursuant to Section 11 of the Act we enclose herewith Notice of Appeal served on you on behalf of our clients Credit Celt International Limited.

Please acknowledge receipt.

Yours faithfully

IN THE MATTER OF CREDIT CELT INTERNATIONAL LIMITED

AND IN THE MATTER OF AN APPEAL FROM A DECISION

OF THE BANK OF ENGLAND DATED 11TH JUNE 1986

AND IN THE MATTER OF THE BANKING ACT 1979

To the Right Honourable Nigel Lawson PC MP, The Chancellor of the Exchequer.

TAKE NOTICE that the above-named Credit Celt International Limited ("the company") the registered office of which is at 19 Rassau Industrial Estate, Ebbw Vale, Gwent appeals to you pursuant to Section 11 of the Banking Act 1979 ("the Act") against a decision of the Bank of England ("the Bank") contained in a letter to the company dated 11th June 1986 ("the notice of refusal") giving notice of their refusal to grant the company a licence to carry on a deposit-taking business on the grounds stated therein, namely

(1) that the Bank was not satisfied that four of the persons, (namely Mr S.K.Sohail, Mr J.O.Andre, Mr T.V.S.Gordon and Mr P.A.Barrett) who intended to hold positions as directors controllers or managers of the company were fit and proper persons to hold their intended positions and

(2) that having regard to the composition of the company's proposed management team and to other matters the Bank was not satisfied that the company would conduct its business in a prudent manner.

AND TAKE NOTICE that the grounds of the appeal are as follows:-

(1) So far as concerns Mr S.K.Sohail, the Bank concluded that he was not a fit and proper person to be a controller within the terms of section 49(3) (d) of the Act or to be a director of the company or, a fortiori, the chairman of hte board of directors of the company on the following principal grounds:-

(i) That he did not have a clear and detailed conception of the company's aims and development;

(ii)That he was not frank and forthcoming in his provision of information to the Bank;

(iii)That his personal financial resources were not clearly established; and

(iv) That his record as a successful businessman was not demonstrated.

As to (i) Having regard to the facts (all of which were known to the Bank) that Mr Sohail has always been consistent in his general aim as to the sort of business that the company should undertake; that he lacks knowledge and experience of banking and that he would therefore be dependant for advice and guidance upon the company's team of executive directors and managers; and that he proposed to subscribe for no more than 20% of the company's share capital, it was unfair and unreasonable for the Bank to require Mr Sohail to have a detailed conception of the

company's aims or a detailed grasp of the manner in which his general ideas would be translated into an operational plan;

As to (ii) The Bank had no sufficient or substantial grounds on which to base its objection that Mr Sohail was not frank and forthcoming in his provision of information to the Bank, and the Bank failed to take any or any proper account of the fact that although the information initially provided by his accountants was found to be defective and inadequate, these defects and inadequacies were remedied by supplementary information within a reasonable period of time.

As to (iii) The Bank's conclusion that Mr Sohail's personal financial resources were not clearly established is unjustified on the evidence submitted to it. Further, the Bank misdirected itself as to the degree of financial standing to be required from shareholder-controllers in as much as it considered that it had to be satisfied that Mr Sohail's resources were sufficient to meet all the possible demands which might be made on them in the future which was an unreasonable requirement;

As to (iv) The Bank's conclusion that Mr Sohail's record as a successful businessman was not demonstrated is unjustified on the evidence submitted to it. Further, it was improper and unjust for the Bank to take account, as it has done, of the opinions as to these matters of persons whose identity has not been disclosed to Mr Sohail or to the

company.

(2) (i) So far as concerns Mr J.O.Andre and Mr T.V.S.Gordon, as was explained in the company's letter of representations to the Bank dated 23rd May 1986 these candidates were only proposed for their positions as chief executive and deputy chief executive of the company because the company believed that its previous candidate for the office of chief executive (Mr Gilbert-Johns) was unacceptable to the Bank and/or was unlikely to be approved by the Bank as a fit and property person to hold that office.

(ii) However, it was impossible, in the short time that was available, for Mr Andre and Mr Gordon to prepare (as Mr Gilbert-Johns had done) a detailed business plan. Accordingly, the company's application was formally considered by the Bank on the basis of a business plan that had not been prepared by the proposed chief executive or his deputy.

(iii) In the event, the Bank took exception (a) to Mr Andre and Mr Gordon both as a team and individually, (b) to the fact that there was no business plan for the company that had been prepared by them, and (c) to the fact that their views as to the balance of the company's business differed from the views set out in the business plan that Mr Gilbert-Johns had prepared. The company contends that there was no evidence on which the Bank could have come to a conclusion that there was any substantial difference between

the views of Mr Andre and Mr Gordon and the views stated in the company's business plan.

(iv) The Bank derived from this the conclusions (a) that it had no detailed plans to measure against the requirements set out in paragraph 10 of schedule 2 to the Act (despite the fact that it had conceded in its letter to the company of 25th April 1986 that the company's plans as prepared and endorsed by Mr Gilbert-Johns would, if implemented, fulfil these particular requirements), (b) that there was a lack of conviction or sense of purpose in the company's plans, and, therefore, (c) that the company would not conduct its business in a prudent manner.

(v) In fact, in its notice of refusal the Bank has said that it cannot recall any meeting, letter or conversation in which it indicated that Mr Gilbert-Johns was unsuitable for the post of chief executive and it has impliedly admitted that it has no objection to Mr Gilbert-Johns as chief executive. Accordingly, the company's application as formally considered by the Bank was based upon a fundamental misapprehension as to the Bank's views on Mr Gilbert-Johns, and the company says that this misapprehension was induced (however innocently) by the Bank.

(vi) In the circumstances it would be unfair and unjust for the conclusions reached by the Bank as to Mr Andre and Mr Gordon and as to the "prudent conduct" criterion set out in paragraph 10 of schedule 2 to the Act to stand, and the Bank ought to be directed to reconsider the company's

application on the basis that its chief executive would indeed be Mr Gilbert-Johns who is now available to serve in that position.

(3) So far as concerns Mr Barrett, the Bank's adverse decision upon the company's application has caused him to withdraw from his proposed involvement with the company both as shareholder and as director. As was explained in the company's letter of representations, E.F.Hutton are willing to subscribe for a substantial part of the company's capital that Mr Barrett would have subscribed for (750,000 shares as against 1,100,000 by Mr Barrett). In these circumstances the Bank ought to be directed to take this change into account when reconsidering (as the company submits it ought to do) the company's application.

(4) Since Messrs Andre Gordon and Barrett were three of the four proposed executive directors of the company (assuming it were given a licence), and since the management team selected Mr Gilbert-Johns when he was the company's candidate for the post of chief-executive is substantially no longer available (again, as in the case of Mr Barrett, because of the Bank's adverse decision upon the company's application) the company and Mr Gilbert-Johns should be permitted a reasonable period within which to recruit a replacement executive board of directors and a replacement management team and to submit the same to the Bank.

Signed [signature] 2nd July 1986

Director, Credit Celt International Limited

The additional particulars required to be contained in this notice of appeal are as follows:

1. The prospective principal place of business of the appellant within the United Kingdom is Cardiff.

2. The address within the United Kingdom to which applications, notices and other documents in connexion with the appeal should be sent is Moreton Phillips and Son, 5 Charterhouse Square, London EC1M 6EE.

3. The person appointed by the appellant to represent it in connexion with the appeal is John Moreton Phillips of 5 Charterhouse Square, London EC1M 6EE.

IN THE MATTER OF CREDIT CELT INTERNATIONAL LIMITED

AND IN THE MATTER OF AN APPEAL

FROM A DECISION OF THE BANK OF

ENGLAND DATED 11TH JUNE 1986

AND IN THE MATTER OF THE BANKING

ACT 1979

NOTICE OF APPEAL

Moreton Phillips and Son
5 Charterhouse Square
London
EC1M 6EE.

JMP/KH/E.56

MC7AAG

MS.65

For the attention of Richard J I Parker Esq
Moreton Phillips and Son
5 Charterhouse Square
LONDON
EC1M 6EE

4 July 1986

On behalf of the Chancellor of the Exchequer I acknowledge receipt of your Notice of Appeal dated 2 July 1986 against the Bank of England's decision to refuse to grant Credit Celt International Limited a licence to carry on a deposit-taking business.

MRS J R LOMAX
Principal Private Secretary

3319/008

PRINCIPAL PRIVATE SECRETARY

FROM: P S HALL
DATE: 4 July 1986
cc: Mr M Hall
Mr D Brummell (T.Sol)
- with pps (for information)

BANKING ACT APPEALS: CREDIT CELT INTERNATIONAL LIMITED

The Solicitors for Credit Celt International Ltd. wrote to the Chancellor on 2 July giving notice of appeal against the Bank of England's refusal to grant a licence to carry on a deposit-taking business.

2. I attach a draft reply for your signature acknowledging receipt of the notice of appeal.

P S Hall

P S HALL

1867/13

A type

DRAFT LETTER FOR THE PRINCIPAL PRIVATE SECRETARY'S SIGNATURE TO:

For the attention of Richard J I Parker Esq
Moreton Phillips and Son
5 Charterhouse Square
LONDON
EC1M 6EE

On behalf of the Chancellor of the Exchequer I acknowledge receipt of your Notice of Appeal dated 2 July 1986 against the Bank of England's decision to refuse to grant Credit Celt International Limited a licence to carry on a deposit-taking business.

MRS J R LOMAX

Principal Private Secretary

1867/010

CONFIDENTIAL

FROM: DEREK JONES
DATE: 4 July 1986

1. MR M HALL
2. ECONOMIC SECRETARY

cc PPS
PS/Sir P Middleton
Mr Cassell
Mr Peretz
Mr Eversheld
Mr Brummell T.Sol

BANKING BILL: CONFIDENTIALITY OF SUPERVISORY INFORMATION

As expected, the BBA have written to express their concern about our proposals for disclosure of information under the new Banking Bill. (See Mr Hall's note of 11 June - flag A). This is a difficult problem, which we have not been able to settle in our discussions with the BBA.

2. The present Banking Act imposes a basic duty of confidence on the Bank in respect of information obtained under, or for the purposes of, the Act. The Act provides for disclosure of such information only in certain specified circumstances (for example, with the consent of the person to whom the information relates; for the purpose of criminal proceedings; for the purposes of Companies Act investigations). There is also a disclosure 'gateway' to allow the Bank to disclose information to the Treasury where it would be desirable or expedient in the interest of depositors or in the public interest.

3. We will be amending these provisions in the Bill to provide for mutual disclosure between the new supervisory authorities (the SIB, SROs and the Building Societies Commission), and to auditors, to facilitate their new supervisory role. But it was also proposed in the White Paper that the current 'public interest' gateway was too narrow and should be widened to allow disclosure to other Government Departments. (The proposal had previously been endorsed by the Leigh-Pemberton Committee).

The relevant extract from the White Paper is attached - flag B.

4. The amendment would provide for disclosure by the Bank:

(a) To the Treasury; or

(b) With the consent of the Treasury, to the Secretary of State for the purpose of discharging his functions (other than the specific functions - such as Companies Act and Insolvency functions - that are dealt with separately);

if it appeared to the Bank to be desirable or expedient to do so in the interests of depositors or in the public interest.

5. Disclosure "to the Secretary of State" is a formula that will allow disclsoure to all the main Government Departments (except, we are advised, to MAFF which does not have a Secretary of State); but not to the Revenue Departments. (It has the presentational advantage of not referring explicitly to the exclusion of the latter).

6. In our view this is no more than a necessary technical improvement to the existing provision. Provision for disclosure to the Treasury in the public interest is a reflection of the occasional need for Government to be aware of the facts of a case. For the average reader, the assumption is likely to be that information already available to the Treasury or Treasury Ministers would, if necessary, also be available to other Ministers or Departments.

7. But this is not the case, and we did recently find ourselves in the position of having information about an institution in Northern Ireland, where the circumstances were sensitive, but disclosure to the Secretary of State for Northern Ireland, or to his officials was not allowed. (Disclosure by Bank or Treasury officials in such circumstances would be a criminal offence under the Act, with penalties of a fine or two years imprisonment). This case, and it is not difficult to imagine

others, led to the proposed amendment.

8. At our instigation, both the Financial Services Bill and the Building Societies Bill contain analogous provisions. The BBA prompted the tabling of an amendment to the FS Bill in Committee (tabled by Mr Yeo), but this was withdrawn and the Clause remains part of the Bill. (Hansard attached, flag C). The BBA may well return to the charge in the Lords.

9. The BBA's objections are first, that widening the scope of disclosure to Government Departments will scare-off internationally mobile deposits, because some overseas depositors are especially nervous about details of their financial affairs being known to any government. Second, that the criterion for disclosure - "the public interest" is unacceptably vague and open to abuse by some future administration. They cite the possibility of a socialist Government using the information to plan an interventionist approach to bank lending.

10. We have discussed both these problems with the BBA. We are sympathetic to their worry about the vagueness of "public-interest", which is not susceptible to close definition. On the other hand, it is an accepted formula for giving expression in statute to the kind of situation envisaged. We cannot think of a better form of words and the BBA have not suggested ones.

11. One alternative that the BBA have suggested would be to qualify "public interest" in some way. But this would have overwhelmed presentational disadvantages: it would be equivalent to saying that Government Departments should not be able to receive information <u>even if</u> it was in the public interest that they should do so.

12. Another alternative would be to remove "public interest" altogether and replace it with a narrower test based on "security of the state of protection of life and property". This would almost certainly be too narrow for our purposes. We would prefer to stick with public interest, which is after all the present basis for disclosure to the Treasury and we should have to justify

any departure from it in the Bill. However, we could probably concede the use of "necessary in the public interest" (rather than "desirable or expedient"), as the BBA suggest, without serious problems.

13. The BBA also suggest that, rather than allow disclosure generally to "the Secretary of State", a small number of Departments should be specified in the legislation. There are several disadvantages here, which the BBA acknowledge. From our point of view, it is not easy to be confident about the Departments it would be safe to leave out, and we would need to clear such omissions with the Departments concerned: understandably, they will probably prefer to be covered 'just in case'. Given the nature of the problem, it would not be easy to make distinctions between Departments. Although we could draw up a priority list (FCO, the Scottish Office and Northern Ireland Office, the Home Office, DTI), the BBA would be unlikely to accept it. Having conceded a list approach we would then be drawn into a debate about who should be on it. So while it remains an option, it is not a very attractive one and we would prefer to keep it as a last resort.

14. On the question of the kind of information to be disclosed, we do not share the BBA's concern that the change proposed will scare off overseas depositors. For the reason given earlier, we would expect most of those customers who had noticed the existing provision to assume that information would already be available to Government Departments on public interest grounds: so the change would not be material. But the BBA do appear to be seriously concerned and we have looked carefully at the options.

15. We do not believe that we can safely exclude all customer information from public interest disclosure. Although in most cases it will be the institution itself, rather than its customers, that concerns us, the JMB case was a clear illustration of how a bank's dealings with individual customers can be an important part of the story.

16. Nor can we think of any additional criterion that could sensibly be applied to the disclosure of customer information. And to do so would probably be counter-productive by drawing attention to the possibility of such disclosure: regardless of its terms, an explicit reference to customer information would do more than anything else to scare-off nervous depositors.

17. There may, however, be scope for a 'concession' reflecting the fact that our concern is not to have disclosure of customer information in its own right, but only to have information concerning the institution and concerning its customers so far as that is relevant. So if the institution had not, as it were, come to our attention, then we would not expect the Bank to disclose information about customers under this heading. (Disclosure would be permitted through the 'criminal prosecutions' gateway).

18. The amendment would need to be carefully worded, especially if it was to avoid an explicit reference to customer information. A description such as "information relating to the affairs of an institution" might be sufficient. If you agree, we could discuss with the BBA the extent to which this would meet their concerns.

19. We would not want to suggest any further concessions at this stage. The BBA will need to consider whether the limited changes we can make are acceptable or whether they will want to press further, by tabling amendments, at the risk of causing precisely that concern amongst depositors that they are seeking to avoid.

20. Finally, there are two background points. The BBA refer to your (and Mr Moore's) opposition in 1979 to the use of "public interest" in the then Banking Bill. You will want to see the Hansard extract, attached at Flag D. Your opposition was not in fact outright. You spoke of the need to ventilate the issue,

and there was a general agreement that the problem was a difficult one, with something to be said on both sides. In our view, events since 1979 have if anything made it more difficult for the Government to constrain the Bank's ability to inform Government Departments of public interest matters related to banking.

21. The BBA also mention a Labour Party policy statement (flag E) referring to the use of powers under the 1946 Bank of England Act to ensure that bank lending to industry suported Labour Party strategy. (This is mentioned by the BBA as evidence of the risk that public interest disclosure could be used by Government to obtain information for which the provision was not originally intended and to help implement policies to which the banks would be opposed).

22. "Powers under the 1946 Act" probably refers to the Treasury's power to give directions to the Bank, again in the "public interest", and to the Bank's power to give directions to the banks, also in the "public interest". (See Section 4 of the 1946 Act, attached at Annex F). We have never known quite what to make of these powers. They have never been used and, at least so far as the power to direct the Bank is concerned, have been regarded as a 'nuclear' weapon. Having been unused for so long, we have tended to regard them as unusable. They are expressed in very general terms, but there is some considerable doubt about what scope or 'vires' they would in practice allow, or whether they would be adequate for the purpose described in the Labour party pamphlet. But the intention nevertheless adds weight to the BBA's concern.

DEREK JONES

1776/016

FROM: **M A HALL**

21 July 1986

ECONOMIC SECRETARY o/r

c c PPS
PS/Sir P Middleton
Mr Cassell
Mr Peretz
Mr D Jones o/r
Mr Eversheld

Mr Brummell T Sol

BANKING BILL: BANKING NAMES

This note seeks your views on a change the Bank have proposed to the regime for banking names, and to consider some points which have arisen on the basic policy. We have already discussed this with you informally.

2. The test for an authorised institution wishing to use a banking name was set out in the White Paper and will be a requirement for paid-up equity capital of £5 million or more (or the foreign currency equivalent). The Bank are now proposing a change to accommodate a difficult case. There is a private unlimited company (we understand it is C Hoare & Co) which is currently a recognised bank and uses a banking names. For its own reasons, this company does not wish to alter the present balance between paid-up equity and reserves, but has suggested that the same effect could be achieved by constituting a permanent undistributable capital reserve, which should then be treated under the rules as though it were paid-up equity. This would involve the company in an alteration of its memorandum or articles, in accordance with Section 264(3)(d) of the Companies Act.

3. The Bank wish to agree to this change. They say that the company has been owned for several generations by the same family but that an increase in issued equity to the qualifying level (it would require a sizeable increase) would cause the Revenue to re-assess the basis on which capital transfer tax was levied, to the point possibly where continuation of family ownership might

be threatened. Their only alternative would be to stop using the banking name ("C Hoare & Co Bankers") which they have used for more than 200 years.

4. We have no objection in principle to the proposed change. The creation of a permanent reserve is a legitimate operation and we are satisifed by the Bank's assurances that it can serve as the equivalent of paid-up equity for their purposes; and that it does not open up any undesirable loopholes or admit other unsuitable institutions. But the change has been put to us solely in order to accommodate one bank and the tax affairs of its owners. A decision to modify the rules to suit one institution should at least be a conscious one.

5. The change would do no harm, and would be in line with our basic policy on banking names; that is, that the new requirement should not be set at a level which would disenfanchise institutions currently entitled to use a banking name or which they could not fairly easily reach with some additional capital. (Nor would it be a unique precedent special arrangements were made in the BS Bill to accommodate the Ecology Building Society, and under the Banking Bill the Airdrie Savings Bank will continue to enjoy relief from the banking names rules on the basis of its unique position as an '1819 savings bank'). We are inclined to concede the point, but find it difficult to assess the political cost, if any, of doing so. We have to assume that our modification of a simple criterion will be transparent, and our reasons understood in the House.

General Issues

6. Having given careful consideration to representations by the BBA and CLSB, neither we nor the Bank recommend any alteration in the policy, beyond the change described above.

7. We do not have strong views about the new test for banking names. Limits of this sort are bound to be arbitrary, and other things being equal we should have preferred to have none. The BBA and CLSB have proposed that the requirement should be for net assets of £10 million. The Bank have considered the banks'

preference for a net assets base - rather than paid-up equity - and for a higher figure, and both we and the Bank have discussed it with the BBA.

8. The £5 million paid-up equity benchmark was chosen at a level to fit the capital structure of the present population of UK recognised banks so that none ran any serious risk of disenfranchisement. Paid-up capital is also a simpler criterion, more easily understood and open to public scrutiny by inspection of a bank's accounts. And, importantly, paid-up equity is not subject to the vagaries of fluctuations in profits in the same way as net assets. We do not want a test for the use of names which borderline institutions will be 'bobbing' above and below - that would mean devising rules for some kind of period of grace and for monitoring adherence to them. This seems an unnecessary complication, especially on top of those already produced by exchange rate fluctuations.

9. As far as the figure is concerned, the banks make the point that £5 million is not much in banking terms. But then nor is £10 million in terms of the public perception of "banks". And neither figure offers any reliable guide to creditworthiness. The presentational advantage of a higher figure (part of a general toughening up)) has to be balanced against the fact that having any limit at all is a concession beyond the Leigh-Pemberton Committee recommendations and contrary to the logic of a single-tier system of authorisation and supervision. Some small institutions are understandably unhappy that the Government has not followed through this logic. They will probably lobby against the existing proposal and would portray any further raising of the level as a sell-out to protect large institutions from fair competition.

10. The £5 million capital test will rule out many small institutions but (apart from the case referred to above) will not cause problems for recognised banks currently entitled to use banking names. If we adopted the BBA/CLSB formula, the Bank advise that there would be a handful, probably two or three, perhaps as many as six recognised banks which would be adversely affected.

11. Finally, the Bill will contain a power to amend the £5 million figure by Order. This will be a safeguard if the proposed test proves inadequate.

12. We should be grateful to know if you are content with this position.

M A HALL

2940/005

FROM: P D P BARNES
DATE: 30 July 1986

NOTE FOR THE RECORD

c/ Just to be aware

CR 31/7

cc: PS/Chancellor
Mr Cassell
Mrs Lomax
Mr Peretz
Mr M Hall
Mr D Jones
Mr Evershed

The Economic Secretary lunched yesterday at Hill Samuel with Mr Richard Lloyd, Chief Executive and Deputy Chairman, and other directors. He was accompanied by Mr M Hall and myself.

2. Hill Samuel expressed concern that the Banking Bill would put them and other UK banks at a competitive disadvantage by regulating them in areas from which competitors would be exempt, or subject to more lenient regulatory regimes. They expressed particular concern about UK subsidiaries of foreign banks who might be able to "arbitrage" between regulations applying in the UK and in their domestic markets; and about non-banks active in the securities business who would not be caught within banking regulations at all. The Economic Secretary noted Hill Samuel's remarks.

PB

P D P BARNES

1779/009

CONFIDENTIAL

BF 28/8

PWP

FROM: **M A HALL**

8 August 1986

ECONOMIC SECRETARY

c c Chancellor
Chief Secretary
Financial Secretary
Sir Peter Middleton
Sir G Littler
Mr A Wilson
Mr Cassell
Mr Peretz o/r
Mrs Lomax o/r
Mr Ilett
Mr D Jones*
Mr Board
Mr Murphy
Mr Evershed*
Mr Ross Goobey

Mr Croft* T.Sol
Mr Devlin RFS
PS/IR

*Without Bill, but with commentary

BANKING BILL

I attach a copy of the draft Banking Bill. This is now virtually complete. Also attached is a commentary highlighting the main areas of interest, for which I am indebted to Mike Evershed. It would be helpful to have any comments from you or other recipients by 12 September.

Timetable

2. The Bill Team are working to a timetable for presentation to L Committee at the end of October, with introduction as soon as possible thereafter. This will enable us to meet our commitments under the advance place scheme. The chief danger to this plan would be if substantial new policy were added to the Bill at this late stage. We must be vigilant to prevent this if at all possible.

3. We should be grateful for your agreement to our consulting the BBA and FHA on the present draft, so that as many as possible technical and presentational problems can be ironed out of the next print, which could be the last opportunity for significant change prior to introduction. (Our Counsel is also involved in the Financial Services Bill). We would ask each of the organisations to set up a very small team to review the Bill on a highly confidential basis. Material would not be circulated beyond those groups, and there would be no consultation of the membership at large - nor any public acknowledgment of the consultation process.

4. The Bank would also like consultation to take place on relevant clauses with the ICAEW, the Takeover Panel, the Stock Exchange and the Deposit Protection Board.

5. On timing, we should like to start the consultation process as early in September as possible.

Scope of consultation

6. To consult only on announced policy, would imply exclusion of:-

Cl 1(4)	Bank immunity from damages.
Cl 3(2)(b)	UK partnerships no longer eligable for authorisation.
Cl 12(1)(b)(ii)) and Cl 12(3)(b)	Restricted authorisations of unlimited duration.
Cl 21	Notification of target institution by proposed new controller.
Cl 24	Enforced disposal of shares.
Cl 32	Cold calling regulations.
Cl 37	Powers of entry against authorised institutions
Cl 44	Measures against illegal deposit-takers.
Cl 87	The offence of deliberately omitting to provide relevant information to the supervisor.

To exclude these items would virtually guarantee no leaks of new policy, and would make the consultation on draft clauses more

defensible to Parliament if it ever became known. But against this must be set the loss of mutual trust if we go through a confidential consultation process without warning the BBA/FHA of new policy developments - especially if they react badly to them. To know in advance likely reactions to new policy could help us to improve presentation and focus your briefing. And the new items are precisely the ones where there is more need to consult.

7. We recommend on balance consulting the BBA/FHA on the basis of the Bill as it stands - but indicating in a covering letter the principal areas on which we intend to ask Counsel for changes. We shall of course impress upon them the need for absolute confidentiality.

Amendments to the Consumer Credit Act

8. There is one tricky aspect. You will see from the Bill that Counsel has put the Consumer Credit Act amendments (EFT/POS and Mortgage Lending) in the 'Miscellaneous' section of the Bill and not in a separate part. He has also kept the long title free of references to the Consumer Credit Act. But he has advised that as a result of the EFT/POS change further amendments of the Consumer Credit Act would be within scope. In his view we could retain the mortgage lending amendment with much less risk, as it is more clearly a consequential change.

9. We have a firm public commitment to make the EFT/POS change - just repeated by Mr Howard in a letter to the Law Society. One possibility would however be to seek to persuade the main parties interested to agree that it would be better wrapped up with the longer term review of banking law (Bills of Exchange Act, etc) which we are currently considering proposing to Ministers. The banks are still divided on EFT/POS, and the project seems to be foundering. They therefore might accept a delay, coupled with a promise of comprehensive reform. But they would also be glad to be able to blame the collapse of EFT/POS on Government

unwillingness to change the law. So care will be needed. If we include the EFT/POS clause in the version for consultation, we shall effectively be committed. We could omit it, suitably disguised, if you think we can safely float the idea of dropping it in exchange for a general review.

10. We shall make further recommendations in the context of the possible review. Meanwhile we think that Counsel has done a reasonable job of keeping the Consumer Credit Act changes in low-profile. It might help a bit to push them further down the list in the miscellaneous section. On balance we advise omitting the EFT/POS provision from the Bill for consultation, and very tentatively floating the idea of dropping the clause in exchange for general review. If we receive a rebuff, we should reinstate the clause in the published version.

Conclusion

11. We should be grateful if you would:-

(a) Confirm that you are content for us to consult the BBA and FHA on this text early in September; and for the ICAEW, Takeover Panel, Stock Exchange and Deposit Protection Board to be consulted on relevant clauses.

(b) Let us know your views on the EFT/POS clause, and

(c) Let us have your comments on the Bill by 12 September.

M A HALL

c c Mr Nicolle BoE

CONFIDENTIAL

COMMENTARY ON THE SECOND DRAFT BANKING BILL

Overview

1. The Second Draft of the Bill is the first reasonably complete version. The only material not yet included even in prototype form is the full list of consequential amendments and repeals. The Bill is expected to go through at least one more thorough revision before being tidied up for L Committee and introduction. This will include second-order changes at various points (for example on the Deposit Protection scheme) arising out of work being done by the Bank on application of the Insolvency Act administrator procedure to banks.

The Bank of England and The Board of Banking Supervision (Clauses 1 and 2 and Schedule 1)

2. These clauses introduce for the first time a general definition of the Bank's supervisory duties and implement in statute the announced policy on the Board of Banking Supervision. They are expected to be the focus of the debate on second reading. The Opposition may well argue that the Board should be strengthened at the Bank's expense, and attempt to define the Bank's functions more widely (for example to take a more interventionist role on investment).

3. The provisions in clause 1(4) on limiting the Bank's liability are new. They are a logical consequence of similar immunities for Financial Services (FS) Bill supervisors. They may also generate controversy. The Bank's desire for immunity in the FS Bill context is a casualty of that Bill's misfortunes. There would be problems of scope in widening immunity here beyond Banking Bill functions.

Restriction of Acceptance of Deposits (Clauses 3 - 7 and Schedule 2)

4. These clauses define the activity which is regulated by the Bill. Apart from the point in para 7 below, they

are complex rather than controversial. The main change from the 1979 Act is the new power to change the definitions of deposit and deposit-taking business by order. This was announced in the white paper.

5. We are not yet satisfied that we have these clauses quite right. In particular we are re-examining how to prevent evasion by institutions arranging the physical acceptance of deposits overseas. (We are considering covering this either by advertising regulations or by revised definitions.) There are also questions outstanding on exemptions: for example for investment businesses taking deposits in the course of their activities, for deposits paid by way of security (e.g. for the hire of goods) and other forms of 'deposit' where repayment is conditional. On the latter we may have to revert to the 1979 Act treatment. Similarly we have more work to do on Schedule 2.

6. In part these clauses are suffering from the search for excellence. In his latest letter Counsel has warned us 'not to seek in anything a greater certainty than its nature permits'. We expect these clauses to be hard work in Committee. Counsel's latest view is that it might be wiser to revert to the 1979 Act wording. This would be a pity, as the 1979 Act is obscure and, some would say, internally contradictory.

7. Clause 3(2)(b) is of particular note. It implements our new policy (not in the White Paper) that UK partnerships should not be eligible for authorisation. By the time the Bill is enacted we expect there to be no such partnerships holding or seeking authorisation. (This exclusion saves making sometimes lengthy special provisions for a non-existent class at several points in the Bill.) But there is a small lobby for parnership's rights as such who may oppose this. In cold print, it looks very odd to allow EC partnerships as we are obliged to do - but prohibit UK ones.

Authorisations (Clauses 8 - 18 and Schedule 3)

8. These clauses introduce the announced policy of a single

tier of authorised institution. There are also many detailed changes. But these mainly flesh out authorisation criteria, rights of representation, time limits, grounds for revocation of authorisation etc.

9. The only substantial policy development not foreshadowed in the White Paper included in this part of the Bill is in clause 12, where the Bill will now permit the Bank to impose restrictions of unlimited duration on an authorised institution. (Under the 1979 Act, conditional licences - now restricted authorisations - were designed to be imposed for a maximum period of one year after which the institution would either have to apply for a new unconditional authorisation or automatically lose its authority to take deposits). This development is of more substance than it may at first appear since hitherto the Bank have operated a fairly clear cut "fit" or "non-fit" authorisation regime under which conditional licences were intended to allow only a limited breathing space for the business to rehabilitate itself or to allow an orderly wind-down. The new power is intended to make it easier to give established firms, which are causing concern but which are expected to continue in business, a conditional licence as an encouragement to reform. Some further detailed changes may be needed, in particular to allow for periodic review of unlimited duration restrictions.

10. Schedule 3 sets out the new minimum criteria for authorisation based on the best of both the earlier criteria for recognised banks and licensed institutions. It sticks to the White Paper proposal for a £1 million minimum net asset level for new authorisations (existing licensed deposit takers and recognised banks will be grandfathered).

Directions (Clauses 19 and 20)

11. This section includes a number of detailed improvements on the 1979 Act. These should not be controversial -

though one change, Clause 19(1)(e), touches on a controversial matter elsewhere by allowing the Bank to give directions to an overseas institution in the wake of the Treasury's reciprocity powers under the Financial Services Bill being used against it.

Changes of Control (Clauses 21 to 24)

12. The principle of giving the Bank the right to be notified in advance of a change of control in an authorised institution and to object to the new controller was announced in the White Paper. The provision for notification also of the target institution is new and may be controversial. Also new and possibly controversial are the powers in clause 24 to force a controller, who has obtained (or retains) his holding in defiance of the Bank, to relinquish his control. The measures available to the Bank in these circumstances will be severe - including freezing of voting rights and application to a court compulsorily to sell the shares concerned. These shares may not be those directly owned by the new controller, for example if a company to which the Bank objects obtains control through a subsidiary then the subsidiary's holding may be compulsorily sold if the ultimate controller's shares are in some way inaccessible to divestment (e.g. because the subsidiary through which it exercises its controlling interest is an overseas company).

Appeals (Clauses 25 to 29)

13. The main change from the 1979 Act arrangements is that appeals against decisions by the Bank will in future not be decided by the Chancellor on the advice of a tribunal but instead by the tribunal itself. This primary change was announced in the White Paper. But in addition the opportunity has been taken to update the appeals procedure in line with recommendations from the Council on Tribunals. For example, rights are now being extended to include persons named by the Bank as unfit. These should not be

controversial and have been given a dry-run in the Building Societies Bill. Some further minor changes are expected in the next draft.

14. Clauses 27(1) and (5) include some careful wording designed to give the Tribunal power to overturn unjustified decisions by the Bank, but not otherwise to substitute its own judgement for that of the supervisor.

Invitations to make deposits (Clauses 30 - 33)

15. We are carrying forward, substantially unchanged from the 1979 Act, provision to make regulations on advertising by authorised institutions, to make directions concerning misleading advertisements and provisions which make fraudulent inducement to place a deposit an offence. The substantial new provision is clause 32 which will give the Treasury a reserve power to regulate cold-calling for deposits. This was not mentioned in the White Paper, though an analogous power exists for regulating cold-calling in the F.S. Bill

Information and Investigations (Clauses 34 - 38)

16. These clauses cover the Bank's powers to obtain information from authorised institutions or their associates. Clause 35 implements announced policy on large exposures. But in one respect it is presently drafted in a less flexible form than first intended. Although this did not feature in the White Paper it was in mind that the Bank should be able to apply lower percentage notification levels on the large exposures of particular institutions. At the Bank's request this idea has not been taken forward.

17. The provisions on large exposures should not be controversial in themselves. Interest has focussed rather on how the Bank will deal with exposures notified to it. In particular some institutions are concerned that in order to remain competitive they will need to be allowed by the

Bank to undertake exposures of 100% of capital base or more when underwriting share issues. The clauses should be sufficient, when taken with administrative action by the Bank, to satisfy the draft EC recommendation on large exposures.

18. Clause 36 implements part of the more comprehensive information gathering powers foreshadowed in the White Paper. It includes a number of detailed improvements and should not be controversial - except possibly clause 36(3)(b) - which in addition to the new right of entry in clause 37 (which was not in the White Paper) provides sufficient statutory powers to enforce compliance with surprise visits and inspections.

19. Clause 38 carries forward, with some minor improvements, existing powers in the 1979 Act for the Bank to appoint investigators to report on the affairs of an authorised institution.

Investigation of Suspected Contraventions (Clauses 39 and 40)

20. These clauses cover the new powers foreshadowed in the White Paper to obtain information from persons suspected of contravening certain provisions of the Bill. As hinted in that paper these are comprehensive. They include in clause 40 a power for the Bank to obtain a warrant for forcible entry. This has been agreed with the Home Office.

21. We are also considering with the Bank whether powers will be required to make it easier to obtain information about illegal deposit-taking, breaches of directions and fraudulent inducement to make deposits from third parties as well as from the suspected offender.

Accounts and Auditors (Clauses 41 - 43)

22. Clause 43 implements the proposals contained in the White Paper for facilitating a dialogue between the auditors of an authorised institution and the Bank. It is the result of protracted negotiation with DTI and the accountancy professional bodies. As agreed with the latter the Bill provides that the auditor may not be held to be in breach of any duty by providing, in good faith, information relevant to the Bank's functions. The professions are however very unhappy about the FS Bill equivalent of Cl. 43(5) which gives the Secretary of State power in effect, to create or override professional rules. They will be equally unhappy with our clause. But, since the professional bodies are being dilatory over creating their own guidance and may in fact not produce guidance which encourages auditors adequately to co-operate with the Bank, this provision is essential.

Unauthorised Acceptance of Deposits (Clauses 44-46)

23. These provisions were not advertised in the White Paper but should not prove to be controversial. They give the Bank for the first time effective powers to prevent suspected or repeated breaches of the prohibition on deposit-taking and to deal with money (and profits) held as a result of illegal deposit-taking. These clauses are in prototype form and some further detailed changes may need to be made before introduction.

Deposit Protection Scheme (Clauses 47-63 and Schedule 4)

24. The opportunity presented by the Bill has been taken to make a number of second-order changes to the Deposit protection scheme. Many of these are to ease the administration of the fund and should excite little comment (an obvious example is Clause 48(3) which allows investment in Treasury Bills of <u>any</u> maturity rather than the 3 months in the 1979 Act). Others rectify generally perceived shortcomings and will be welcomed (for example, protection will be given to individual clients whose money is pooled

in a single client account and then placed on deposit). The two changes announced in the White Paper, increasing the minimum contribution and making overseas banks liable to contribute are also included. But because of the requirement not to discriminate against EC institutions, which may already have contributed to schemes giving equivalent protection to UK depositors, a power of exclusion for such institutions has been retained.

25. Interest is expected to centre around the level of protection under the scheme. This is unchanged from the previous Banking Act at 75 per cent of the first £10,000. Since then the Building Societies Bill has been forced to concede 90% protection and the F.S. Bill and new pensions scheme protection arrangements are likely to protect 90% of at least £30,000. So we will be under pressure to concede more.

Banking Names and Descriptions (Clauses 64-69)

26. These clauses implement the proposals in chapter 7 of the White Paper. The provision on banking names in clause 64, which requires an authorised UK institution to have £5 million in paid-up equity capital before being able to use a banking name, is not in line with the BBA's preference for a test of £10 million net assets. It is also causing problems for one old established bank (C Hoare & Co.) which does not have £5 million paid up equity and claims that it will not be able to create the necessary new shares without a significant adverse change in its tax position. We do not intend giving way to the BBA because of the variability of net assets and the fact that the £10 million level would require several existing banks to change their names. But whether we can make an exception for C Hoare and Co. depends on how genuine and honest their reasons for not issuing more shares are. However, since we already have one exception in place (Clause 64(6)(a)iii refers to the Airdrie Savings Bank) it will be difficult to object to a special provision being made as such. We

are in contact with Hoares. The Bank are currently debating internally how to treat "investment banks". We may need further amendment to take account of them.

27. It is worth noting that we cannot prevent use of its normal name rules either by a an institution from another EC member state (for Community law reasons), or for overseas institutions more generally unless their name is misleading (because of technical difficulties in defining an equivalent test to the £5 million paid up equity). The other provisions in this group of clauses are complex but should not prove controversial.

Representative Offices (Clauses 70-76)

28. These clauses implement policy announced in the White Paper. Most notably clause 76 provides reserve powers for the Bank to formally regulate the establishment of representative offices should problems arise. These provisions are unlikely to prove controversial.

Disclosure of Supervisory Information (Clauses 78 - 83)

29. These provisions are of great concern to the Banking Associations. In particular the BBA has objected strongly to the powers announced in the White Paper for the Bank to give information to the Secretary of State in the public interest. These powers appear in the Bill in clause 80(8)(b). We are in correspondence with the BBA about possible concessions (for example, to exclude information about customer's affairs). The 'Secretary of State' formula already meets one concern of theirs by excluding the revenue departments.

30. There may also be an outcry at the number of new disclosure gateways which are necessary to implement the White Paper proposal 'to introduce certain amendments to the existing restrictions [to deal with the complexities of the supervision of financial institutions]' The expansion has taken us from 2 sections in the 1979 Act

to 6 clauses here. These new provisions have been the subject of protracted negotiation with DTI and others concerned and, though some further tidying-up changes are expected, on most of them our hands are tied by inter-departmental agreements.

Miscellaneous Provisions (Clauses 84 - end)

31. Much of the material in this section is of little note but two clauses contain significant changes.

32. The Clause 84 provisions on the Consumer Credit Act were promised in the White Paper but we are advised by Counsel that they carry risks for the Bill in opening it up to further amendments of that Act from the consumer lobby. The Electronic Funds Transfer at Point of Sale amendment (Clause 84(4)) carries the greatest danger. We are reviewing how to minimise this risk (see submission).

33. Clause 87 implements the policy announced in the White Paper of providing a new general offence of knowingly or recklessly providing false information to the supervisor. But it goes wider in also making it an offence to deliberately omit to provide relevant information. This new breadth of scope may attract adverse comment from the Banking Community.

1779/009

CONFIDENTIAL

FROM: M A HALL

8 August 1986

ECONOMIC SECRETARY

c c Chancellor
Sir Peter Middleton o/r
Mr Cassell
Mr Peretz o/r
Mrs Lomax o/r
Mr Ilett
Mr D Jones
Mr Board
Mr Evershed

Mr Croft T.Sol
Mr Devlin RFS

BANKING BILL : MATTERS OUTSTANDING

This note reports progress on matters outstanding from your meeting of 29 July (except for the Consumer Credit Act, covered in my separate submission covering the draft Bill itself).

(a) **Banking Names/C Hoare and Co**

2. Provided Lord Brabazon writes to Hoares as you advised, the ball is now in Hoares' court to contact us.

(b) **Foreign Currency Deposits**

3. We are discussing this with the Bank on the lines agreed at your meeting. We shall report further in September. But this is difficult, and we are not hopeful of a neat solution.

(c) **Confidentiality: BBA Concerns**

4. Again, we have produced a draft revised approach (Flag A) which we think reflects your ideas. But the Bank have doubts about going beyond substituting "necessary" for "desirable or expedient" to cover disclosure to the Treasury and the Secretary

of State. They believe this would make little difference in practice. We are not yet therefore in a position to reply to the BBA.

(d) **1946 Bank of England Act**

5. You asked us consider the extent to which the Labour Party would be able to use the 1946 Bank of England Act to compel bank lending in support of their industrial strategy. A copy of the relevant section is attached.

6. The relevant powers are in section 4 of the 1946 Act. They are in two parts: a power for the Treasury to give the Bank of England such directions as it thinks necessary in the public interest (Section 4(1)), and a power for the Bank, if it thinks it necessary in the public interest and with Treasury authorisation, to issue directions to the banks (section 4(3)). The Labour party's document 'Investing in Britain' says:-

> "These [other measures] include making use of the powers of the Bank of England, under the 1946 Bank of England Act, to ensure that bank lending to industry supports our strategy."

which makes clear that it is the Bank of England powers under section 4(3) that are in mind.

7. There would be at least four problems attached to the use of these powers in the way proposed by the Labour Party:-

(a) The primary discretion on whether to issue directions to banks belongs to the Bank of England (we have clear legal advice that the Treasury's powers under section 4(1) may not be used to compel the Bank to act in this way).

(b) In 1965 Counsel advised the Bank that its section 4(3) direction making power could only safely be used in furtherance of that part of the public interest with which the Bank were properly concerned (ie the financial public interest). If this view were upheld it could make use of the Banks power for say, regional or industrial policy reasons, ultra vires. (The Treasury

Solicitor's view would be that the public interest is not necessarily to be so narrowly construed.)

(c) The 1946 Act itself prevents directions concerning the affairs of a particular customer of a banker. (This would prevent a direction to the bank of a failing company to extend support).

(d) The Act itself does not provide for any sanctions to be attached to the directions (but one could not exclude recourse to the Courts to secure compliance).

8. So to use a direction in the way proposed a future government would have to obtain the cooperation of the Governor and Court, resolve considerable difficulties over its form and drafting and finally, secure compliance. They might wish they had started with a clean sheet of paper.

9. Repealing or amending section 4 of the 1946 Act to make it impossible to use as proposed by the Opposition would have the advantage of putting the matter beyond doubt. But there are grave disadvantages:-

(a) It would open the scope of the Bill to the constitution of the Bank of England and its relationships with the Treasury;

(b) It would be seen as a high profile response to opposition policy;

(c) All governments would lose the occasional advantage of being able to wave this vague stick in support of mainstream financial policy objectives.

10. Our strong advice is to let section 4 of the 1946 Act lie.

11. The Bank and Treasury Solicitor's Department concur.

M A HALL

RECIPIENT	INFORMATION	TEST FOR DISCLOSURE
*The Treasury	Any information	Appears to the Bank to be desirable or expedient in the interests of depositors or in the public interest
The Secretary of State	Information relating to the institution which does not enable the affairs of an identifiable customer to be reasonably ascertained+	Appears to the Bank to be necessary in the interests of depositors or in the public interest
	Information relating to the institution which enables the affairs of an identifiable customer to be reasonably ascertained+	Appears to the Bank to be necessary in the interests of depositors

*ie as at present. It would help if Counsel were to distance the Treasury from the Secretary of State in the drafting:-

(a) to emphasise the different relationship which the Treasury has with the Bank;

(b) to avoid making obvious the differences of the treatment between the Treasury and the Secretary of State.

Treasury directions to the Bank and relations of the Bank with other banks.

4. (1) The Treasury may from time to time give such directions to the Bank as, after consultation with the Governor of the Bank, they think necessary in the public interest.

(2) Subject to any such directions, the affairs of the Bank shall be managed by the court of directors in accordance with such provisions (if any) in that behalf as may be contained in any charter of the Bank for the time being in force and any byelaws made thereunder.

(3) The Bank, if they think it necessary in the public interest, may request information from and make recommendations to bankers, and may, if so authorised by the Treasury, issue directions to any banker for the purpose of securing that effect is given to any such request or recommendation :

Provided that :—

(*a*) no such request or recommendations shall be made with respect to the affairs of any particular customer of a banker ; and

(*b*) before authorising the issue of any such directions the Treasury shall give the banker concerned, or such person as appears to them to represent him, an opportunity of making representations with respect thereto.

(4) If, at any time before any recommendations or directions are made or given in writing to a banker under the last foregoing subsection, the Treasury certify that it is necessary in the public interest that the recommendations or directions should be kept secret, and the certificate is transmitted to the banker together with the recommendations or directions, the recommendations or directions shall be deemed, for the purpose of section two of the Official Secrets Act, 1911, as amended by any subsequent enactment, to be a document entrusted in confidence to the banker by a person holding office under His Majesty ; and the provisions of the Official Secrets Acts, 1911 to 1939, shall apply accordingly. 1 & 2 Geo. 5. c. 28.

(5) Save as provided in the last foregoing subsection, nothing in the Official Secrets Acts, 1911 to 1939, shall apply to any request, recommendations or directions made or given to a banker under subsection (3) of this section.

(6) In this section the expression " banker " means any such person carrying on a banking undertaking as may be declared by order of the Treasury to be a banker for the purposes of this section.

(7) Any order made under the last foregoing subsection may be varied or revoked by a subsequent order.

[*Subs.* (8) *rep.* 14 *Geo.* 6. *c.* 6 (*S.L.R.*)]

Interpretation.

5. For the purposes of this Act—

(*a*) the expression " the Bank " means the Bank of England ;

(*b*) the appointed day shall be such day as the Treasury may by order appoint, not being later than three months from the date of the passing of this Act.

Short title.

6. This Act may be cited as the Bank of England Act, 1946.

CONFIDENTIAL

c/ letter to issue?

FROM : R.J.T.WATTS
DATE : 29 AUGUST 1986

CHANCELLOR OF THE EXCHEQUER

cc Economic Secretary
Sir P Middleton
Mr Cassell
Mr A Wilson
Mr Peretz
Mr Hall
Mr F Croft- T Sol

TYPISTS
Please also type draft letter attached.

BANKING ACT APPEAL BY LONDON AND ARAB INVESTMENTS LTD

London and Arab Investments Ltd (LAI) appealed on 1 October 1985 against the Bank of England's decision to revoke its licence to carry on a deposit-taking business. You appointed Mr Allan Heyman QC, Mr Alfred Goldman, and Mr Jim Butler FCA to hear the appeal.

2. The Appointed Persons have submitted the attached report. They recommend that you accept an application made jointly by the parties that the appeal be allowed. The final decision is however for you to make "having regard" to the Appointed Persons report. You are required to provide to the parties a statement of the reasons for your decision.

Organisational Changes

3. In brief the Bank of England and, more reluctantly, the Appointed Persons are now satisfied that changes in management, and an injection of further capital, mean that LAI should be allowed to retain its licence.

4. The reasons for the Bank's original decision to revoke are set out in paragraph 3 of the report. They paint a picture of

imprudent conduct, inadequate assets and directors who failed the fit and proper test.

5. Soon after your appointment of the Appointed Persons it became clear that the Bank of England and the Appellant were close to an accommodation. At a hearing on 15 April the parties explained that a number of organisational changes had taken place and that the Bank of England were now content that LAI should keep its licence. They asked that the Appointed Persons should recommend to the Chancellor that the appeal be allowed. The possibility of seeking to withdraw the appeal was not put forward by the parties because it would have meant LAI having to make a new application for a licence.

6. The Appointed Persons, quite properly, were not prepared to recommend that the appeal be upheld solely on the basis that the Bank of England was now content. Before being prepared to recommend that LAI should keep its licence they insisted on being provided with further details. Subsequently the Appointed Persons established that:

i. LAI's capital has been increased from £2.4m to £5.4m

ii. all but one of LAI's directors have resigned and been replaced by new Board members

iii. Societe Bancaire Arab has acquired 10% of LAI's share capital and has furnished a letter of comfort.

7. In addition the Appointed Persons:

i. obtained confirmation from the auditors that a clean audit report will be provided if LAI are successful in the appeal

ii. insisted that Ernst and Whinney's report on lending procedures be completed

iii. required that LAI's audited accounts for the period 31 December 1984 to 31 December 1985 be approved by the Directors.

8. The Appointed Persons make clear that on the basis of the information put before them on 15 April they would have had no option but to recommend rejection of the appeal. However on the basis of the information and assurances provided subsequently they feel able to recommend that the criticisms on which the Bank of England based its original revocation have now been satisfactorily dealt with and that the appeal be allowed.

9. The report also implicitly makes clear that the Appointed Persons were unhappy that (1) they should have been asked to accept without evidence the Bank's assurances that the serious criticisms on which the Bank had based its decision to revoke had been adequately dealt with, (2) the time it took the parties to produce such evidence,and (3) the fact that the Bank of England should have been ready to agree to LAI keeping its licence in the absence of Ernst and Whinney's final report on lending procedures and audited accounts for the period 31 December 1984 to 31 December 1985. The Appointed Persons hope to have the opportunity to discuss their concerns with Sir Peter Middleton.

CONCLUSION

9. We see no reason to differ with the recommendation in the Appointed Persons report that you accept the application made jointly by the parties that the appeal be allowed.

10. If you agree you should write to the parties in terms of the attached drafts which have been cleared with the Treasury Solicitor.

R. Watts

R.J.T.WATTS

CONFIDENTIAL

DRAFT LETTER FOR THE CHANCELLOR'S SIGNATURE TO

Head of Banking Supervision
Bank of England
Threadneedle Street
LONDON EC2R 8AH

BANKING ACT 1979: APPEAL BY LONDON AND ARAB INVESTMENTS LTD

This appeal by London and Arab Investments Limited ("the appellant") was brought under section 11 of the Banking Act 1979 ("the Act") against a decision of the Bank of England dated 11 September 1985 confirming its intention to revoke the appellant's licence to carry on a deposit-taking business. As required by the Act and the Banking Act 1979 (Appeals) Regulations 1980 ("the Regulations") the matter was referred for a hearing before three persons appointed for the purpose, namely Mr Allan Heyman QC (Chairman), Mr P J Butler FCA, and Mr A I F Goldman, Solicitor ("the appointed persons"). I have now received the appointed persons' report, a copy of which is enclosed. I have considered this report and I accept the advice contained in paragraph 30 of the report that the criticisms on which the Bank based its revocation of LAI's licence have now been satisfactorily dealt with. I have therefore decided that the Appeal be allowed and that no order as to costs should be made.

CONFIDENTIAL

DRAFT LETTER FOR THE CHANCELLOR'S SIGNATURE TO

For the attention of J.R.Farr Esq

Messrs Herbert Smith

Watling House

35-37 Cannon Street

LONDON EC4M 5SD

BANKING ACT 1979: APPEAL BY LONDON AND ARAB INVESTMENTS LTD

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NIGEL LAWSON.

(b) the identification, taking and evaluation of security was haphazard;

(c) the monitoring of borrowers' and guarantors' changing circumstances was deficient or omitted; and

(d) the control of borrowings to within agreed credit limits was ineffectual and in many cases there was no credit limit.

4.4 In the light of the points in paragraphs 4.1 to 4.4 above, the Bank considers that the manner in which the company has conducted its business has fallen far short of the standard of prudence required of the company as a licensed deposit taker.

5.2 The Bank considers that the company has failed to make adequate provisions for bad and doubtful debts .....

5.3 The Bank considers that the company had inadequate net assets to safeguard the interest of depositors .....

6.1 Paragraph 7 of Schedule 2 to the Act provides that every director, controller and manager of a licensed institution must be a fit and proper person to hold that position .....

6.2 The Bank considers that Messrs. Fadoul, Ojjeh, Solomon and Al-Atassi are not fit and proper persons to hold the position of director of the company and that Mr Tabiaat has not been fit and proper to hold the position of director of the company.

C/ There are a large number of annexes which I have not included in folder, but you may see if you wish CR2918

LONDON AND ARAB INVESTMENTS LIMITED

1. On the 16th August 1985 the Bank of England ("the Bank") served a written notice on London and Arab Investments Limited ("LAI") pursuant to Section 7(3)(a) of the Banking Act 1979 ("the Act") to the effect that it proposed to revoke under Section 7 of the Act the licence granted on 21st October 1980 under the Act to LAI, formerly Burlington Investments Limited.

2. In its said notice the Bank set out its grounds for revocation under Section 6(1)(c) of the Act namely (i) that the criterion in paragraph 10 of Part II of Schedule 2 to the Act was not being and had not been fulfilled and (ii) that the criterion in paragraph 7 of Part II of Schedule 2 to the Act was not being and had not been fulfilled.

3. The above-mentioned grounds for revocation were amplified in the said notice which included inter alia the following paragraphs:

> "4.2 On the basis of information obtained by Mr Wainright-Lee and Miss Hearn of the Banking Supervision Division of the Bank during a visit to the company [LAI] on 11, 12, 15 and 16 July 1985, the Bank has concluded that the company's lending procedures have been inadequate. Their enquiries into lending procedures indicated that these were seriously deficient in that:
>
> (a) the company lacked a professional formalised and consistent approach to the assessment of applications to borrow and lacked a formalised procedure to sanction or decline such applications;

6. In Part B of their said letter of the 29th August 1985 Messrs Herbert Smith & Co. on behalf of LAI set out the latter's proposals to the Bank to avoid the threat of a revocation of its licence. The most relevant of these proposals are as follows:

> Part B. 1. "The directors recognise that serious problems exist with respect to the conduct of the Company's affairs but firmly believe that the position can be remedied. They have indicated their willingness to do whatever is necessary to effect those remedies and achieve acceptable standard and (as noted above) would have full recourse to the advice and assistance of the Bank. The directors submit that it is not in the interests of existing depositors, nor in the interest of the financial community as a whole, for the Company's licence to be revoked.

3. SPECIFIC PROPOSALS FOR REFORM

The directors consider that if the Company were to be allowed to continue its deposit taking business pursuant to a temporary or conditional licence the following steps should be taken immediately

(i) An effective and experienced general manager must be appointed who possesses the ability and judgment necessary to recruit competent staff and to overhaul or (where necessary) institute tighter operational controls and procedures

The directors are therefore actively seeking a suitable candidate .....

8.6 The interest of existing depositors have already been threatened by the imprudent conduct of the company's business and they remain under threat. Matters have not been improving in spite of promptings by the Bank. Mr Wainright-Lee drew the company's attention to some of the inadequacies of procedures and systems noted in 4.2 on the occasion of an earlier visit on 5 and 11 June 1984. It is clear from his visit in July this year that no steps had been taken to meet his criticisms; Mr Lloyd accepted that this was so. Any future depositors would be exposed to the same risks as existing depositors.

8.7 In the Bank's view, even if the company's capital were substantially increased and an adequate replacement were found for Mr Major, [manager] these actions alone would not be sufficient to persuade the Bank not to exercise its powers to revoke under Section 7(1)(a)".

4. A further notice was served by the Bank on LAI on the 16th August 1985 pursuant to Section 8(3) of the Act giving directions set out in the Annexe to the notice for the purpose of safeguarding the assets of LAI prohibiting the soliciting of deposits and requiring information. In taking this action the Bank had regard to its conclusions about LAI's management and the conduct of the business set out in the said notice of the 16th August 1985.

5. Written representations were made by Messrs Herbert Smith & Co. on behalf of LAI in letters dated the 29th August 1985 and 9th September 1985 respectively. Furthermore oral representations were made at a meeting on the 21st August 1985 between Messrs Fadoul, Ojjeh and Roberts on behalf of LAI and Messrs Roper and Wainright-Lee of the Bank.

7. By a letter dated the 11th September 1985 the Bank notified LAI that pursuant to paragraph 2(1) of Schedule 4 to the Act that it had decided to revoke under Section 7(1)(a) of the Act the licence granted on the 21st October 1980 under the Act to LAI.

In its said letter the Bank dealt in detail with the representations both written and oral made by LAI to the Bank, the following passages appear to be of particular relevance:

"6.2 The Bank notes that representations 1.6, 1.8, 3.3, 3.4, 4.2 and 4.3 seek to persuade the Bank that the Chairman's report and plan of 28 June 1985 provides reassurance that the Bank would be able to devise and implement in collaboration with the company's management, satisfactory lending procedures and adequate policy guidelines, delegated authorities and lending limits and that the Board will have the necessary reporting in place to oversee satisfactorily the performance of the company's management.

6.3 The Bank has reconsidered the business plan in the light of these representations and remains of the view that the plan is unrealistic and unconvincing.

6.9 ..... The Bank has considered proposals that the present directors should resign and seek replacement and that the shareholders should be changed, but is unable to take a view on these matters in isolation, since it has no idea of the identities of either new directors or new shareholders.

(ii) The Board

The directors of the Company accept that many of the deficiencies and failings which have been identified by the Bank are attributable to them and specifically to their lack of expertise in U.K. banking .....

Accordingly, the present directors are (should the Bank so recommend) willing to tender their resignations with immediate effect and to procure, with the assistance of the shareholders, the appointment of a new or interim board approved by the Bank.

(iii) Capital

The Bank is aware that a further injection of capital in the amount of £1.2m was proposed for September 1985. We understand that if the Company's licence is revoked and the business of the Company ceases the shareholders will be unwilling to contribute further capital.

However, if the Company were permitted to continue its business subject to a conditional licence, the shareholders have agreed to make available to the Company the sum of £1.2m either as capital or in the form of a subordinated loan .....".

10. On the 3rd February 1986 the Chancellor of Exchequer appointed A. Heyman Q.C. (Chairman) A.I.F. Goldman and P.J. Butler to hear the appeal on his behalf in accordance with the Banking Act 1979 (Appeals) Regulations 1980.

11. A preliminary hearing was arranged for Tuesday 11th March but this was abandoned as the parties had informed Mr Roger Watts of the Treasury that the appeal was unlikely to be proceeded with. Accordingly a new hearing date was fixed for the 15th April 1986 when it was hoped that the appeal could be disposed of.

12. On the 9th April 1986 Mr Farr of Messrs Herbert Smith & Co. informed Mr Roger Watts that the Bank had decided to continue the licence held by LAI. He further informed him that the Bank and LAI were agreed that they would request the Appointed Persons to advise the Chancellor that the appeal should be allowed.

13. On the 15th April 1986 a preliminary hearing was held at 1 New Square, Lincoln's Inn which apart from the Appointed Persons and Mr Roger Watts was attended by Mr Austin Allison of Counsel and Mr P. Croll of Messrs Freshfields representing the Bank and Mr Rhodri Davies of Counsel and Mr P. Frost of Messrs Herbert Smith & Co. representing LAI.

Mr Davies informed the Appointed Persons that his client had made a number of organisational changes in respect to the Bank's concerns and had appointed Messrs Ernst and Whinney to carry out an internal control review. Messrs Ernst & Whinney, Chartered Accountants, had succeeded Messrs Touche Ross as LAI's auditors on 25th July 1985. Mr Davies understood that the Bank were now content that LAI should continue to be a licensed deposit taker under the Act. The parties had

6.11 The Bank accepts that the shareholders may be prepared to inject a further £1.2m capital into the company. However the Bank is still of the same opinion expressed in paragraph 8.7 of the Notice that such an injection of capital and the appointment of a suitable experienced general manager alone would not be sufficient to allay the Bank's concerns given its conclusions about the directors and the failure of the corporate plan to address the real problems facing the company.

7.1 The Bank, therefore having taken into account the company's representations, still considers that its powers to revoke the company's licence are exercisable and should be exercised for the reasons given in the notice. The Bank does not consider that there is a real prospect of all the criteria in Part II to Schedule 2 to the Act being fulfilled with respect to the company within the period of a conditional licence and has therefore decided not to grant the company a conditional licence".

8. The Bank furthermore on the same day gave notice to the company pursuant to Section 9(1) of the Act confirming directions given to the company under Section 8 of the Act in the Bank's notice of 16 August 1985 by virtue of which the company was effectively prevented from trading except with the prior consent of the Bank in writing.

9. On the 1st October 1985 Messrs Herbert Smith & Co. on behalf of LAI served notice of appeal on the Bank pursuant to the Banking Act 1979 (Appeals) Regulations 1980.

confirmation from Messrs Herbert Smith & Co. for the appellants that they agreed with the position as set out in the submissions (Appendix I hereto).

The following extracts from the submissions are of particular relevance:

> "3.1 Messrs. Ernst & Whinney, Chartered Accountants, have begun a comprehensive review of LAI's lending procedures and systems of internal control in accordance with instructions given by LAI in a letter dated 11 March 1986 a copy of which is annexed hereto ..... LAI has undertaken to implement their recommendations.
>
> 3.3 There has been an increase in LAI's paid up share capital from £2.4 million to a total of £5.4 million. The risk asset ratio thereby produced is as high as 112%.
>
> 3.4 Societe Bancaire Arabe, which has acquired 10% of the share capital of LAI and which is regarded by the Bank as a reputable institution, has furnished the Bank with a comfort letter (copy annexed) in which it endorses the feasibility of a Business Plan submitted by LAI to the Bank on 23 January 1986.
>
> 3.5 Messrs. Fadoul, Solomon and Al-Atassi have resigned as directors of LAI and Mr. Fadoul has ceased to be a controller (Messrs. Tabiaat and Major's appointments with LAI terminated before the licence was revoked).

considered the possibility of seeking to withdraw the appeal but that would appear to necessitate LAI having to make a new application for a licence, and that would involve a discontinuance and delay which would be disadvantageous to LAI. The two parties therefore agreed to make an application that the Appointed Persons would recommend to the Chancellor that the appeal be allowed.

Mr Allison on behalf of the Bank supported this application.

The Appointed Persons replied that in their report to the Chancellor they would need to set out reasons why the appeal ought to be allowed and that no detailed reasons had been given as to how the severe criticisms made by the Bank in their said letters of the 16th August and 11th September 1985 had been dealt with.

They therefore requested the parties to make available to them as soon as possible

(a) an agreed document setting out in summary form the original criticisms made by the Bank together with the ways in which LAI had been able to meet these criticisms to the satisfaction of the Bank,

(b) a copy of the report as to LAI's lending procedures and systems of internal control commissioned by LAI.

14. On the 18th April 1986 the Appointed Persons received from Messrs Freshfields submissions on behalf of the Bank setting out the background to the Bank's decision not to contest the appeal. In the accompanying letter Messrs Freshfields stated that they had received

16. On the 11th June 1986 Messrs Herbert Smith sent to the Appointed Persons a copy of a letter dated 9th June 1986 from Messrs Ernst & Whinney to them enclosing Draft Accounts of LAI for the year ending 31st December 1985, abridged management accounts of LAI prepared by its own staff for the 5 month period ended 31st March 1986 and finally a draft report covering the internal controls in operation at LAI, their adequacy and recommendations as to further controls required. The said letter together with the said enclosures are together Appendix III hereto.

17. The Appointed Persons were however still not satisfied with the information they had received and consequently on the 20th June 1986 Mr Roger Watts wrote to Messrs Herbert Smith (copy to Messrs Freshfields) on their behalf seeking further clarification of the following points:

> "i. The Appointed Persons would welcome confirmation from Ernst & Whinney that a clean audit report would be provided if London and Arab were successful in its appeal. The Appointed Persons also hope that Ernst and Whinney will be able to tell them what provisions are necessary at 31 December 1985.
>
> ii. It appears that Note 4 on the 1985 accounts (Loans to and transactions with Directors - to be determined) has still to be provided which seems somewhat peculiar to the Appointed Persons who would have expected all information regarding directors to have been ascertained by this stage.

3.6 Mr. Backir Zouheiri has been appointed Chairman and Managing Director of LAI. He was until recently Group General Manager of European Arab Bank in the United Kingdom and is Chairman of the Arab Bankers Association in London. The following have also joined the Board of LAI. [The persons names and their qualifications are thereafter set out] ..... The Bank is satisfied that the persons named above are fit and proper to hold their respective positions.

4. By reason of the changes of circumstances described above the Bank is satisfied that it is now appropriate that LAI should continue to hold a licence to carry on a deposit taking business".

15. The Appointed Persons were concerned by the fact that they were being asked to advise the Chancellor to allow the appeal at a time when a review of LAI's lending procedures etc. had only been begun by Ernst & Whinney but had not been completed. They were of the opinion that they could not report to the Chancellor until the report had been completed and they had had an opportunity to consider it.

Accordingly they asked through Mr Roger Watts for a sight of this report before they could deal further with the appeal. On 23rd April 1986 Messrs Herbert Smith sent to the Appointed Persons copies of Messrs Ernst & Whinney's letter to Mr Ojjeh of LAI dated the 25th March 1986 dealing with the "Internal Control Review" and of their letter dated 17th April 1986 to Mr Ojjeh giving a progress report; these are attached as Appendix II hereto. Messrs Herbert Smith asked that the hearing arranged for 24th April should be adjourned until further information was available from Messrs Ernst & Whinney.

While Messrs Herbert Smith's said letter does not give rise to any further questions save such as could be put at the resumed hearing Messrs Ernst & Whinney's letter did require some further questions to be put. It read as follows:

> "(i) We can confirm that, subject to reaching agreement with the directors as to the final provision for bad debts and to finalising note 4 (as to which see (ii) below) we would provide a clean audit report if LAI were successful in its appeal. As we mentioned in our letter dated 9 June 1986, on the most pessimistic view the final bad debts provision would be £600,000 in excess of that included in the draft accounts. We are aware that the management of LAI considers that if the appeal is successful such a large provision will not be necessary. In view of the present absence of certainty as to the outcome of the appeal we have not yet sought to agree the final bad debts provision;
>
> (ii) We have some enquiries outstanding on note 4. The main difficulty is over tracing all connected transactions concerning persons who were directors but resigned and left the company during the course of the year;
>
> (iii) Our internal control review has now been finalised in the terms of the draft without alteration. We hope to issue it formally within the next few days".

19. Further questions were set out in a letter from Mr Roger Watts to Messrs Herbert Smith dated the 14th July 1986 in which he informed them that the Appointed Persons would be available for a hearing on

iii. The Appointed Persons cannot understand why the Ernst and Whinney report is still in draft. The summary seems to demonstrate a very poor position. The Appointed Persons note the statement in the Ernst and Whinney letter that the management and in particular Mr Strevens, has fully accepted the report's recommendations but would like to know exactly what is being done about the recommendations and would like to see evidence of what has been done.

iv. The Bank of England originally directed that Coopers should supervise the activities. This appears now to have ceased but the Appointed Persons are not clear whether Ernst and Whinney are now performing this function of whether reliance is now being placed solely on the involvement of senior management.

v. The Appointed Persons note that even before making any further provision for bad debts London and Arab have made a loss of £156,000 during the five months to 31 May".

The said letter is Appendix IV hereto.

18. Messrs Herbert Smith replied on the 27th June dealing with points (iii) to (v) while points (i) and (ii) were dealt with by Messrs Ernst & Whinney in a letter to Messrs Herbert Smith dated the 26th June, a copy of which was enclosed with the said letter of the 27th June. The said two letters are Appendix V hereto.

21. Messrs Herbert Smith replied on the 17th July 1986 enclosing two letters, one from Ernst and Whinney and one from LAI both dated 17th July 1986. The former dealt with points a - e raised on the said letter of 14th July stating

(a) that they enclosed a set of completed accounts for LAI to 31st December 1985 which were in a form in which they would be prepared to complete their audit report once the licence had been restored

(b) that the enclosed report on review of control was in its final form

(c) that they had been appointed by the board of LAI to undertake an internal audit role until a permanent person was recruited (see letter of appointment of same date)

(d) that they considered the LAI recruitment programme realistic and

(e) that they would attend the hearing.

The two said letters are Appendix VI hereto.

22. The Bank wrote to the Appointed Persons on 17th July 1986 informing them

(a) that following the capital injection of £2.4 million in April 1986 the Bank was satisfied that LAI was adequately capitalised. The risk asset ratio at 30th June 1986 was 98%.

Friday 18 June if a number of items which they regarded as essential prerequisites of a positive recommendation could be made available in time. These were as follows:

"a. The accounts to 31 December 1985, together with the notes thereof, completed in a form which Ernst and Whinney are prepared to sign providing bank status is restored.

b. A final copy of Ernst and Whinney's review of control should be available. Ernst & Whinney should confirm also that satisfactory systems are now in place, subject only to additional recruitment.

c. Some temporary cover will be required for the five people to be recruited. This could be provided [for] by Ernst and Whinney.

d. A recruitment programme should be agreed to acquire the additional people within a reasonable period.

e. An Ernst and Whinney partner should attend the hearing and be in a position to confirm points b, c and d above".

20. On the same date Mr Roger Watts wrote to the Bank asking them to confirm that with the additional capital subscribed it was satisfied that LAI had adequate capital and for information as to why Coopers and Lybrand were withdrawn from overseeing LAI's activities and whether the Bank was content to rely upon its own contacts with the Directors and Management of LAI.

the Bank's letter of 17th July 1986 would remain in place until the Chancellor's decision was known and (b) that the sole reason for the Bank's decision to withdraw Coopers and Lybrand from the case was the increase in capital and the strengthened management team.

At the request of the Chairman Mr Allison undertook to supply the Appointed Persons with the last three of the regular reports provided on LAI by Coopers and Lybrand. Mr Allison also stressed that it was the Bank's intention to continue to scrutinise the affairs of LAI with vigilance and if necessary take action again.

In reply to questions by the Appointed Persons, Mr Dewar stated (a) that they were now satisfied that they had obtained the information previously not available in order to complete Note 4 to the accounts (b) that LAI would recruit 3 people no later than 3 months after the Chancellor's decision had been made known and (c) that the internal audit to be carried out by them would be comprehensive.

Mr Davies submitted that in the light of the information and documents now available the Appointed Persons should advise the Chancellor to allow the appeal. He confirmed the information given by Mr Dewar and undertook to obtain the Board of LAI's decision by the end of the month as to whether the Board would sign the accounts prepared by Ernst and Whinney and placed before the Appointed Persons.

Both parties agreed that the question of costs did not arise.

(b) Coopers and Lybrand were withdrawn from LAI in consequence of the increase in capital and the strengthening of the management team by the appointment of Messrs Zouheiri Strevens and Sutton. The directors remained in place. The Bank was now content to rely upon its own contact with the directors and management of LAI.

23. On Friday 18th July 1986 the hearing of the appeal took place in Room 29/G H.M. Treasury. It was attended by the Appointed Persons, Mr Austin Allison of Counsel and P. Croll of Messrs Freshfields representing the Bank Mr Rhodri Davies of Counsel and Mr P. Frost of Messrs Herbert Smith representing LAI, Mr G. Dewar and Mr D. Markwick of Ernst and Whinney and Mr Roger Watts of the Treasury.

The Chairman informed the parties that the presumption in the Appeals Regulations was that hearings should be held in public unless there was good cause to the contrary. In the present case the Appointed Persons had taken the view, in the absence of an application, that the hearing should be in private because the object of the appeal might very well be lost if details of the documents were made public at that stage.

Mr Allison and Mr Davies confirmed that their clients would be content with this procedure in the present case.

Mr Allison repeated the Bank's earlier submissions on the 18th april 1984 to the effect that it was content to have the appeal allowed because of the change in the management of LAI and the injection of further capital. He also stated (a) that the directions referred to in

27. On 15th April 1986 the Appointed Persons had no evidence before them in relation to the following matters:

(a) The organisations changes made by LAI in response to the Bank's concern

(b) Information as to the increase of LAI's capital from £2.4 million to £5.4 million

(c) The fact that Societe Bancaire Arabe and acquired 10% of LAI's share capital

(d) The resignation of all but one of LAI's directors and the appointment of a new Chairman and Managing Director of LAI, and new Board members, with details of their respective qualifications

28. Furthermore:

(i) Ernst & Whinney's report as to LAI's lending procedures commissioned by the latter was not completed until July 1986, and

(ii) Audited accounts of LAI for the period 31st December 1984 to 31st December 1985 were not approved by the directors until 11th August 1986.

29. It will be seen from the narrative in this report that after considerable perseverance on the part of the Appointed Persons the information required by them to advise the Chancellor was not obtained until mid August 1986.

24. On 24th July 1986 Messrs Freshfields delivered copies of the last three Coopers and Lybrand reports dated respectively 27th February, 19th March and 9th April 1986 to the Appointed Persons. These show that the assets of LAI on a break up basis were deficient by £599,000 if the additional provisions for doubtful debts recommended by them were made. In view of the injection of £3 million new capital which had not yet taken place by 9th April 1986 it would appear that LAI has ample cover to enable it to continue to trade. The report dated 9th April 1986 is Appendix VII thereto.

25. By a letter dated 14th August 1986 Messrs Herbert Smith informed the Appointed Persons that the Board of LAI had signed the accounts for the year ending 31st December 1985.

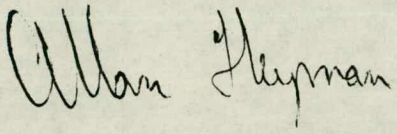
Conclusions

26. It has been necessary to set out in considerable detail the material available to the Appointed Persons on 15th April 1986 when the Bank and LAI first invited them to allow the appeal and the material and information obtained since then as a result of the pressure put on the parties by the Appointed Persons through the Treasury.

As already stated the Appointed Persons were on 15th April 1986 acutely aware of the fact that very serious allegations had been made by the Bank as to the conduct and the state of LAI's business which led it to revoke its licence and accordingly they could not advise the Chancellor until all relevant information as to ~~who~~ how these serious allegations had been dealt with were made available.

30. Having considered all the aspects of the case very carefully especially the Ernst and Whinney report, the organisational changes, the increase in capital and the audited accounts the Appointed Persons are now able to advise the Chancellor of the Exchequer that the criticisms on which the Bank based its revocation of LAI's licence have been satisfactorily dealt with and that the Appeal be allowed and that no order as to costs should be made.

The Appointed Persons would however like to stress that had the parties declined to furnish the further evidence now provided by them, they would have had no alternative on 15th April 1986 but to advise the Chancellor of the Exchequer to reject the appeal.



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CONFIDENTIAL

PUP

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

1 September 1986

Messrs Herbert Smith
Watling House
35-37 Cannon Street
LONDON EC4M 5SD

For the Attention of J R Farr Esq

Dear Sirs

BANKING ACT 1979:
APPEAL BY LONDON AND ARAB INVESTMENTS LTD

This appeal by London and Arab Investments Limited ("the appellant") was brought under Section 11 of the Banking Act 1979 ("the Act") against a decision of the Bank of England dated 11 September 1985 confirming its intention to revoke the appellant's licence to carry on a deposit-taking business. As required by the Act and the Banking Act 1979 (Appeals) Regulations 1980 ("the Regulations") the matter was referred for a hearing before three persons appointed for the purpose, namely Mr Allan Heyman, QC (Chairman), Mr P J Butler, FCA and Mr A I F Goldman, Solicitor ("the appointed persons"). I have now received the appointed persons' report, a copy of which is enclosed. I have considered this report and I accept the advice contained in paragraph 30 of the report that the criticisms on which the Bank based its revocation of LAI's licence have now been satisfactorily dealt with. I have therefore decided that the Appeal be allowed and that no order as to costs should be made.

Yours etc

Nigel Lawson

NIGEL LAWSON

(b) the identification, taking and evaluation of security was haphazard;

(c) the monitoring of borrowers' and guarantors' changing circumstances was deficient or omitted; and

(d) the control of borrowings to within agreed credit limits was ineffectual and in many cases there was no credit limit.

4.4 In the light of the points in paragraphs 4.1 to 4.4 above, the Bank considers that the manner in which the company has conducted its business has fallen far short of the standard of prudence required of the company as a licensed deposit taker.

5.2 The Bank considers that the company has failed to make adequate provisions for bad and doubtful debts .....

5.3 The Bank considers that the company had inadequate net assets to safeguard the interest of depositors .....

6.1 Paragraph 7 of Schedule 2 to the Act provides that every director, controller and manager of a licensed institution must be a fit and proper person to hold that position .....

6.2 The Bank considers that Messrs. Fadoul, Ojjeh, Solomon and Al-Atassi are not fit and proper persons to hold the position of director of the company and that Mr Tabiaat has not been fit and proper to hold the position of director of the company.

LONDON AND ARAB INVESTMENTS LIMITED

1. On the 16th August 1985 the Bank of England ("the Bank") served a written notice on London and Arab Investments Limited ("LAI") pursuant to Section 7(3)(a) of the Banking Act 1979 ("the Act") to the effect that it proposed to revoke under Section 7 of the Act the licence granted on 21st October 1980 under the Act to LAI, formerly Burlington Investments Limited.

2. In its said notice the Bank set out its grounds for revocation under Section 6(1)(c) of the Act namely (i) that the criterion in paragraph 10 of Part II of Schedule 2 to the Act was not being and had not been fulfilled and (ii) that the criterion in paragraph 7 of Part II of Schedule 2 to the Act was not being and had not been fulfilled.

3. The above-mentioned grounds for revocation were amplified in the said notice which included inter alia the following paragraphs:

> "4.2 On the basis of information obtained by Mr Wainright-Lee and Miss Hearn of the Banking Supervision Division of the Bank during a visit to the company [LAI] on 11, 12, 15 and 16 July 1985, the Bank has concluded that the company's lending procedures have been inadequate. Their enquiries into lending procedures indicated that these were seriously deficient in that:
>
> (a) the company lacked a professional formalised and consistent approach to the assessment of applications to borrow and lacked a formalised procedure to sanction or decline such applications;

6. In Part B of their said letter of the 29th August 1985 Messrs Herbert Smith & Co. on behalf of LAI set out the latter's proposals to the Bank to avoid the threat of a revocation of its licence. The most relevant of these proposals are as follows:

Part B. 1. "The directors recognise that serious problems exist with respect to the conduct of the Company's affairs but firmly believe that the position can be remedied. They have indicated their willingness to do whatever is necessary to effect those remedies and achieve acceptable standard and (as noted above) would have full recourse to the advice and assistance of the Bank. The directors submit that it is not in the interests of existing depositors, nor in the interest of the financial community as a whole, for the Company's licence to be revoked.

3. SPECIFIC PROPOSALS FOR REFORM

The directors consider that if the Company were to be allowed to continue its deposit taking business pursuant to a temporary or conditional licence the following steps should be taken immediately

(i) An effective and experienced general manager must be appointed who possesses the ability and judgment necessary to recruit competent staff and to overhaul or (where necessary) institute tighter operational controls and procedures

The directors are therefore actively seeking a suitable candidate .....

8.6 The interest of existing depositors have already been threatened by the imprudent conduct of the company's business and they remain under threat. Matters have not been improving in spite of promptings by the Bank. Mr Wainright-Lee drew the company's attention to some of the inadequacies of procedures and systems noted in 4.2 on the occasion of an earlier visit on 5 and 11 June 1984. It is clear from his visit in July this year that no steps had been taken to meet his criticisms; Mr Lloyd accepted that this was so. Any future depositors would be exposed to the same risks as existing depositors.

8.7 In the Bank's view, even if the company's capital were substantially increased and an adequate replacement were found for Mr Major, [manager] these actions alone would not be sufficient to persuade the Bank not to exercise its powers to revoke under Section 7(1)(a)".

4. A further notice was served by the Bank on LAI on the 16th August 1985 pursuant to Section 8(3) of the Act giving directions set out in the Annexe to the notice for the purpose of safeguarding the assets of LAI prohibiting the soliciting of deposits and requiring information. In taking this action the Bank had regard to its conclusions about LAI's management and the conduct of the business set out in the said notice of the 16th August 1985.

5. Written representations were made by Messrs Herbert Smith & Co. on behalf of LAI in letters dated the 29th August 1985 and 9th September 1985 respectively. Furthermore oral representations were made at a meeting on the 21st August 1985 between Messrs Fadoul, Ojjeh and Roberts on behalf of LAI and Messrs Roper and Wainright-Lee of the Bank.

7. By a letter dated the 11th September 1985 the Bank notified LAI that pursuant to paragraph 2(1) of Schedule 4 to the Act that it had decided to revoke under Section 7(1)(a) of the Act the licence granted on the 21st October 1980 under the Act to LAI.

In its said letter the Bank dealt in detail with the representations both written and oral made by LAI to the Bank, the following passages appear to be of particular relevance:

"6.2 The Bank notes that representations 1.6, 1.8, 3.3, 3.4, 4.2 and 4.3 seek to persuade the Bank that the Chairman's report and plan of 28 June 1985 provides reassurance that the Bank would be able to devise and implement in collaboration with the company's management, satisfactory lending procedures and adequate policy guidelines, delegated authorities and lending limits and that the Board will have the necessary reporting in place to oversee satisfactorily the performance of the company's management.

6.3 The Bank has reconsidered the business plan in the light of these representations and remains of the view that the plan is unrealistic and unconvincing.

6.9 ..... The Bank has considered proposals that the present directors should resign and seek replacement and that the shareholders should be changed, but is unable to take a view on these matters in isolation, since it has no idea of the identities of either new directors or new shareholders.

(ii) The Board

The directors of the Company accept that many of the deficiencies and failings which have been identified by the Bank are attributable to them and specifically to their lack of expertise in U.K. banking .....

Accordingly, the present directors are (should the Bank so recommend) willing to tender their resignations with immediate effect and to procure, with the assistance of the shareholders, the appointment of a new or interim board approved by the Bank.

(iii) Capital

The Bank is aware that a further injection of capital in the amount of £1.2m was proposed for September 1985. We understand that if the Company's licence is revoked and the business of the Company ceases the shareholders will be unwilling to contribute further capital.

However, if the Company were permitted to continue its business subject to a conditional licence, the shareholders have agreed to make available to the Company the sum of £1.2m either as capital or in the form of a subordinated loan .....".

10. On the 3rd February 1986 the Chancellor of Exchequer appointed A. Heyman Q.C. (Chairman) A.I.F. Goldman and P.J. Butler to hear the appeal on his behalf in accordance with the Banking Act 1979 (Appeals) Regulations 1980.

11. A preliminary hearing was arranged for Tuesday 11th March but this was abandoned as the parties had informed Mr Roger Watts of the Treasury that the appeal was unlikely to be proceeded with. Accordingly a new hearing date was fixed for the 15th April 1986 when it was hoped that the appeal could be disposed of.

12. On the 9th April 1986 Mr Farr of Messrs Herbert Smith & Co. informed Mr Roger Watts that the Bank had decided to continue the licence held by LAI. He further informed him that the Bank and LAI were agreed that they would request the Appointed Persons to advise the Chancellor that the appeal should be allowed.

13. On the 15th April 1986 a preliminary hearing was held at 1 New Square, Lincoln's Inn which apart from the Appointed Persons and Mr Roger Watts was attended by Mr Austin Allison of Counsel and Mr P. Croll of Messrs Freshfields representing the Bank and Mr Rhodri Davies of Counsel and Mr P. Frost of Messrs Herbert Smith & Co. representing LAI.

Mr Davies informed the Appointed Persons that his client had made a number of organisational changes in respect to the Bank's concerns and had appointed Messrs Ernst and Whinney to carry out an internal control review. Messrs Ernst & Whinney, Chartered Accountants, had succeeded Messrs Touche Ross as LAI's auditors on 25th July 1985. Mr Davies understood that the Bank were now content that LAI should continue to be a licensed deposit taker under the Act. The parties had

6.11 The Bank accepts that the shareholders may be prepared to inject a further £1.2m capital into the company. However the Bank is still of the same opinion expressed in paragraph 8.7 of the Notice that such an injection of capital and the appointment of a suitable experienced general manager alone would not be sufficient to allay the Bank's concerns given its conclusions about the directors and the failure of the corporate plan to address the real problems facing the company.

7.1 The Bank, therefore having taken into account the company's representations, still considers that its powers to revoke the company's licence are exercisable and should be exercised for the reasons given in the notice. The Bank does not consider that there is a real prospect of all the criteria in Part II to Schedule 2 to the Act being fulfilled with respect to the company within the period of a conditional licence and has therefore decided not to grant the company a conditional licence".

8. The Bank furthermore on the same day gave notice to the company pursuant to Section 9(1) of the Act confirming directions given to the company under Section 8 of the Act in the Bank's notice of 16 August 1985 by virtue of which the company was effectively prevented from trading except with the prior consent of the Bank in writing.

9. On the 1st October 1985 Messrs Herbert Smith & Co. on behalf of LAI served notice of appeal on the Bank pursuant to the Banking Act 1979 (Appeals) Regulations 1980.

confirmation from Messrs Herbert Smith & Co. for the appellants that they agreed with the position as set out in the submissions (Appendix I hereto).

The following extracts from the submissions are of particular relevance:

> "3.1 Messrs. Ernst & Whinney, Chartered Accountants, have begun a comprehensive review of LAI's lending procedures and systems of internal control in accordance with instructions given by LAI in a letter dated 11 March 1986 a copy of which is annexed hereto ..... LAI has undertaken to implement their recommendations.
>
> 3.3 There has been an increase in LAI's paid up share capital from £2.4 million to a total of £5.4 million. The risk asset ratio thereby produced is as high as 112%.
>
> 3.4 Societe Bancaire Arabe, which has acquired 10% of the share capital of LAI and which is regarded by the Bank as a reputable institution, has furnished the Bank with a comfort letter (copy annexed) in which it endorses the feasibility of a Business Plan submitted by LAI to the Bank on 23 January 1986.
>
> 3.5 Messrs. Fadoul, Solomon and Al-Atassi have resigned as directors of LAI and Mr. Fadoul has ceased to be a controller (Messrs. Tabiaat and Major's appointments with LAI terminated before the licence was revoked).

considered the possibility of seeking to withdraw the appeal but that would appear to necessitate LAI having to make a new application for a licence, and that would involve a discontinuance and delay which would be disadvantageous to LAI. The two parties therefore agreed to make an application that the Appointed Persons would recommend to the Chancellor that the appeal be allowed.

Mr Allison on behalf of the Bank supported this application.

The Appointed Persons replied that in their report to the Chancellor they would need to set out reasons why the appeal ought to be allowed and that no detailed reasons had been given as to how the severe criticisms made by the Bank in their said letters of the 16th August and 11th September 1985 had been dealt with.

They therefore requested the parties to make available to them as soon as possible

(a) an agreed document setting out in summary form the original criticisms made by the Bank together with the ways in which LAI had been able to meet these criticisms to the satisfaction of the Bank,

(b) a copy of the report as to LAI's lending procedures and systems of internal control commissioned by LAI.

14. On the 18th April 1986 the Appointed Persons received from Messrs Freshfields submissions on behalf of the Bank setting out the background to the Bank's decision not to contest the appeal. In the accompanying letter Messrs Freshfields stated that they had received

16. On the 11th June 1986 Messrs Herbert Smith sent to the Appointed Persons a copy of a letter dated 9th June 1986 from Messrs Ernst & Whinney to them enclosing Draft Accounts of LAI for the year ending 31st December 1985, abridged management accounts of LAI prepared by its own staff for the 5 month period ended 31st March 1986 and finally a draft report covering the internal controls in operation at LAI, their adequacy and recommendations as to further controls required. The said letter together with the said enclosures are together Appendix III hereto.

17. The Appointed Persons were however still not satisfied with the information they had received and consequently on the 20th June 1986 Mr Roger Watts wrote to Messrs Herbert Smith (copy to Messrs Freshfields) on their behalf seeking further clarification of the following points:

> "i. The Appointed Persons would welcome confirmation from Ernst & Whinney that a clean audit report would be provided if London and Arab were successful in its appeal. The Appointed Persons also hope that Ernst and Whinney will be able to tell them what provisions are necessary at 31 December 1985.
>
> ii. It appears that Note 4 on the 1985 accounts (Loans to and transactions with Directors - to be determined) has still to be provided which seems somewhat peculiar to the Appointed Persons who would have expected all information regarding directors to have been ascertained by this stage.

3.6 Mr. Backir Zouheiri has been appointed Chairman and Managing Director of LAI. He was until recently Group General Manager of European Arab Bank in the United Kingdom and is Chairman of the Arab Bankers Association in London. The following have also joined the Board of LAI. [The persons names and their qualifications are thereafter set out] ..... The Bank is satisfied that the persons named above are fit and proper to hold their respective positions.

4. By reason of the changes of circumstances described above the Bank is satisfied that it is now appropriate that LAI should continue to hold a licence to carry on a deposit taking business".

15. The Appointed Persons were concerned by the fact that they were being asked to advise the Chancellor to allow the appeal at a time when a review of LAI's lending procedures etc. had only been begun by Ernst & Whinney but had not been completed. They were of the opinion that they could not report to the Chancellor until the report had been completed and they had had an opportunity to consider it.

Accordingly they asked through Mr Roger Watts for a sight of this report before they could deal further with the appeal. On 23rd April 1986 Messrs Herbert Smith sent to the Appointed Persons copies of Messrs Ernst & Whinney's letter to Mr Ojjeh of LAI dated the 25th March 1986 dealing with the "Internal Control Review" and of their letter dated 17th April 1986 to Mr Ojjeh giving a progress report; these are attached as Appendix II hereto. Messrs Herbert Smith asked that the hearing arranged for 24th April should be adjourned until further information was available from Messrs Ernst & Whinney.

While Messrs Herbert Smith's said letter does not give rise to any further questions save such as could be put at the resumed hearing Messrs Ernst & Whinney's letter did require some further questions to be put. It read as follows:

"(i) We can confirm that, subject to reaching agreement with the directors as to the final provision for bad debts and to finalising note 4 (as to which see (ii) below) we would provide a clean audit report if LAI were successful in its appeal. As we mentioned in our letter dated 9 June 1986, on the most pessimistic view the final bad debts provision would be £600,000 in excess of that included in the draft accounts. We are aware that the management of LAI considers that if the appeal is successful such a large provision will not be necessary. In view of the present absence of certainty as to the outcome of the appeal we have not yet sought to agree the final bad debts provision;

(ii) We have some enquiries outstanding on note 4. The main difficulty is over tracing all connected transactions concerning persons who were directors but resigned and left the company during the course of the year;

(iii) Our internal control review has now been finalised in the terms of the draft without alteration. We hope to issue it formally within the next few days".

19. Further questions were set out in a letter from Mr Roger Watts to Messrs Herbert Smith dated the 14th July 1986 in which he informed them that the Appointed Persons would be available for a hearing on

iii. The Appointed Persons cannot understand why the Ernst and Whinney report is still in draft. The summary seems to demonstrate a very poor position. The Appointed Persons note the statement in the Ernst and Whinney letter that the management and in particular Mr Strevens, has fully accepted the report's recommendations but would like to know exactly what is being done about the recommendations and would like to see evidence of what has been done.

iv. The Bank of England originally directed that Coopers should supervise the activities. This appears now to have ceased but the Appointed Persons are not clear whether Ernst and Whinney are now performing this function of whether reliance is now being placed solely on the involvement of senior management.

v. The Appointed Persons note that even before making any further provision for bad debts London and Arab have made a loss of £156,000 during the five months to 31 May".

The said letter is Appendix IV hereto.

18. Messrs Herbert Smith replied on the 27th June dealing with points (iii) to (v) while points (i) and (ii) were dealt with by Messrs Ernst & Whinney in a letter to Messrs Herbert Smith dated the 26th June, a copy of which was enclosed with the said letter of the 27th June. The said two letters are Appendix V hereto.

21. Messrs Herbert Smith replied on the 17th July 1986 enclosing two letters, one from Ernst and Whinney and one from LAI both dated 17th July 1986. The former dealt with points a - e raised on the said letter of 14th July stating

(a) that they enclosed a set of completed accounts for LAI to 31st December 1985 which were in a form in which they would be prepared to complete their audit report once the licence had been restored

(b) that the enclosed report on review of control was in its final form

(c) that they had been appointed by the board of LAI to undertake an internal audit role until a permanent person was recruited (see letter of appointment of same date)

(d) that they considered the LAI recruitment programme realistic and

(e) that they would attend the hearing.

The two said letters are Appendix VI hereto.

22. The Bank wrote to the Appointed Persons on 17th July 1986 informing them

(a) that following the capital injection of £2.4 million in April 1986 the Bank was satisfied that LAI was adequately capitalised. The risk asset ratio at 30th June 1986 was 98%.

Friday 18 June if a number of items which they regarded as essential prerequisites of a positive recommendation could be made available in time. These were as follows:

"a. The accounts to 31 December 1985, together with the notes thereof, completed in a form which Ernst and Whinney are prepared to sign providing bank status is restored.

b. A final copy of Ernst and Whinney's review of control should be available. Ernst & Whinney should confirm also that satisfactory systems are now in place, subject only to additional recruitment.

c. Some temporary cover will be required for the five people to be recruited. This could be provided [for] by Ernst and Whinney.

d. A recruitment programme should be agreed to acquire the additional people within a reasonable period.

e. An Ernst and Whinney partner should attend the hearing and be in a position to confirm points b, c and d above".

20. On the same date Mr Roger Watts wrote to the Bank asking them to confirm that with the additional capital subscribed it was satisfied that LAI had adequate capital and for information as to why Coopers and Lybrand were withdrawn from overseeing LAI's activities and whether the Bank was content to rely upon its own contacts with the Directors and Management of LAI.

the Bank's letter of 17th July 1986 would remain in place until the Chancellor's decision was known and (b) that the sole reason for the Bank's decision to withdraw Coopers and Lybrand from the case was the increase in capital and the strengthened management team.

At the request of the Chairman Mr Allison undertook to supply the Appointed Persons with the last three of the regular reports provided on LAI by Coopers and Lybrand. Mr Allison also stressed that it was the Bank's intention to continue to scrutinise the affairs of LAI with vigilance and if necessary take action again.

In reply to questions by the Appointed Persons, Mr Dewar stated (a) that they were now satisfied that they had obtained the information previously not available in order to complete Note 4 to the accounts (b) that LAI would recruit 3 people no later than 3 months after the Chancellor's decision had been made known and (c) that the internal audit to be carried out by them would be comprehensive.

Mr Davies submitted that in the light of the information and documents now available the Appointed Persons should advise the Chancellor to allow the appeal. He confirmed the information given by Mr Dewar and undertook to obtain the Board of LAI's decision by the end of the month as to whether the Board would sign the accounts prepared by Ernst and Whinney and placed before the Appointed Persons.

Both parties agreed that the question of costs did not arise.

(b) Coopers and Lybrand were withdrawn from LAI in consequence of the increase in capital and the strengthening of the management team by the appointment of Messrs Zouheiri Strevens and Sutton. The directors remained in place. The Bank was now content to rely upon its own contact with the directors and management of LAI.

23. On Friday 18th July 1986 the hearing of the appeal took place in Room 29/G H.M. Treasury. It was attended by the Appointed Persons, Mr Austin Allison of Counsel and P. Croll of Messrs Freshfields representing the Bank Mr Rhodri Davies of Counsel and Mr P. Frost of Messrs Herbert Smith representing LAI, Mr G. Dewar and Mr D. Markwick of Ernst and Whinney and Mr Roger Watts of the Treasury.

The Chairman informed the parties that the presumption in the Appeals Regulations was that hearings should be held in public unless there was good cause to the contrary. In the present case the Appointed Persons had taken the view, in the absence of an application, that the hearing should be in private because the object of the appeal might very well be lost if details of the documents were made public at that stage.

Mr Allison and Mr Davies confirmed that their clients would be content with this procedure in the present case.

Mr Allison repeated the Bank's earlier submissions on the 18th april 1984 to the effect that it was content to have the appeal allowed because of the change in the management of LAI and the injection of further capital. He also stated (a) that the directions referred to in

27. On 15th April 1986 the Appointed Persons had no evidence before them in relation to the following matters:

(a) The organisations changes made by LAI in response to the Bank's concern

(b) Information as to the increase of LAI's capital from £2.4 million to £5.4 million

(c) The fact that Societe Bancaire Arabe and acquired 10% of LAI's share capital

(d) The resignation of all but one of LAI's directors and the appointment of a new Chairman and Managing Director of LAI, and new Board members, with details of their respective qualifications

28. Furthermore:

(i) Ernst & Whinney's report as to LAI's lending procedures commissioned by the latter was not completed until July 1986, and

(ii) Audited accounts of LAI for the period 31st December 1984 to 31st December 1985 were not approved by the directors until 11th August 1986.

29. It will be seen from the narrative in this report that after considerable perseverance on the part of the Appointed Persons the information required by them to advise the Chancellor was not obtained until mid August 1986.

24. On 24th July 1986 Messrs Freshfields delivered copies of the last three Coopers and Lybrand reports dated respectively 27th February, 19th March and 9th April 1986 to the Appointed Persons. These show that the assets of LAI on a break up basis were deficient by £599,000 if the additional provisions for doubtful debts recommended by them were made. In view of the injection of £3 million new capital which had not yet taken place by 9th April 1986 it would appear that LAI has ample cover to enable it to continue to trade. The report dated 9th April 1986 is Appendix VII thereto.

25. By a letter dated 14th August 1986 Messrs Herbert Smith informed the Appointed Persons that the Board of LAI had signed the accounts for the year ending 31st December 1985.

Conclusions

26. It has been necessary to set out in considerable detail the material available to the Appointed Persons on 15th April 1986 when the Bank and LAI first invited them to allow the appeal and the material and information obtained since then as a result of the pressure put on the parties by the Appointed Persons through the Treasury.

As already stated the Appointed Persons were on 15th April 1986 acutely aware of the fact that very serious allegations had been made by the Bank as to the conduct and the state of LAI's business which led it to revoke its licence and accordingly they could not advise the Chancellor until all relevant information as to how these serious allegations had been dealt with were made available.

30. Having considered all the aspects of the case very carefully especially the Ernst and Whinney report, the organisational changes, the increase in capital and the audited accounts the Appointed Persons are now able to advise the Chancellor of the Exchequer that the criticisms on which the Bank based its revocation of LAI's licence have been satisfactorily dealt with and that the Appeal be allowed and that no order as to costs should be made.

The Appointed Persons would however like to stress that had the parties declined to furnish the further evidence now provided by them, they would have had no alternative on 15th April 1986 but to advise the Chancellor of the Exchequer to reject the appeal.

Allan Heyman

SM2/17

CONFIDENTIAL

PUD

FROM: CATHY RYDING
DATE: 1 SEPTEMBER 1986

MR WATTS

cc Economic Secretary
Sir P Middleton
Mr Cassell
Mr A Wilson
Mr Peretz
Mr Hall

Mr F Croft - Tsy Sol

BANKING ACT APPEAL BY LONDON AND ARAB INVESTMENTS LTD

The Chancellor has seen your minute of 29 August and the attached draft letter which will be dispatched shortly.

2. The Chancellor would be grateful for a brief note setting out how this case would have fared under the new procedures in the forthcoming Banking Bill.

C.R

CATHY RYDING

1779/29

FROM: DEREK JONES
DATE: 3 September 1986

1. MR M HALL
2. ECONOMIC SECRETARY

cc: PPS
PS/Sir P Middleton
Mr Cassell
Ms Lomax
Mr Peretz
Mr Il ett
Mr Evershed

Mr Croft T Sol

BANKING BILL: EC BANKS AND CROSS-BORDER SERVICES

We should be grateful for your views on a proposal that the Bank have made to include in the Bill provisions to relax the requirements for EC banks taking deposits in the UK. The main choice is between introducing a more open, "communautaire" approach, which the Bank would prefer, or retaining the existing, more restrictive arrangement.

Background

2. There are two ways in which overseas banks might seek to take deposits in the UK: by establishing a branch; or, without establishment, by means of local agents or the advertising of services to be supplied by post or other 'courier' mechanism. There is no debate about the former and both we and the Bank are clear that branches of overseas, including EC, banks should require authorisation. The issue concerns the latter type of arrangement, known in EC jargon as the provision of "cross-border services".

3. The present Act, and the new Bill, operate through a prohibition on the acceptance of deposits. So in order to be caught by the Act it is not necessary to be established here, but only to take deposits. The would-be provider of cross-border banking services is therefore caught by the Act

and requires authorisation and supervision. In practice however the Bank cannot properly supervise an institution with no presence here. The Bank, therefore, has hitherto used its residual discretion under the Act ("the Bank may authorise ...") to require that, in order to be authorised, an overseas institution must be permanently established in the UK: so providing mind and management here to be responsive to supervision.

4. These arrangements have the effect of making illegal the taking of deposits by agents or travelling representatives and of forcing overseas bankers that wish to take deposits in the UK to open a branch here.

Proposed Change

5. The Bank have proposed that the Bill should allow EC banks which are authorised in their home country but without permanent establishment in the UK to take deposits 'across border' in the UK, without any UK authorisation or supervision. There are the following arguments in favour:

(i) there seems no great risk to UK depositors given that all the institutions would be supervised in a Member State and that the Credit Institutions Directive provides minimum uniform supervisory standards. Institutions would be responsible for the actions of any agents used in the UK. If necessary, the Bank believe that the home supervisors would be amenable to pressure to put right any abuses.

(ii) the present requirements might be open to challenge under EC law. The Credit Institutions Directive permits us to authorise branches but is silent on cross-border deposit-taking. The Bank have so far managed to fend-off EC banks wishing to take deposits cross-border. But we understand that the Danish mortgage banks are persistent and the Commission would be likely to sympathize with their case.

(iii) the draft Mortgage Credit Directive adopts the proposed approach, by requiring a regime in which authorisation in the home country would serve throughout the Community (although giving home authorities a supervisory role). Generally the UK argues for a more open 'internal market', especially in services such as insurance, where UK firms are likely to gain business if allowed free access to EC markets. HMG has taken this line in two insurance cases currently before the European Court. To provide explicitly for cross-border deposit-taking would therefore enhance the UK's open-market credentials and help our reputation in Brussels.

6. Although we are sympathetic to this open approach, we see some major difficulties with the Bank's proposal:

(a) notwithstanding the spirit of the Directive, UK firms would be unlikely to enjoy reciprocal opportunities for cross-border banking in other EC countries. With the exception of the Netherlands, the Bank's view is that other member states do not allow cross-border operations. There is no reason to suppose that others would follow a UK lead. Although the basis of banking law varies, and the UK approach through a prohibition on the taking of any deposits is a strict variant, it nevertheless seems certain that UK institutions would see the change as assisting overseas banks to obtain UK business, without gaining reciprocal opportunities abroad. We could not defend this in terms of 'UK Ltd'.

(b) in order to comply with EC law, the Bill already contains provisions that may be seen as giving favourable treatment to EC institutions. (Partnerships will not be eligible for

I have my doubts about the political acceptability of this, having said it in cold print in the Bill. MMG 3/9

authorisation, but we are obliged to allow EC partnerships; there will be requirements for banking names but we cannot prevent an EC institution using its domestic name anywhere in the Community). We would be reluctant to include any further provisions of this kind.

(c) although the Directive requires supervision of all EC banks, and the supervisory authorities are reputable, we nevertheless remain worried at the idea of agents of overseas banks operating here wholly without UK supervision. We think the position would be difficult to defend if UK depositors lost money as a result of the collapse of an EC bank in such circumstances.

(d) we are not being forced by EC law to adopt a new approach, nor is there any great pressure to do so from other countries.

In our view, the arguments against the proposal are more compelling.

Financial Services Bill

7. Much the same issue arises for the supervision of financial services institutions. The approach taken by the FS Bill is to deem to be authorised any institution established and authorised in another member state and carrying-on investment business in the UK but not from a permanent place of business here. Such institutions will be required to notify their intention of carrying-on business in the UK. The notice will need to contain details of EC authorisation, address, nature of services, etc. It will be an offence not to provide such notice. Deemed authorisation is subject to domestic supervision providing "equivalent protection" to investors, and institutions are also required to comply with the provisions of the FS Act and rules made under it. If rules are broken, the Secretary of State is empowered to terminate or suspend authorisation or to impose conditions. Having ceased to be authorised, it would be an offence to carry on investment

business in the UK.

8. This regime is quite different from the straightforward exemption proposed by the Bank. It is however likely to present the SIB with some serious headaches in terms of the practicalities of supervision (bearing in mind that there will be no UK establishment) and the Banking Supervisors are doubtful about how well it can be made to work. But it does represent a possible alternative approach.

Conclusions

9. If, as argued above, the Bank's proposal is not acceptable, there are the following policy options:

(i) continue to make establishment a requirement for authorisation on the existing basis (ie through the Bank's discretion).

(ii) make establishment a formal requirement for authorisation in the new Bill (ie the same policy as now but made statutory).

(iii) change the existing policy so as to allow cross-border deposit-taking, but subject to requirements similar to those in the FS Bill.

10. Of these, we prefer the first. Option (ii) is also safe prudentially but is more likely to attract EC attention and we see no need for it given that the Bank's discretionary power has served, without serious challenge, since 1979. Option (i) also leaves room for manoeuvre if the policy is challenged at some time in the future. Option (iii) is superficially attractive in combining a more communautaire approach with prudential controls. But we share the Bank's reservations about the practicality of supervisory control where the deposit-taker operates entirely from overseas. And we would still be faced with the question of reciprocity. There seems little merit in moving in this direction unless and until there is a general move towards the establishment of cross-border

deposit-taking on equal terms.

11. Finally, there is some read-across to our recent consideration of the problem of overseas deposit-taking, where deposits are technically 'accepted' overseas - so avoiding the Act's controls - but where the depositors are UK residents and where the funds may be returned for use in the UK. If we were unable to tackle this potential 'loophole' then its existence would tend to strengthen the case for a liberal regime on cross-border activity. In a modern banking system it would not always be easy to distinguish between deposits accepted here by overseas banks (cross-border) and deposits accepted overseas by those banks. There would be less point in continuing to prevent cross-border business if the result was to prompt the use of the 'overseas acceptance' loophole.

12. However, our present intention is to include provisions aimed at closing the loophole, in which case the regime will be consistent and reasonably watertight.

DEREK JONES

Copy also to Mr Nicolle, BoE

33/22

FROM: **P D P BARNES**
DATE: 4 September 1986

MR D JONES

cc PPS
PS/Sir Peter Middleton
Mr Cassell
Ms Lomax
Mr Peretz
Mr M Hall
Mr Ilett
Mr Evershed
Mr Croft - T Sol

BANKING BILL: EC BANKS AND CROSS-BORDER SERVICES

The Economic Secretary has seen your submission of 3 September.

2. He favours including a regulation making power in the Banking Bill in general terms, but not to implement this unless equivalent reciprocal arrangements apply in other member states.

PB

P D P BARNES
Private Secretary

LD/002

1. Alex
2 PUP

FROM: CATHY RYDING
DATE: 8 SEPTEMBER 1986

PS/ECONOMIC SECRETARY

cc PS/Sir P Middleton
Mr Cassell
Mrs Lomax
Mr Peretz
Mr M Hall
Mr Ilett
Mr D Jones
Mr Evershed
Mr Croft - T Sol

BANKING BILL: EC BANKS AND CROSS-BORDER SERVICES

The Chancellor has seen Mr Jones' minute to the Economic Secretary of 3 September and your minute to Mr Jones of 4 September.

2. The Chancellor would be grateful if the Economic Secretary would have a look at the alarming situation revealed (for the first time, so far as he can recall) in 6(b) of Mr Jones' minute of 3 September.

C.R

CATHY RYDING

CONFIDENTIAL

FROM: M EVERSHED
DATE: 10 September 1986

1. MR HALL
2. CHANCELLOR

cc Economic Secretary
Sir P Middleton
Mr Cassell
Mr A Wilson
Mrs Lomax
Mr P Hall
Mr Watts o/r
Mr Croft T.Sol

The system will undoubtedly change for the better.
MM 10/9

BANKING ACT APPEAL BY LONDON AND ARAB INVESTMENTS (LAI) LTD

You asked how this case would have fared under the new procedures in the forthcoming Banking Bill.

2. The main cause of the problem in this case was that the Bank of England, having made a strong case for LAI to have their licence revoked, suddenly came to an accommodation with them after the appeal was under way. Since the present appeals regulations do not allow for withdrawal of the Bank's opposition to the appeal, and LAI were unwilling to abandon it and incur delay in reapplying for a licence, the appeal had to be taken to the end.

3. Under the new Bill we intend implementing regulations allowing the Bank to withdraw opposition to an appeal. To ensure that this is possible Counsel has drafted in clause 28 of the Bill that regulations may in particular make provision for:

> "Enabling an appellant to withdraw an appeal or the Bank to withdraw its opposition to an appeal and for the consequences of any such withdrawal".

On this basis the LAI case could have ended at or before the preliminary hearing on 15 April 1986 with the two parties agreeing that the appeal should be allowed. (Whether or not a hearing would be required at all following the Bank's withdrawal of opposition and what form it took would depend on the exact drafting of the regulations.)

4. But had the case proceeded and the Bank not withdrawn their opposition, the appeal would probably have been rejected under the new Bill because the question for determination by the Tribunal will be:

> "Whether, for the reasons adduced by the appellant, the decision was unlawful or not justified by the evidence on which it was based."

There is little doubt from the appointed persons report that they considered that the Bank's decision to revoke was justified on the evidence available at the time. They recommended unholding the present appeal only because of new evidence of remedial action which will not be admissible under the new arrangements. (This contrasts with the present position where there is no guidance on the question to be determined by the appointed persons who have tended to treat cases as 'de-novo' hearings - taking into account evidence on the present position and future intentions.)

5. Having lost the appeal under the new rules LAI would have had to reapply for authorisation. The question whether or not the remedial action was sufficient to justify it would have been a matter for the Bank and not the Tribunal (though LAI could have appealed against a refusal to authorise).

6. The appeal would also have been disposed of much faster because the early delays in LAI, due to problems with the Bank over the appointment of Mr Heyman, would be unlikely to occur under the Bill when the Lord Chancellor becomes responsible for appointing the Chairman. And the four month delay in the present case arising from the time taken to obtain evidence for the appointed persons about the current situation at LAI would certainly not have occurred because this evidence would not have been relevant. So the new Tribunal would probably have settled the matter at a full hearing held around or soon after the date of the April preliminary hearing in the present case.

7. Two further important differences in the way the case would have fared are that the four individuals named by the Bank as

unfit could have made representations and appealed in their own behalf to the Tribunal to clear their names and that in future the Tribunal itself will determine the case. (So beyond appointing two members to the Tribunal, you would not have been involved).

M.Ever

M EVERSHED

3702/2/fm

1874/06

PS/ Chancellor
Sir P Middleton.
Mr A Wilson
Mr Peretz
Mr Hall
Mr F Croft - Tsy Sol.

FROM: P D P BARNES
DATE: 11 September 1986

MR WATTS

cc PS/Chancellor
Sir P Middleton
Mr Cassell
Mr A Wilson
Mr Peretz
Mr Hall
Mr F Croft - Tsy Sol

BANKING ACT APPEAL BY LONDON AND ARAB INVESTMENTS LTD

The Economic Secretary has seen your submission to the Chancellor of 29 August and his Private Secretary's reply.

The Economic Secretary wonders whether this would not have been a case for our new conditional licence.

P D P BARNES
Private Secretary

RA3.40

CONFIDENTIAL

pwp

FROM: A C S ALLAN
DATE: 12 September 1986

MR EVERSHED

cc PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Wilson
Mrs Lomax
Mr M Hall
Mr P Hall
Mr Watts
Mr Croft - T. Sol

BANKING ACT APPEAL BY LONDON AND ARAB INVESTMENTS (LAI) LTD

The Chancellor was grateful for your note of 10 September explaining how this case would have fared under the new procedures in the forthcoming Banking Bill.

ACSA

A C S ALLAN

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

22 September 1986

Dear Nigel

BANKING BILL

As Norman Lamont may have told you, QL spent some time at its meeting on 16 September considering how next Session's programme was shaping up. It was clear from our discussion that it will be most important for the business managers in the Commons for the Banking Bill to be introduced at the very start of the Session. I understand that preparation of the Bill is, in fact, going well but I thought I should stress just how important it is that this progress is maintained and ask you to do what you can to ensure that the Bill is ready on time.

I am sending a copy of this letter to the Lord Privy Seal, the Chief Whip, Commons, First Parliamentary Counsel and Sir Robert Armstrong.

Yours

Willie

The Rt Hon Nigel Lawson MP